WHAT ROLE DOES THE UK GENERAL ANTI-ABUSE RULE PLAY IN PREVENTING TAX AVOIDANCE USING LOAN RELATIONSHIPS AND HOW DOES THIS ROLE AFFECT THE WAY WE SHOULD CONCEPTUALISE THE GAAR WHEN APPLIED TO OTHER CORPORATION TAX MATTERS?

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ABSTRACT

This dissertation considers the role of the UK General Anti Abuse Rule ('GAAR') in challenging loan relationship based tax avoidance in comparison with the other measures, which are at the disposal of Her Majesty's Revenue and Customs. In particular, the potential effectiveness of the GAAR is compared with the loan relationship Targeted Anti-Avoidance Rule at s455B – s455D of the Corporation Tax Act 2009 ('CTA 2009'), Section 441, CTA 2009 and the Ramsay Principle. The analysis is based on a detailed review of 13 recent loan relationship avoidance cases, including *Greene King, Stagecoach* and *Suez Teesside,* and provides an assessment of the impact GAAR could have on these cases. Finally, this dissertation briefly considers how conclusions reached in respect of loan relationships may affect the role of the GAAR when applied to other corporation tax matters.

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ABBREVIATIONS

BMBF	Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes) [2004] UKHL 51, [2005] STC 1
C (e.g. Sir Terence Etherton C)	Chancellor of the High Court
CA	Court of Appeal
CGT	Capital Gains Tax
CTA 2009	Corporation Tax Act 2009
DOTAS	Disclosure of tax avoidance schemes
ECJ	European Court of Justice
FA (No.2) 2015	Finance (No.2) Act 2015
FA 1996	Finance Act 1996
FA 2013	Finance Act 2013
FTT	First-tier Tribunal (Tax)
GAAP	Generally accepted accounting principles
GAAR	General Anti-Abuse Rule
GAAvioidR	General Anti-Avoidance Rule
HMRC	Her Majesty's Revenue and Customs
IFRS	International Financial Reporting Standards

IP	Intellectual property
J (e.g. Mann J)	Justice
LJ/LJJ	Lord Justice / Lord Justices
LR TAAR	Loan Relationship Targeted Anti-Avoidance Rule
NPV	Net Present Value
P&L	Profit and Loss account
Paragraph 13	Paragraph 13 of Schedule 9, FA 1996.
PJ (e.g. Ribeiro PJ)	Permanent Judge of the Hong Kong Court of Final Appeal
SC	Supreme Court
SCJ	Supreme Court Justice
Section 441	Section 441, CTA 2009
TAAR	Targeted Anti-Avoidance Rule
TUC	Trade Union Conference
UT	Upper Tribunal (Tax and Chancery Chamber)
WHT	Withholding Tax

CHAPTER I: INTRODUCTION

It is an often cited quote attributable to Benjamin Franklin that there are only two certainties in life: death and taxes.[1] Within a corporation tax context, given that companies do not necessarily die, that is to say liquidated or dissolved, perhaps this truism can be reframed to suggest that two certainties of corporate life are: tax and tax avoidance. As will be seen, there have been a number of recent tax cases, often involving big brands, where groups have, or are perceived to have, avoided tax. Often, these schemes involve loan relationships, which are brought into tax under Part 5, Corporation Tax Act 2009 ('CTA 2009'). At the same time as they proceed through the courts, HMRC has sought to introduce legislation to prevent such schemes from being successful. Within a loan relationship context, these anti-avoidance measures range from specific provisions to prevent certain types of avoidance arrangement, to a targeted anti-avoidance rule ('TAAR') for the loan relationship regime at Section 455B-D, CTA 2009 (the 'LR TAAR').

In addition to bring in specific measures counteracting loan relationship avoidance schemes, a General Anti-Abuse Rule ('GAAR') was introduced in 2013. Although corporation tax matters, including loan relationships, are within the scope of the GAAR, the question is: what is the role of the GAAR in defeating loan relationship avoidance schemes, given the introduction of the LR TAAR? This is the primary question that this dissertation has sought to answer. It is an important and timely question because both

[1] Fred Shapiro, 'Quotes Uncovered: Death and Taxes' (*Freakonomics*, 17 February 2011) <http://freakonomics.com/2011/02/17/quotes-uncovered-death-and-taxes/> accessed 17 February 2018.

pieces of legislation were introduced in relatively quick succession and currently there is a level of uncertainty over how they will apply (both individually and combined). In addition to considering the role of the GAAR, the role of other anti-avoidance measures will also be reviewed. Specifically, the role of Section 441, CTA 2009, and the Ramsay Principle will be reviewed.[2].

After considering the role of the GAAR in defeating loan relationship schemes, the dissertation looks beyond loan relationships to how the insights gained may apply to other corporation tax matters. Given the difference between Part 5 and other areas of the corporation tax legislation, the commentary in this regard will be indicative only, but it will raise significant questions which could usefully be explored through further research.

In seeking to answer the above questions, this dissertation is structured as follows. Chapter II introduces the methodology. Chapter III then addresses the meaning of the term 'tax avoidance'. This will serve to highlight that whilst the term is commonly used, it is a difficult word to define. The following three Chapters, Chapters IV – VI, introduce the key areas of detailed consideration, namely the GAAR, the Ramsay Principle and the Loan Relationship regime. Once these areas have been covered, Chapter VII provides a detailed comparison of the different anti-avoidance measures. Chapter VIII takes a step back and considers thematically the differences between the GAAR and LR TAAR. The final Chapter (Chapter IX) seeks to answer the question: what is the role of the GAAR to

[2] Although, arguably the Ramsay principle are not, strictly speaking, 'measure' but rather case law principles, for simplify, this dissertation will continue to use the word 'measure' where is it referring to both legislative provisions and case law principle.

counteract loan related avoidance? It then discusses briefly how these conclusions affect the application of the GAAR to other corporation tax matters, and proposes areas for further research.

The substantive research contained within the dissertation is based on the legislation enacted prior to 1 June 2018. Similarly, this dissertation only considered case law judgement where those judgements were issued prior to 1 June 2018.

Finally, it should be noted that the following terminological conventions have been used throughout:

- Unless otherwise indicated references to the 'courts' should be read as including the FTT and the UT.
- As noted in Chapter VI, Paragraph 13, Schedule 9, FA 1996 was rewritten as Section 441, CTA 2009 as part of the Tax Law Rewrite Project. Except when necessary, this dissertation does not seek to distinguish between references to Section 441 and Para 13.
- References have been made to taxpayers entering into tax avoidance 'schemes'. Whilst other terms could have been used instead, such as 'transaction' or 'arrangements', for simplicity, the word 'scheme' has been used to describe such arrangements. For the avoidance of doubt, although for some the word 'scheme' may have negative connotations, it has been used here in an entirely neutral and non-judgemental way.

CHAPTER II: METHODOLOGY AND METHOD

II.1 Methodology

Prior to discussing the specific method adopted within this research, it is important to briefly discuss the underlying methodology upon which it is based. Oats[3] differentiates method from methodology by explaining that whereas method "refers to the specific techniques employed in the pursuit of research" methodology refers to "the practices and assumptions of the researcher, with the ideas and presuppositions that they carry through into the research project."[3] As can be seen from Lamb et al.,[4] there are a number of ways to undertake tax research including interdisciplinary perspectives, ranging from legal research[5] to political[6] or social policy research.[7]

Given the subject matter of this thesis, the approach taken in this research is to look at the question from a legal perspective. This is not to deny that other perspectives could enrich the analysis. For instance, Radaelli notes that "[c]ontemporary political systems are characterized by constraints, and political science explains the nature and source of constraints under which political actors operate, and the strategies used to relax or change them". [8] In the field of taxation, HMRC exercises significant power and it could be argued that the GAAR is such a strategy that relaxes the constraint on HMRC's

[3] Lynne Oats, 'On Methods and Methodology' in Lynne Oats (ed), *Taxation: A Fieldwork Research Handbook* (Routledge 2012) 9.
[4] Margaret Lamb and others (eds), *Taxation: An Interdisciplinary Approach to Research* (Oxford University Press 2005).
[5] Judith Freedman, 'Taxation Research as Legal Research' in Margaret Lamb and others (eds), *Taxation: An Interdisciplinary Approach to Research* (Oxford University Press 2005).
[6] Claudio M Radaelli, 'Taxation Research as Political Science' in Margaret Lamb and others (eds), *Taxation: An Interdisciplinary Approach to Research* (Oxford University Press 2005).
[7] Rebecca Boden, 'Taxation Research as Social Policy Research' in Margaret Lamb and others (eds), *Taxation: An Interdisciplinary Approach to Research* (Oxford University Press 2005).
[8] Radaelli (n 6) 87.

social power. However, given that the question posed by this dissertation is how various tax provisions interact, using a legal research method seems most appropriate, particularly given that such research "is rarely concerned with finding new facts or information. It is more likely to consist of 'careful study' – classification, and analysis and theorization."[9]

Freedman divides legal research into two subsets: a 'black-letter' approach which mainly consists of "attempting to fit the cases and legislation into a rational framework, pointing out the internal inconsistencies and the supposed 'principles'" [10]; and a broader approach where a wider framework is used. There are a number of such frameworks that can be used in this regard, including looking at a question from a historical perspective or using theoretical perspectives from other disciplines. In attempting to move beyond a pure black letter law approach, this dissertation will consider the historical context of the relevant tax provisions.

II.2 Method

II.2.1 A two-step approach

Hutchinson and Duncan describe doctrinal legal research (the term they use for black letter law research) as a two-step process, which begins with "locating the sources of the law and then interpreting and analysing the text".[11] Within this approach, the purpose of the first step is to identify 'objective reality'. Whilst acknowledging that legal scholars may reject the existence of 'objective reality', they argue that there are positive

[9] Freedman, 'Taxation Research as Legal Research' (n 5) 13.
[10] ibid.
[11] Terry Hutchinson and Nigel Duncan, 'Defining and Describing What We Do: Doctrinal Legal Research' (2012) 17 Deakin Law Review 83, 110.

statements of the law, for instance in Parliamentary statue. As such, they consider that the law only becomes contingent when it is interpreted and applied to specific facts. They describe the second step of the process as 'more nebulous.' Drawing on Chynoweth[12], Hutchinson and Duncan comment:

> *Those studying the methodologies of lawyers point to a number of techniques used within the synthesizing process once the documents are located and read. They call for a description of the particular line of inquiry being developed, whether it is conceptual, evaluative or explanatory. The application of such techniques, along with a description of, for example, the use of deductive logic, inductive reasoning and analogy where appropriate, would constitute the second part of the methodology.* [13]

Chynoweth[14] describes how each of these techniques can be used within the legal context. Deductive logic can be used by applying the law to a specific set of facts, which for a legal scholar "will be hypothetical and the purpose is to undertake a more in-depth analysis."[15] The main challenge with using this technique is that this type of reasoning, by itself, is unlikely to enable firm conclusions to be drawn on how the law will apply in specific situations. Inductive reasoning involves extrapolating from a specific case to create a more general rule. Chynoweth considers that this technique is particularly

[12] Paul Chynoweth, 'Legal Research' in Andrew Knight and Les Ruddock (eds), *Advanced Research Methods in the Built Environment* (2008).
[13] Hutchinson and Duncan (n 11) 111 (citation omitted).
[14] Chynoweth (n 12).
[15] ibid 32.

useful where the law as it stands does not address a particular issue. Finally, analogy can be used to determine how a law will apply to a specific case, where a similar case had previously been considered by the courts. He points out that, given the inevitable factual differences between cases, it is possible to distinguish a case from its predecessors, which would allow the courts to come to a different conclusion.

Discussed below is how this two-step model for legal research has been applied within this dissertation. Of the four anti-avoidance measures considered, two, namely the GAAR and the LR TAAR, have only recently been introduced whereas the other two measures, namely Section 441 (and its predecessor, Paragraph 13) and the Ramsay Principle have been around for a number of years. Specifically, Paragraph 13 applied to periods ending after 31 March 1996 and the judgement in *Ramsay* was handed down in March 1981. As a result, in respect of Section 441 and the Ramsay Principle, by analysing the judicial precedents it is possible to gain a good understanding of how these will apply going forward. As similar judicial precedents are not available in respect of GAAR and the LR TAAR, an alternative method has needed to be adopted and is discussed below. It is followed by a brief discussion of the impact of adopting this alternative method on the discussions in relations to Section 441 and the Ramsay Principle.

II.2.2 The GAAR and LR TAAR

As noted above the GAAR and LR TAAR are relatively new, and they have not, therefore, been considered by the courts. Although the precise wording of the provisions are freely available, without judicial precedents, there is a degree of uncertainty over how they will apply in practice. Thus, although this dissertation will undertake a side-by-side comparison of the text of the GAAR and the LR TAAR to identify the linguistic differences between these provisions, the practical relevance of these is difficult to determine without further context.

That said, although there is not judicial precedent on how the GAAR and the LR TAAR will apply, the courts have considered a number of cases where loan relationships have been used as part of tax avoidance schemes. As HMRC has historically used multiple arguments to challenge tax avoidance schemes,[16] the relevant judgements on these cases should contain sufficient information to consider how the TAAR and the GAAR may have applied to the schemes, which should, in turn, provide a better understanding of how these pieces of legislation might apply in practice. Within this dissertation, the facts of these cases, as described in the relevant judgements, together with the text of the underlying provisions, provide an 'objective reality' upon which the analysis has been based.

In order to identify a suitable body of case law, a Westlaw search was undertaken in their 'Case Analysis Documents' data base, using the search criteria ' "loan relationship" AND "tax avoidance" ' within the free text field. This search identified 39 items relating to 26 unique cases.[17] Of these, 12 were considered appropriate to be used within the body of this dissertation. The reason for the exclusion of the remaining 14 cases is contained within Appendix A. The 12 cases considered relevant are as follows:

1. *A.H. Field*[18]

[16] cf. *Stagecoach Group PLC & Stagecoach Holdings Limited v HMRC* [2016] UKFTT 120 (TC), [2016] SFTD 982; *Smith & Nephew Overseas Limited and Other v HMRC* [2017] UKFTT 151 (TC).
[17] A list of these cases is contained within Appendix A.
[18] *AH Field (Holdings) Limited v HMRC* [2012] UKFTT 104 (TC).

2. *Bank of Ireland*[19]

3. *Cater Allen*[20]

4. *DCC Holdings*[21]

5. *Fidex*[22]

6. *Suez Teesside*[23]

7. *Greene King*[24]

8. *Smith & Nephews*[25]

9. *Stagecoach*[26]

10. *Travel Document Services*[27]

11. *Versteegh*[28]

12. *Vocalspruce* [29]

For simplicity, the above cases will be referred to collectively as the 'Relevant Cases'.

A number of the above cases are subject to appeal; Appendix B contains a table indicating the current status of each. In addition, as will be discussed further at VII.3,

[19] *HMRC v Bank of Ireland Britain Holdings Limited* [2008] EWCA Civ 58, [2008] STC 398.
[20] *Cater Allen International Limited and another v HMRC* [2015] UKFTT 232 (TC), [2015] SFTD 765.
[21] *DCC Holdings (UK) Ltd v HMRC* [2010] UKSC 58, [2011] STC 326.
[22] *Fidex Limited v HMRC* [2016] EWCA Civ 385, [2016] STC 1920.
[23] *GDF Suez Teesside (Formerly Teesside Power Limited) v HMRC* [2017] UKUT 68 (TCC), [2017] STC 1622.
[24] *Greene King PLC & Greene King Acquisitions Limited v HMRC* [2016] EWCA Civ 782, [2017] STC 615.
[25] *Smith and Nephew (FTT, 2017)* (n 16).
[26] *Stagecoach (FTT, 2016)* (n 16).
[27] *Travel Document Service and Another v HMRC* [2018] EWCA Civ 549.
[28] *Spritebeam Limited and others v HMRC and another* [2015] UKUT 75 (TCC), [2015] STC 1222; sub nom *Versteegh Limited & Other v HMRC* [2013] UKFTT 642 (TC), [2014] SFTD 547.
[29] *Vocalspruce Ltd v HMRC9* [2014] EWCA Civ 1302, [2015] STC 861.

Appendix C contains an analysis of the references to *Ramsay* and *BMBF* in the Relevant Cases.

Moving on to the 'more nebulous' second step, this dissertation will use the three techniques outlined by Chynoweth[30] to analyse the Relevant Cases. The primary method will be what he refers to as 'deductive reasoning' as this dissertation will consider the schemes in the Relevant Cases. Referring back to Chynoweth's definition of deductive logic, these will be treated as hypothetical cases to which the GAAR and the TAAR will be applied.

As Chynoweth notes,[31] the main challenge with this type of reasoning is that the law is rarely sufficiently clear cut to enable one to definitively conclude on how it should apply in a specific situation. However, this depends on the nature of that legislation. For instance, applying a similar method to investigate the UK dividend exemption should enable the researcher to reach near definitive conclusions as to when the dividend exemption would apply because the relevant legislation is relatively mechanical and unambiguous.

This is in contrast to other provisions which tend to be drafted more broadly in order to apply to a wider range of situations. The GAAR is, arguably, an example of this because people may disagree as to what is a reasonable course of action in any given situation. Although the GAAR attempts to limit the uncertainty around what is caught by its provisions through inclusion of the phrase 'cannot reasonably be regarded as a

[30] Chynoweth (n 12).
[31] ibid.

reasonable course of action', a degree of uncertainty remains. Indeed, Way goes as far as saying that he does "not really know how this would operate in practice."[32] This same uncertainty appears in the LR TAAR as a result of the phrase "reasonably be regarded as consistent with any principles" on which the provision is based. As a result of the uncertainty in these provisions it would be difficult to produce any definitive conclusions about the application of the GAAR and the LR TAAR based solely on deductive reasoning using only the facts in the Relevant Cases and the wording of the legislation. That said, the use of deductive reasoning in combination with other techniques should enable this dissertation to draw some preliminary conclusions. This will be achieved by first placing the GAAR and LR TAAR into their broader context and then considering how they would apply to the schemes in the Relevant Cases.

When seeking to apply the GAAR and LR TAAR legislation to historical cases, this dissertation asks a number of questions of the schemes concerned, thereby breaking them into their component parts. This is based on the process used within Part D of HMRC's GAAR guidance,[33] where HMRC outlines a number of real and hypothetical tax avoidance schemes and considers how the GAAR may apply to those schemes. The structure of these examples is set out at the beginning of Appendix D, followed by the case analyses of the Relevant Cases.

In a number of the Relevant Cases, HMRC successfully challenged the effectiveness of the schemes in question. However, the analysis presented here will

[32] Patrick Way, 'The Rule of Law, Tax Avoidance and the GAAR' (2013) XII GITC Review 79, 99.
[33] HMRC, 'HMRC's GAAR Guidance (Approved by the Advisory Panel with Effect from 30 January 2015)' (2015).

proceed on the basis that the schemes would have otherwise been effective. At first appearance, this type of counter-factual analysis may seem unusual and counter-intuitive. However, the courts often use a similar type of analysis in its decisions where there are multiple issues to consider.[34] The rationale for doing so is that although the courts may find in favour of HMRC on one decisive issue, they discuss and draw a conclusion regarding other issues in case their decision regarding the decisive issue is successfully appealed. As such, the counter-factual analysis applied here is not unprecedented; rather it is consistent with the decision-making process of the courts.

II.2.3 Section 441 and the Ramsay principle

With respect to the sections on the Ramsay Principle and Section 441, a different method can be employed as they have both been considered by the courts on multiple occasions. These cases can be considered in order to determine how Section 441 and the Ramsay Principle should apply to loan relationship avoidance cases, enabling this dissertation to consider the role of the GAAR vis-à-vis Section 441 and the Ramsay Principle.

To identify suitable cases to consider in respect of Section 441, the starting point was the information contained in a 'Legislation Analysis' for Section 441 and its predecessor Paragraph 13 on Westlaw. Legislation Analysis identified the following:

Paragraph 13

[34] cf. *Greene King PLC & Greene King Acquisitions Limited v HMRC* [2012] UKFTT 385 (TC), [2012] SFTD 1085; *Stagecoach (FTT, 2016)* (n 16); *Iliffe News & Media Limited and others v HMRC* [2012] UKFTT 696 (TC), [2013] SFTD 309.

1. *A.H. Field*[35]
2. *DCC Holdings*[36]
3. Explainaway[37]
4. *Fidex*[38]
5. *Iliffe News & Media*[39]
6. *Travel Document Services*[40]
7. *Versteegh* Limited[41]
8. *MJP Media* Services[42]

Section 441

9. *BCM Cayman* [43]

Of these cases, all bar two were identified as part of searches undertaken to identify the Relevant Cases, with the two new candidates being *BCM Cayman* and *Iliffe*. A review indicated that only *Iliffe* is relevant to the questions posted by this dissertation. With respect to *BCM Cayman*, the citation identified was concerned with the taxpayers' application for the FTT to direct HMRC to issue closure notices in respect of a number of ongoing enquiries, including in respect of the application of Section 441. As this case is primarily concerned with a procedural matter, limited information is provided about the underlying facts of the case. Although the substantive issues are noted, they are not

[35] *A.H. Field (FTT, 2012)* (n 18).
[36] *DCC Holdings (SC, 2010)* (n 21).
[37] *Expainaway Limited & Others v HMRC* [2012] UKUT 362 (TCC), [2012] STC 2525.
[38] *Fidex (CA, 2016)* (n 22).
[39] *Iliffe News & Media (FTT, 2012)* (n 34).
[40] *Travel Document Service and Another v HMRC* [2017] UKUT 45 (TCC), [2017] STC 973.
[41] *Versteegh (FTT, 2013)* (n 28).
[42] *MJP Media Services Limited v HMRC* [2012] EWCA Civ 1558, [2013] STC 2218.
[43] *BCM Cayman LP and Others v HMRC* [2017] UKFTT 226 (TC).

discussed in detail and could change prior to HMRC issuing closure notices. As a result, this case is currently not relevant to the topic of this dissertation, although this could change in the event that the substantive issues are brought before the FTT at a later date.

With regard to the cases to be considered as part of the discussion of the Ramsay Principle, it was considered impractical to use those identified in the Westlaw 'Case Analysis'. This is because the *Ramsay* case has been cited in a significant number of cases and the Case Analysis for *Ramsay* is 68 pages long and reviewing such a large number of cases was considered impractical. Instead, this dissertation considers the cases cited by two important recent cases, namely *UBS*[44] and *BMBF*.[45] Within these, the House of Lords and Supreme Courts cited the following cases in the discussion of the Ramsay Principle, at paragraphs [61] to [68] in *UBS* and [26] to [39] of *BMBF* (unless otherwise stated, the cases below were referred to in both):

1. *BMBF*[46] (cited by *UBS*)
2. *Carreras*[47]
3. *Arrowtown*[48]
4. *Burmah Oil*[49]
5. *Furniss v Dawson*[50]

[44] *UBS AG v HMRC & Deutsche Bank Group Services (UK) Ltd v HMRC* [2016] UKSC 13, STC 934.
[45] *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2004] UKHL 51, [2005] STC 1.
[46] ibid.
[47] *Carreras Group Ltd v Stamp Commissioner* [2004] UKPC 16, [2004] STC 1377.
[48] *Collector of Stamp Revenue v Arrowtown Assets Limited* [2003] HKFCA 46, [2003] 6 ITLR 454.
[49] *Inland Revenue Commissioners v Burmah Oil Co Limited* [1982] STC 30 (UKHL).
[50] *Furniss (Inspector of Taxes) v Dawson* [1984] STC 153 (UKHL).

6. *Scottish Providence*[51] (cited by *UBS* – the House of Lords gave their decision in this case on the same day as *BMBF*)
7. *MacNiven v Westmoreland*[52]
8. *Ramsay*[53]
9. *Tower MCashback*[54] (cited by *UBS* – case decided post *BMBF*)
10. *McGuckian*[55] (cited by *UBS* only)
11. *Snook*[56] (cited by *UBS* only)
12. *Aberdeen Construction*[57] (cited by *UBS* only)

Three cases will be excluded from consideration for the following reasons. Snook concerns the concept of a sham, and therefore is not considered a *Ramsay* case. *Arrowtown* was not considered by a UK court and its main relevance to *BMBF* and *UBS* is Ribeiro PJ's often quoted summation of the Ramsay Principle, which was affirmed by Lord Nicholls in *BMBF*. Finally, *Aberdeen Construction* pre-dates *Ramsay*, and therefore does not discuss the Ramsay Principle. For simplicity the remaining cases will, together with *UBS*, be referred to collectively as the 'Relevant Ramsay Cases', each of which will be discussed at V.2.

[51] *Inland Revenue Commissioners v Scottish Provident Institution* [2004] UKHL 52, [2005] STC 15.
[52] *MacNiven (Inspector of Taxes) v Westmoreland Investments Limited* [2001] UKHL 6, [2001] STC 237.
[53] *WT Ramsay Limited v Inland Revenue Commissioners* [1981] STC 174 (UKHL).
[54] *Tower MCashback LLP 1 and another v HMRC* [2011] UKSC 19, [2011] STC 1143.
[55] *Inland Revenue Commissioners v McGuckian* [1997] STC 908 (UKHL).
[56] *Snook v London and West Riding Investments Ltd* [1967] 1 All ER 518 (CA (Civ)).
[57] *Aberdeen Construction Group Ltd v Inland Revenue Commissioners* [1987] 1 All ER 962 (UKHL).

II.3 Summary of key points

- The analysis within this dissertation is based on a review of a number of historical tax cases, which have either involved loan relationship avoidance (the Relevant Cases) or the Ramsay Principle (the Relevant Ramsay Cases).
- To explore how the GAAR and LR TAAR may have applied, this dissertation will compare them and consider how they may have applied to the schemes in the Relevant Cases.
- Before looking at various measures relevant to this dissertation in detail, it is important to briefly discuss what is meant by the term ‘tax avoidance’. The next chapter seeks to do this.

CHAPTER III: WHAT IS TAX AVOIDANCE?

III.1 Introduction

Although currently there is significant public attention being given to tax avoidance, there is much disagreement over the definition of the term itself[58] There are a myriad of terms used to describe arranging one's affairs to legally minimise one's tax liability, including using terms such as 'tax planning', 'tax mitigation' and 'unacceptable avoidance'.[59] With the introduction of the GAAR, a new term has been introduced, namely 'abusive' tax avoidance. To be able to talk meaningfully about the role of the GAAR in preventing loan related avoidance, it is important to first consider the meaning of this term. However, this chapter will not seek to define the term 'tax avoidance', if that is even possible, but rather to give a broader context and meaning when it is used throughout this dissertation.

III.2 Evasion, avoidance and mitigation

Lord Templeman, writing extra-judicially, describes three ways that a person can reduce their tax liability.[60] Firstly they could seek to evade tax completely. Secondly, they could seek to avoid a tax liability. Thirdly, they could seek to mitigate their tax liability. Tax evasion, which is illegal, takes place where a taxpayer hides or under-declares the income they generate. Tax avoidance, which is legal, takes place where a

[58] Michael P Devereux, Judith Freedman and John Vella, 'Tax Avoidance' (Oxford University Centre for Business Taxation 2012) <https://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Reports/TA_3_12_12.pdf> accessed 3 February 2018.

[59] Steve Bond, Malcolm Gammie and John Whiting, 'Tax Avoidance' in Robert Chote and others, *The IFS Green Budget: January 2006* (Institute for Fiscal Studies 2006).

[60] Lord Templeman, 'Tax and the Taxpayer' [2001] Law Quarterly Review 575.

"taxpayer's advisers invent a scheme whereby he can hope to enjoy the benefit of a taxable event without becoming liable to pay the tax."[61] For instance, a taxpayer may undertake a scheme, which generates income, without giving rise to a tax charge. Such schemes involve artificial steps that do not have a commercial purpose. Tax mitigation, which is also legal, is where a taxpayer reduces their tax liability by incurring expenditure which Parliament intends to give relief for.

Although others may use different terms and definitions, most commentators would agree, at least to some extent, with these three categories. The differences between each of them are discussed further below.

III.2.1 Evasion versus avoidance

According to Barker, although the difference between tax evasion and tax avoidance is a matter of legality, the emphasis when making this distinction should not be on whether the outcome of an activity is legal, it should be on the taxpayer's conduct.[62] He argues that tax evasion normally involves fraud or attempts to conceal a taxpayer's true actions. Whereas, he notes that: [t]ax avoidance's domain is the shadow world that results from the incongruence between statutory language and the context, intent or purpose of the legislation."[63] Although some argue that those involved in tax avoidance are not concerned with the detection risk, that is to say, whether the relevant tax authorities identify their conduct, Barker considered that the latter is only true from a narrow perspective. Although taxpayers who undertake a tax avoidance scheme would

[61] ibid 575.
[62] William B Barker, 'The Ideology of Tax Avoidance' (2009) 40 Loyola University Chicago Law Journal 229.
[63] ibid 250 (citations omitted).

not be concerned with criminal persecution if their activities are found out, a tax authority can only challenge those schemes they know about. As Barker put it, “undiscovered tax avoidance is successful tax avoidance.”[64]

Many of the themes noted by Barker are also noted by Prebble and Prebble. In particular, they note that secrecy is important for tax avoidance to be successful. They go as far as to say that “[a]voidance that can only succeed if not discovered is only contingently legal and is just short of tax evasion at the most serious end of the scale.”[65] Freedman, writing from a UK perspective, also agreed with many of these points. In respect of the disclosure point, she questions at what point the drive for secrecy becomes concealment.[66]

III.2.2 Avoidance verses mitigation

Unlike tax evasion and tax avoidance, where at least conceptually, there is a clear distinction between the two terms (i.e. legality), the boundary between tax avoidance and tax mitigation is both conceptually and practically problematic. Lord Hoffmann and others argue that unless the legislation under consideration uses these terms it is not in not useful to introduce them. Instead, in *Westmoreland*,[67] Lord Hoffmann, citing his judgement in *Norglen*,[68] argued tax avoidance schemes either work or not. With the

[64] ibid 243.
[65] Zoë M Prebble and John Prebble, ‘The Morality of Tax Avoidance’ (2010) 43 Creighton Law Review 693, 718.
[66] Judith Freedman, ‘Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle’ [2004] British Tax Review 332.
[67] *Westmoreland (HL, 2001)* (n 52).
[68] *Norglen Ltd (in liquidation) v Reeds Rains Prudential Ltd and others* [1998] 1 All ER 218 (UKHL).

question of whether a tax avoidance scheme works depends on how the relevant legislation is constructed.

As noted above Lord Templeman defined tax avoidance as the reduction of a person's tax liability in a way that is contrary to the intention of Parliament. However, writing extra-judicially, Lord Hoffmann argues that this formulation "raises a logical difficulty",[69] namely, why was tax due in the first place. Although Lord Templeman would respond by suggesting that tax is due because Parliament intended it to be due, this, in Lord Hoffmann's view merely raised the question of how the intention of Parliament should be determined. Furthermore, Lord Hoffman questions whether, post-*Ramsay*, it was possible for the court to interpret a tax statute in such a way that it agreed that although Parliament intended to levy a tax, no actual tax was due.[70] Similar themes can be found in the academic literature. For instance, Weisbach argues that there "is no a priori way to distinguish [tax] shelters [broadly equivalent to tax avoidance[71]] from any other tax planning."[72]

Freedman argues that there is a spectrum of activities between tax evasion and tax planning of the sort that all people would find acceptable:

> *Between these activities, difficult as they are to define, is the grey area of activity which some consider to be completely legitimate and even*

[69] Lord Hoffmann, 'Tax Avoidance' [2005] British Tax Review 197, 204.
question of how to determine the intention of Parliament is discussed further at Section VIII.3.
[71] Illinois Revenue, 'Abusive Tax Shelters - Definitions' <http://www.revenue.state.il.us/AbusiveTaxShelter/General/definitions.htm> accessed 1 March 2018.
[72] David A Weisbach, 'Ten Truths about Tax Shelters' (2002) 55 Tax Law Review 215, 216.

> *desirable for the proper functioning of the tax system and others consider reprehensible.*[73]

For instance, some, such as Murphy see the term 'tax avoidance' as a broad term covering a range of activities,[74] whilst others would view the same activities as sensible tax planning. Freedmen's use of the word 'reprehensible' is interesting because it points to a question of morality and raised the question of what the role of morality is in differentiating between tax avoidance and tax mitigation.

Honoré, writing on the interaction of morality and the law comments that, although people have a moral obligation to pay tax, "[a]part from the law, no one has a moral obligation to pay any particular amount of tax."[75] If Honoré is correct, then taxpayers do not have a moral obligation not avoid tax as tax avoidance schemes are designed to ensures that no tax that is legally due. This argument supports Lord Hofmann's position that the key distinction is not between tax avoidance and tax mitigation; instead, it is between successful tax avoidance versus unsuccessful tax avoidance.

Freedman, after reflecting on Honoré's position, suggested another way by which morality can come into a discussion of tax avoidance, namely via social norms, which guide taxpayer's decisions on whether to enter tax avoidance. However, she argues that

[73] Judith Freedman, 'The Tax Avoidance Culture: Who Is Responsible? Governmental Influences and Corporate Social Responsibility' (2006) 59 Current Legal Problems 359, 365.
[74] Richard Murphy, *The Joy of Tax: How a Fair Tax System Can Create a Better Society* (Bantam Press 2015).
[75] Tony Honoré, 'The Dependence of Morality on Law' (1993) 13 Oxford Journal of Legal Studies 1, 5.

relying on such social norms to prevent tax avoidances in unlikely to be successful in the long term since “taxation is a topic where there will be genuine moral disagreements”.[76]

From the above discussion, it can be seen that although most commentators acknowledge that there is a distinction between tax avoidance and tax mitigation, it is challenging to determine where to draw the line between the two terms. That said, Barker suggests that"[g]ood tax lawyers know when they are pushing hard at the edge of the envelope."[77] This quote is probably also true for tax advisers in the UK. That is to say, although an experienced UK tax adviser may not be able to provide a detailed test to determine whether a scheme amounts to tax avoidance, they would be able to make a determination upon viewing such a scheme.

III.3 Implications for this dissertation

The previous section has explored the challenges of defining the term tax avoidance. Before moving on, it is important to consider what these discussions mean for the purposes of this dissertation. Although the literature highlights that the distinction between tax evasion and tax avoidance may not be a clear as it first appears, this dissertation focuses on activities that fall outside of the scope of tax evasion. Many of the Relevant Cases were reported to HMRC under the Disclosure of Tax Avoidance Schemes (‘DOTAS’) regime, which would indicate that the taxpayers and their advisers were not attempting to avoid disclosing the nature of the schemes to HMRC. Furthermore, the GAAR is a legislative provision to prevent ‘abusive’ tax avoidance, as

[76] Freedman, ‘Defining Taxpayer Responsibility’ (n 66) 339.
[77] Barker (n 62) 230, citing John Braithwaite, Markets in Vice, Markets in Virtue (Oxford University Press 2005).

opposed to tax evasion. Thus, this dissertation is concerned only with tax avoidance and not tax evasion.

Once tax evasion is excluded, the question then becomes what is meant by the term tax avoidance? Although Lord Templeman, sought to distinguish tax avoidance from tax mitigation, it has been shown above that this distinction has been questioned. At the same time, it seems reasonable to distinguish between, say, an individual putting money into an ISA and a company buying of an off-the-self avoidance scheme. Between these two extremes there is a range of activities which some may label tax avoidance but others would label tax mitigation.

Further investigation into the distinction between tax avoidance and tax mitigation is unlikely to assist in answering the question posed by this dissertation because the question of where the line should be drawn comes down to one's own political and moral perspective. Therefore, this dissertation will use the term tax avoidance in a broad way to refer to any method used legally to reduce a person's liabilities to tax. That said, we focus on activities towards the more aggressive end of the tax avoidance spectrum.

Although it could be argued that the inclusion of the word aggressive adds an emotive edge and merely adds to the terminological quagmire, two points should be made. Firstly, the GAAR is intended only to apply to abusive tax avoidance arrangements, which are likely to at the more aggressive end of the tax avoidance spectrum. Secondly, although it may be difficult to specify *a priori* what makes a tax avoidance arrangement aggressive, in practice, an experienced tax practitioner knows when they are pushing the boundaries.[78] From a practical perspective, given the method used within this dissertation relies on analysis of cases that have been considered by the courts, this would indicate that HMRC disagree with the taxpayer's analysis. Although this does not necessary mean that schemes should be considered aggressive avoidance, HMRC are focused on challenging tax avoidance schemes through the courts.[79]

Furthermore, not seeking to distinguish tax mitigation from tax avoidance is appropriate given the measures reviewed in this dissertation. This is because each of the measures contain a different criterion to determine whether it applies to the scheme in question. Thus, in order to explore the key question in our research we have taken a broad view of what tax avoidance is. This will enable us to analyse what type of avoidance each measure is designed to counteract.

III.4 Summary of key points

- The key difference between tax evasion and tax avoidance is legality, although the boundary can become blurred.
- It is more challenging to distinguish between tax avoidance and tax mitigation. This dissertation will use the term 'tax avoidance' in a broad way to refer to any legal method used to reduce a person's liabilities to tax.
- The next chapter will introduce the GAAR, which, introduces a new term into the mix, namely 'abusive tax avoidance'.

[78] Drawing on Barker's comments, cited above ([n 62]).
[79] Andrew Goodall, 'We Will Beat You, HMRC Tells Tax Avoidance Schemers' (*Tax Journal*, 22 August 2012) <https://www.taxjournal.com/articles/we-will-beat-you-hmrc-tells-tax-avoidance-schemers-22082012> accessed 17 March 2018.

CHAPTER IV: INTRODUCTION TO THE GAAR

IV.1 Introduction

As the GAAR is central to this dissertation, this chapter provides an introduction to it and reviews the provisions within the context of the Aaronson Report.[80] By contextualising the GAAR provisions in this way, a fuller exploration of its purpose and the safeguards contained within it should be possible. Given the question this dissertation seeks to answer; we only consider the parts of the legislation which affect whether the GAAR will apply to a tax avoidance scheme. A discussion of how tax advantages obtained in the schemes to which the GAAR applies are counteracted and the procedural issues related to the application of the GAAR are beyond the scope of this research.

This chapter will begin by reviewing the GAAR legislation as enacted within FA 2013, references being made to the Aaronson Report where relevant. Such references will enable the GAAR legislation to be contextualized and the purpose of certain key phrases to be explored. Following on from this, the safeguards recommend by the Aaronson Report will be discussed. As part of this discussion, this dissertation will consider how these safeguards were enacted within FA 2013.

[80] Graham Aaronson, 'GAAR Study: A Study to Consider Whether a General Anti-Avoidance Rule Should Be Introduced into the UK Tax System.' (2011) <http://webarchive.nationalarchives.gov.uk/20130321041222/http:/www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf> accessed 3 September 2016.

IV.2 The GAAR as enacted in Finance Act 2013

Following the Aaronson Report[81] and subsequent consultation, the GAAR was enacted as Part 5 of FA 2013, which received Royal Assent on 17 July 2013.[82] The GAAR applies to a broad range of taxes including corporation tax, income tax and inheritance tax.[83] The main tax that the GAAR does not apply to is VAT. This is because VAT was already subject to an abuse of law doctrine, which has been developed by the European Court of Justice as a result of the *Halifax* case.[84]

The GAAR seeks to counteract tax 'arrangements' that are considered 'abusive.' [85] The term arrangement is broadly defined as including "any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable)"[86] which is a very common definition tax legislation.[87]

A 'tax arrangement' is in turn defined as an arrangement "if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements."[88] The phrase 'main purpose, or one of the main purposes' is used on a number of other occasions as part of Targeted Anti-Avoidance Rules ("TAARs"), for instance, the TAARs within the UK dividend exemption.[89] Cooper highlights that this test looks at the purpose

[81] ibid.
[82] Introductory Text, FA 2013
[83] Section 206(3)
[84] Antony Seely, 'Tax Avoidance: A General Anti-Abuse Rule - Background History (1997 - 2010)' (2015) House of Commons Library Standard Note 2956.
[85] Section 209(1), FA 2013
[86] Section 214, FA 2013
[87] Cf. Section 169G(1), TCGA 1992, Section 89(2), FA 2015
[88] Section 207(1), FA 2013
[89] Part 9A, CTA 2009

of the arrangement, rather than the motives of the individual participants involved. [90] That is to say, the purpose of an arrangement can only be determined with reference to the objective facts surrounding the implementation of that arrangement, rather than the subjective intentions of the participators or designers of those arrangements.

A broad definition of a "tax advantage" is used for determining if the GAAR applies.[91] A tax arrangement is considered abusive where those arrangements *"*cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances including … [those listed at Subsections 207(2)(a)-(c)]." Broadly speaking, subsection (a) and (c) are concerned with whether the results of a tax arrangement are consistent with the purpose of the underlying tax provisions or exploit a shortcoming in them. Subsection (b) is concerned with whether the tax arrangements contain any artificial or contrived steps. The phrase 'all the circumstances including' introducing subsections (a) to (c) indicates that the factors listed are not exhaustive and regard should be taken of all other relevant factors. Furthermore, Section 207(3) goes on to explicitly state that where a tax arrangement is part of other wider arrangements, regard should be taken of those other arrangements.

The authors of the Aaronson Report considered that it was important to have a double reasonableness test as opposed to a single reasonableness test. The purpose of the double reasonableness test is to set a high hurdle by requiring the court to find in favour of the taxpayer in circumstances where, even if the court does not consider the

[90] Graeme S Cooper, 'The Role and Meaning of "Purpose" in Statutory GAARs' (Sydney Law School 2016) Legal Studies Research Paper No. 16/22 <https://papers.ssrn.com/abstract=2752276> accessed 2 December 2016.2
[91] Section 208, FA 2013

arrangement to be reasonable, they could accept that such a view might reasonably be held.[92] As Aaronson explains, the double reasonableness test "asks not merely whether you think it is reasonable but also whether you regard it as reasonable that someone else could have a different view."[93]

Section 207(4) and (5), respectively, contain a list of factors which might indicate that a tax arrangement is abusive and a single factor which might indicate that an arrangement is not abusive. The lists in these two sections should not be considered exhaustive and other factors may be relevant.[94] Broadly speaking, the indicators of abusiveness cover situations where either the result for tax purposes is significantly different from the economic result of that arrangement (in the taxpayer's favour) or where there is a claim for a repayment or crediting of tax where the underlying tax has not been paid and is unlikely to be paid. However, there is an escape clause here as a result is only abusive "if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted."[95]

The single indicator that a scheme might not be abusive is that the tax arrangement was standard practice and, at the time the arrangement had been entered into, HMRC had accepted the practice. This means that tax arrangements should not be subject to the GAAR where HMRC has not historically challenged similar arrangements. That said, HMRC's GAAR guidance indicates that they would take a close look at the facts of the scheme and the context of their historical position before accepting that this

[92] Aaronson (n 80).
[93] Economic Affairs Committee, 'The Draft Finance Bill' HL 2012-13,139 Ev Q3.
[94] Section 207(6), FA 2013.
[95] Section 207(4), FA 2013

indication is present.[96] As such, whether this indicator would prevent the GAAR from applying would require a close analysis of the facts.

IV.3 Safeguards

Within the Aaronson Report,[97] the authors recommend six safeguards to ensure that the GAAR would not apply to acceptable tax planning. These safeguards are as follows:

1) The GAAR should include "explicit protection for reasonable tax planning".[98] This safeguard is achieved within GAAR by the inclusion of the double reasonableness test at Section 27(2),[99] as discussed in the previous section.
2) The GAAR should not be used against schemes that are not tax motivated. This safeguard is achieved by the inclusion of a motive test at Section 207(1). Again, this section has already been discussed.
3) When seeking to apply the GAAR, the burden of proof should be on HMRC to show that an arrangement is abusive. This is achieved by the inclusion of Section 211(1)(a) and is discussed further at IV.3.1.
4) There should be an advisory panel to advise HMRC on the application of the GAAR. Their role is twofold; firstly, to comment on the application of the GAAR in specific cases, with such advice being publically available in an

[96] HMRC, 'HMRC's GAAR Guidance (Approved by the Advisory Panel with Effect from 28 March 2018)' (2018).
[97] Aaronson (n 80).
[98] ibid 1.11(i).
[99] The precise wording of the double reasonable test at Section 207(2) is different from the wording proposed within the Aaronson Report, however, the revised working does not materially affect how the double reasonable test should apply.

anonymised format; and secondly, to approve the GAAR guidance issued by HMRC. The roles of the panel are outlined in Schedule 43, FA 2013 and are discussed further at IV.3.2.

5) When determining whether the GAAR is applicable, both HMRC and the taxpayer should be able to refer to any materials which are in the public domain, even if ordinarily, such materials would be inadmissible in court. This safeguard is achieved by Section 211(3) and discussed further below at IV.3.3.
6) The GAAR should only be able to be applied with the authorisation of a senior HMRC official. This safeguard was legislated for within Schedule 43, FA 2013, which provides that only a 'designated HMRC official' can seek to invoke the GAAR. The role of the designated HMRC official will not be discussed further as it is considered a procedural safeguard and therefore beyond the scope of this dissertation.

IV.3.1 Burden of proof

Normally, where tax disputes are considered by the courts, the burden of proof is on the taxpayer to show that their interpretation of the relevant provision is correct, whereas in GAAR cases, the burden of proof rests with HMRC.[100] Specifically, Section 211(1) states that HMRC must show: firstly, there is a tax arrangement which is abusive; and secondly the proposed counteraction of the arrangement is just and reasonable.

[100] HMRC, '2015 GAAR Guidance' (n 33) para C8.2.

The Aaronson Report[101] recommended placing the burden of proof on HMRC for two main reasons. Firstly, the authors considered that if the burden of proof was placed on the taxpayer it would be difficult for a taxpayer to show that a tax arrangement is not abusive. Secondly, their review of how GAARs were implemented in other jurisdictions found that, where the burden of proof is on the taxpayer, judges are reluctant to override specific rules with a general rule given that "Parliament has laid down rules, and prima facie those rules ought to be capable of being followed without penalty."[102]

IV.3.2 The GAAR Advisory Panel

As noted above, the GAAR Advisory Panel is comprised of a number of independent tax experts and is designed to advise HMRC on the application of the GAAR.[103] The Panel has two primary functions. Firstly, before HMRC can apply the GAAR to a tax arrangement, it is required to refer the scheme to the Panel for its opinion on whether the taxpayer's actions were reasonable[104] (i.e. a single reasonableness test[105]). HMRC is not bound by the Panel's opinion, however, the courts are required to take the Panel's opinion into consideration as part of any subsequent appeal.[106] HMRC states that anonymised versions of these opinions will be released shortly after the main opinion has been provided.[107] The first set of opinions were published in July 2017,[108] with a total of 6 sets of opinions published to date, although

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[101] Aaronson (n 80).
[102] Economic Affairs Committee (n 93) Ev Q3.
[103] Although the Aaronson report recommended that the membership of this panel should include both HMRC and non-HMRC members, with the latter being in the majority, it was later decided that the panel should comprise solely of non-HMRC members.
[104] Para 11(3), Sch 43, FA 2013
[105] HMRC, '2015 GAAR Guidance' (n 33) E4.2.5.
[106] ibid E4.2.9.
[107] ibid E4.2.8.
[108] 'GAAR Advisory Panel Opinion of 18 July 2017: Employee Rewards Using Gold Bullion' <https://www.gov.uk/government/publications/gaar-advisory-panel-opinion-employee-rewards-using-gold-bullion> accessed 2 March 2018.

a number of these appear to deal with similar subjects. Five relate to employee remuneration schemes and one relates to a scheme extracting cash from a company without triggering an income tax liability or a charge under Section 455, CTA 2010. Given that the subject matter of these opinions is not related to the loan relationship code, they are not directly relevant to the subject of this dissertation and therefore are not discussed further.

The second function of the Panel is to approve HMRC's GAAR guidance. Although this is not a statutory duty per se, the courts are only required to take into consideration HMRC's GAAR guidance if it has been approved by the Panel (specifically, the version approved at the time the tax arrangement was entered into).[109] The context of HMRC's GAAR Guidance is discussed further as Section IV.4.

With respect to GAAR guidance which HMRC has drafted but is not yet approved by the Panel, HMRC may still be able to use this as evidence in court under Section 211(3) providing it is in the public domain. The critical difference between these two situations is that the court *must* take into account the approved GAAR guidance whereas, it *may* take account of any other materials, such as unapproved guidance, in the public domain at the time of the transaction.

IV.3.3 The source that can be used by the court

Section 211(3)(a) allows the courts, when determining whether the GAAR applies, to take into account a broader range of materials than courts have traditionally been allowed under the principles set out in *Pepper v Hart.*[110] Specifically, they may consider any other

[109] Section 211(2)
[110] *Pepper (Inspector of Taxes) v Hart* [1992] STC 898 (UKHL).

material which was in the public domain at the time that arrangement was entered into. This section is very broadly drafted and the courts may take into account “guidance, statements or other material (whether of HMRC, a Minister of the Crown or anyone else).”[111] As HMRC’S GAAR guidance notes, there “is no limit to the nature of this material, providing only it is relevant,” and it could include official documents, such as ministerial statements and non-official documents such as journal articles.[112]

IV.4 HMRC’s GAAR guidance

As noted above, part of the role of the GAAR advisory panel is to approve the GAAR guidance issued by HMRC. HMRC’s guidance was first published in 2013,[113] then revised in 2015,[114] 2017[115] and 2018.[116] Although each iteration has introduced a number of small amendments, there have not been any major changes in the guidance between the different versions. HMRC’s website contains a list of the changes made between versions.[117] The GAAR Guidance contains five sections, the content of each is outlined below:

- Part A is a short introduction to the purpose of the guidance and its legal status. Part A will not be considered further.

[111] Section 211(3)(a)
[112] HMRC, ‘2015 GAAR Guidance’ (n 33) para C8.5.
[113] HMRC, ‘HMRC’s GAAR Guidance (Approved by the Advisory Panel with Effect from 15 April 2013)’ (2013).
[114] HMRC, ‘2015 GAAR Guidance’ (n 33).
[115] HMRC, ‘HMRC’s GAAR Guidance (Approved by the Advisory Panel with Effect from 31 March 2017)’ (2017).
[116] HMRC, ‘2018 GAAR Guidance’ (n 96).
[117] HMRC, ‘Tax Avoidance: General Anti-Abuse Rule Guidance - Earlier Versions’ <https://www.gov.uk/government/publications/tax-avoidance-previous-guidance-on-general-anti-abuse-rule> accessed 30 March 2018.

- Part B summarises how the GAAR is designed to apply and what types of tax avoidance schemes it is designed to target. Although this guidance is useful to understand the types of schemes that HMRC intends to use the GAAR to counteract, it is generally in line with what was proposed in the Aaronson Report. As such, it will not be considered further.
- Part C contains a detailed discussion of the GAAR legislation and how HMRC considers each element of the GAAR legislation is designed to apply. HMRC's comments in this regard will be noted, where relevant in Chapter VII.
- Part D contains 32 examples of how the GAAR is likely to apply in specific cases (plus a further 4 schemes that straddle the implementation of the GAAR). A number of these examples are based on historical cases, including *BMBF*[118] and *Mayes*.[119]. The relevant examples from Part D will be discussed in Section IV.4.1.
- Part E details the procedural aspects of how the GAAR will apply and will not be considered further.

IV.4.1 HMRC's examples

Of the 32 main examples which HMRC provides, 6 consider corporation tax matters. These examples cover schemes involving tax provisions ranging from capital allowances to unauthorized unit trusts. Of these examples, two concern schemes

[118] *BMBF (HL, 2004)* (n 45).
[119] *Mayes v HMRC* [2009] EWHC 2443 (Ch), [2010] STC 1.

involving the loan relationship regime, one likely to have been challenged by HMRC using the GAAR, and other not.

The first example concerns a scheme designed to manipulate the late paid interest rules. Although these rules have since been repealed, the 2018 guidance still contains this example as HMRC considered it remains useful to show the principles of how the GAAR will apply. The scheme involves a company paying interest on a loan where the connected party lender is a tax resident in a country with a double tax treaty with the UK, thereby meaning that the interest payable is deductible on an accruals basis. As the company would like a deduction for interest payable on a paid basis, the company arranges for the lender to assign a small element of the interest to a connected party in a tax haven (‘Haven Co’), thereby causing the interest payable on the whole loan to be deductible on a paid basis.

HMRC conclude that they would not seek to apply the GAAR against such a scheme. Although the assignment of a small element of the interest to Haven Co is a contrived step, HMRC consider it unclear whether the relevant legislation was designed to prevent such a scheme from being successful. Further, they note, that none of the indicators of abusiveness are present and historically HMRC granted clearance for such schemes.

The second example involves a Company A acquiring Company B, in such a way that the shares of Company B are treated as if they were a debt instrument in the hands of Company A. This means that Company A would be taxable on the fair value gains or losses arising from the shares of Company B. After that acquisition, Company B then pays a large dividend to Company A, which results in a significant decrease in the fair value of Company B and prima facia, gives rise to a deductible fair value loss in Company A. This scheme has a number of similarities to *Travel Document Services*.[120] HMRC indicates that they would use the GAAR against this type of scheme because they consider that all of the elements that indicate the GAAR would apply do exist. Namely, the scheme is contrived, it exploits a shortcoming in the relevant provisions, and it gives rise to tax deduction in Company A where no economic loss arose.

Although these examples are useful to determine how one should perform a GAAR analysis (indeed the analyses contained within Appendix D are based on the structure of these examples), there is a question of how useful they are in understanding how the GAAR should apply. Some have gone so far as to say that they provide very little guidance on how the GAAR will apply because none of the examples give “consideration of borderline scenarios.”[121] Indeed, the examples provided are either straightforward tax planning, or are clearly abusive. As such, although they provide an indication of how HMRC will approach GAAR cases, the conclusions reached in respect of the examples do not give much clarity over how the GAAR will apply in less clear-cut cases.

IV.5 Summary of key points

- The GAAR is designed to enable HMRC to counteract tax avoidance schemes that are considered abusive. A scheme is considered abusive if it “cannot reasonably be regarded as a reasonable course of action”.

[120] *Travel Document Service (UT, 2017)* (n 40).
[121] William Watson, ‘The X Factor’ (*Slaughter and May*, 2013) 4 <https://www.slaughterandmay.com/media/2027840/the-x-factor.pdf> accessed 30 March 2018.

- The Aaronson Report recommended that the GAAR contain a number of safeguards to provide additional protection for taxpayers who undertake sensible tax planning, including the creation of an independent GAAR Advisory Panel to advise HMRC how the GAAR should apply.
- HMRC have issued guidance on how the GAAR applies. This guidance has been approved by the GAAR Advisory Panel and includes examples of how the GAAR may apply in specific cases.
- Prior to the introduction of the GAAR, HMRC sought to use the Ramsay Principle to defeat tax avoidance schemes. The Ramsay Principle will be the subject of the next chapter.

CHAPTER V: INTRODUCTION TO THE RAMSAY PRINCIPLE

V.1 Introduction

Since the House of Lords decision in the *Ramsay* case,[122] the Ramsay Principle has been one of the key tools that HMRC uses to prevent tax avoidance schemes from being successful. This principle developed over a number of years and the present form can be summarised in a quote from Ribeiro PJ: "The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."[123] This phrasing of the Ramsay Principle was affirmed by the House of Lords in the *BMBF* case.[124] Although the Ramsay Principle is strictly speaking not a GAAR, some have seen it as equivalent to one. For instance, Prebble and Prebble commented in 2010 that although the UK did not have a statutory GAAR, "it does have a judicially developed anti-avoidance rule [i.e. the Ramsay Principle] that sometimes have roughly the same effect."[125]

The first section of this chapter will review the development of the Ramsay Principle from its initial formulation in *Ramsay*.[126] As will be seen, although this principle continues to be referred to as the Ramsay Principle, its nature has shifted significantly over time and continues to be developed by the courts.

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[122] *Ramsay (HL, 1981)* (n 53).
[123] *Arrowtown (HKFCA, 2003)* (n 48) [35].
[124] *BMBF (HL, 2004)* (n 45).
[125] Rebecca Prebble and John Prebble, 'Does the Use of General Anti-Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law - A Comparative Study' (2010) 55 Saint Louis University Law Journal 21, 26.
[126] *Ramsay (HL, 1981)* (n 53).

The second part of this chapter will consider the *Mayes* case.[127] Although it concerns income tax rather than corporation tax, it highlights a key weakness in the Ramsay Principle. Indeed, this case was one of the key reasons that the GAAR was considered necessary over and above the Ramsay Principle.:[128] That said, as will be discussed at VIII.3.2, the effectives of the GAAR in challenging schemes similar to the one is *Mayes* is open to question.

V.2 Development of the Ramsay principle

With the top rate of income tax on investment income in 1974/75 of 98%, the 1970's was a period, when many high earners looked to marketed tax avoidance schemes to reduce their tax liabilities. [129] In these cases, they often relied on the *Duke of Westminster* case[130], which led the tax profession and courts to interpret tax statutes in a literal way.[131] In the 80 years since the *Duke of Westminster*, Lord Tomlin's judgement has often been quoted,[132] specifically his dictum that:

> *Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then however unappreciative the Commissioners of Inland Revenue or his fellow*

[127] *Mayes v HMRC* [2011] EWCA Civ 407, [2011] STC 1269.
[128] Aaronson (n 80).
[129] Graham Aaronson, 'The Swing of the Pendulum: Tax Avoidance in Modern Times' *Tax Journal* (30 September 2016) 6.
[130] *Inland Revenue Commissioners v Duke of Westminster* All ER 259 (UKHL).
[131] Aaronson (n 129). According to Simpson, judges historically took a literal interpretation of taxing statutes to avoid being in breach of Article 4 of the Bill of Rights of 1688, which prevents the Crown from levying taxes without the consent of Parliament ('The Ramsay Principle: A Curious Incident of Judicial Reticence?' [2004] British Tax Review 358)..
[132] cf. HMRC, '2015 GAAR Guidance' (n 33); Malcolm Gammie, 'Moral Taxation, Immoral Avoidance - What Role for the Law?' [2013] British Tax Review 577; David Bloom, 'Tax Avoidance - A View from the Dark Side' (2016) 39 Melbourne University Law Review 950.

> *taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.*[133]

The approach to tax avoidance cases was changed after the House of Lords heard the appeal in the cases of *Ramsay v IRC*.[134] The scheme in *Ramsay* involved the taxpayer investing £185k in Caithmead Limited ('C Limited') as well as making two loans to it. After various transactions, the taxpayer was able to extract its investment in C Limited by selling one of the loans at a profit, which resulted in the values of C Limited decreasing. The taxpayer then disposed of C Limited for its market value, which produced a loss. Although commercially the taxpayer did not make a net loss from the scheme (other than in respect of adviser fees), they sought to argue that a deductible capital loss arose. This was on the basis that although that the profit arising from the disposal of loan was non-taxable, the loss on disposal of C Limited was deductible.

Within his judgement in, Lord Wilberforce outlined four principles that apply in tax avoidance cases. Firstly, taxpayers can only be taxed on 'clear words.' Secondly, taxpayers are entitled to arrange their affairs to reduce their tax liabilities, and as such, transactions "must be considered according to … [their] legal effect."[135] Thirdly, it is a matter of fact whether an arrangement is a sham and, as such, is a matter for the Special Commissioners (now the FTT) to determine. Fourthly, if the "transaction is genuine, the court cannot go behind it to some supposed underlying substance".[136]

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[133] *Duke of Westminster (HL, 1935)* (n 130) 267.
[134] *Ramsay (HL, 1981)* (n 53).
[135] ibid 180a.
[136] ibid 180b-c.

Although these four principles may seem, on first appearance, relatively unproblematic and perfectly consistent with the judgement in Duke of Westminster, Lord Wilberforce introduced important qualifications to the first and last principles. These jointly gave rise to a significant change in how the courts dealt with tax avoidance cases.

With respect to the first principle, although a taxpayer could only be taxed on 'clear words,' Lord Wilberforce made clear that this did "not confine the courts to literal interpretation" .[137] Instead, the courts should interpret the provision within the broader legislative context and with regard to its purpose. In *Ramsay*, moving away from an overly literal interpretation of taxing statutes allowed the court to consider whether a 'real world' loss arose as, in the words of Lord Wilberforce, "capital gains tax was constructed to operate in the real world, not that of make-belief."[138]

With regard to the fourth principle, although Lord Wilberforce confirmed the courts cannot tax a transaction in accordance with its underlying substance, this principle "does not compel the court to look at a document or a transaction in blinkers".[139] Rather, the court is required to consider the legal nature of the transaction when it is viewed as part of the wider scheme. The scheme in *Ramsay* would only produce a tax loss if each of the individual steps of the transaction were considered in isolation. When the scheme was considered as a whole, Lord Frazer viewed it as giving

[137] ibid 179j.
[138] ibid 182a.
[139] ibid 182d.

rise to the "magic result of creating a tax loss that would not be a real loss" as the deductible loss was matched by a non-taxable gain.[140]

Although Lord Wilberforce took care to ground these two principles in historical case law and to distinguish the Duke of Westminster case, *Ramsay* clearly changed the way that the courts viewed tax avoidance transactions. Indeed, in *Burmah Oil,*[141] the second Relevant Ramsay case, Lord Diplock, in a short concurring judgement said that it "would be disingenuous to suggest … [that *Ramsay*] did not mark a significant change in the approach adopted by this House in its judicial role to a pre-ordained series of transactions … into which there are inserted steps that have not commercial purpose."[142]

The second case in the *Ramsay* series is *Burmah Oil*.[143] This scheme involved the taxpayer subscribing for shares in one of its subsidiaries, which had no assets, to allow the subsidiary to repay a debt (which, if waived, would have been non-deductible owed to the taxpayer. Subsequently, the taxpayer placed the subsidiary into liquidation and claim a capital loss, with the cash used to subscribe for shares increasing the taxpayers base cost in its subsidiary, thereby increasing the capital loss available. Although Counsel for the taxpayer sought to distinguish this case from *Ramsay*, the House of Lords determined that the Ramsay Principle applied to deny relief for a capital loss. This was on the basis that, as Lord Frazer put it in the leading judgement, "when the scheme was

[140] ibid 190d. It is interesting to note that the House of Lords considered the technical merits of the scheme in *Ramsay* and found that it did not work from a technical perspective. As such, the House of Lords did not need to outline a new approach to defeat it.
[141] *Burmah Oil (HL, 1982)* (n 49).
[142] ibid 32e-f.
[143] *Burmah Oil (HL, 1982)* (n 49).

carried through to completion there was no real loss and no loss in the sense contemplated by the legislation."[144]

Prior to *Furniss v Dawson*,[145] the *Ramsay* principle had only been considered in the context of self-cancelling transactions, which had no enduring legal consequences. According to Lord Templeton, writing extra-judicially, this led the 'tax avoidance industry' to consider that *Ramsay* did not apply to "tax avoidance schemes which produced enduring results."[146] In *Furniss*, the House of Lords clarified that the *Ramsay* principle did apply to linear transactions that leave the taxpayer in a different place from where they started. The scheme in this case involved the taxpayers' sale of a trading company to a third party. Rather than selling their trading company directly, the taxpayers inserted an Isle of Man Holding company above the trading company, with the Isle of Man company selling the trading company to the third party. If successful, this scheme would have allowed the taxpayer to defer the gain arising if the trading company were sold directly to the third party.

Lord Brightman in his leading opinion, reformulating Lord Diplock's opinion in *Burmah Oil*, stated that for the *Ramsay* principle to apply two conditions needed to be satisfied.[147] Firstly, "there must be a preordained series of transactions; or, if one likes, one single composite transaction."[148] Secondly, "there must be steps inserted which have no commercial (business) *purpose* apart from the avoidance of tax."[149] Where both

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[144] ibid 39a-b.
[145] *Furniss v Dawson (HL, 1984)* (n 50).
[146] Templeman (n 60) 578.
[147] *Furniss v Dawson (HL, 1984)* (n 50).
[148] ibid 166f-g.
[149] ibid 166g (emphasis in original).

conditions are satisfied, the *Ramsay* principle applies such that the steps which are inserted are to be ignored for tax purposes.

In respect of the first condition, Lord Brightman explicitly restated two points regarding this condition, which were already evident in earlier judgements. [150] Firstly, an arrangement should be considered a composite transaction even if the taxpayer is not contractually obliged to complete the transaction once it has been started. This was already evident in the *Ramsay* judgement, where Lord Frazer opined that the "absence of [a] contractual obligation does not in my opinion make any material difference."[151] Secondly, the Ramsay Principle may still apply where a composite transaction achieves a commercial end. This point was previously alluded to in Lord Diplock's opinion in *Burmah Oil*, where he referred to "a pre-ordained series of transactions (whether or not they included the achievement of a legitimate commercial end)".[152]

The next Relevant Ramsay Case that came before the House of Lords was *Craven v White,*[153] which was conjoined with two other appeals. In a number of key respects, the transaction ultimately undertaken in *Craven v White* was similar to the scheme in *Furniss*. The critical fact that distinguished *Craven v White* from *Furniss* was that when the taxpayer inserted the Isle of Man company into the structure, the taxpayer was considering an alternative transaction whereby the operations of the taxpayer's company would be merged with another company, with the insertion of the Isle of Man Company being commercially necessary to facilitate such a merger. Counsel for White

[150] *Furniss v Dawson (HL, 1984)* (n 50).
[151] *Ramsay (HL, 1981)* (n 53) 190f-g.
[152] *Burmah Oil (HL, 1982)* (n 49) 32f.
[153] *Craven (Inspector of Taxes) v White* [1988] STC 476 (UKHL).

sought to distinguish *Furniss* on the basis that the two transactions (i.e. the insertion of the Isle of Man company and the third party sale) were not carried out "simultaneously or contemporaneously."[154]

In a majority decision, the House of Lords found that the Ramsay Principle did not apply to the scheme in this case. The key question was how the precedent set by *Furniss* applied to the facts of this case. Lord Oliver, in his leading judgement, considered that there were two views of the precedent set by *Furniss*. The first view was that any transaction designed to avoid a tax charge arising from a second transaction should be ignored for tax purposes "because it has been planned to take place and therefore forms part of a scheme for the avoidance of tax'".[155] The other view is that *Furniss* confirmed that the Ramsay Principle can be applied to linear transitions as well as circular self-cancelling transactions, but only where the transactions can be seen as "constituting a single composite and indivisible whole involving only a single disposal for tax purposes."[156] .

Lord Oliver was of the view that the House of Lords should take a narrow view of the precedent set by *Furniss*, namely that for the Ramsay Principle to apply the transaction should be part of a composite transaction where are all the steps are pre-planned and there is no practical likelihood it will not be undertaken as planned. On the facts of the case, Lord Oliver considered that, at the time the Isle of Man company was inserted into the structure, there was sufficient uncertainty over the final transaction to

[154] ibid 488c.
[155] *Craven v White (HL, 1988)* (n 153) 496g.
[156] ibid 196j.

prevent the two transactions being a considered single composite transaction to which the Ramsay Principle could be applied.

Following *Craven v White*, the next Relevant Ramsay Case was *Inland Revenue Commissioners v McGuckian*.[157] Although the fact that the Ramsay Principle applied in this case is not particularly noteworthy, Lord Steyn's description of the state of tax law pre-Ramsay is cited by both *BMBF*[158] and *UBS*.[159] In McGuckian, Lord Steyn described tax law pre-*Ramsay* as an "island of literal interpretation."[160] This, combined with a step-by-step analysis of composite transactions, "allowed tax avoidance schemes to flourish to the detriment of the general body of taxpayers". [161]

The next case to consider, *MacNiven v Westmoreland*,[162] is particularly relevant to this dissertation because its involved what would now be treated as a loan relationship. The facts of this case are relatively straight forward. Westmoreland Investment Limited ('WIL') was owned by a tax exempt pension scheme (the 'Pension Scheme'). WIL owed the Pension Scheme £70m, including £40m in accrued interest. Although WIL was of limited value to the Pension Scheme, there was a market for a company with brought forward tax losses. As at the time, interest was only deductible on a paid basis (except for interest paid to banks), a tax deduction for the accrued interest needed to be crystallised so the value of WIL could be maximised. To facilitate this, the Pension Scheme lent WIL £20m, to allow some of the accrued interest to be paid, thereby

[157] *McGuckian (HL, 1997)* (n 55).
[158] *BMBF (HL, 2004)* (n 45) at [28].
[159] *UBS & DB (SC, 2016)* (n 44) at [61].
[160] *McGuckian (HL, 1997)* (n 55) 915f.
[161] ibid 915g.
[162] *Westmoreland (HL, 2001)* (n 52).

crystallising a deduction for the accrued interest. The process was repeated twice more with the same effect. When WIL paid the interest to the Pension Scheme, WIL accounted for the income tax due on the interest payment. However, as the Pension Scheme was exempt from tax, it was able to reclaim the income tax suffered. The Pension Scheme then sold WIL to a third party for nominal value and the outstanding debt at a significant discount, with the value of this debt arising from the fact that WIL had carried forward losses.

HMRC sought to argue that that the Ramsay Principle applied to this scheme with the effect it should be disregarded for tax purposes. Lord Hoffmann gave the leading judgement in this case. He identified the "innovation in *Ramsay* was to give the statutory concepts of 'disposal' and 'loss' a commercial meaning."[163] Although in his judgement in *Ramsay*, Lord Wilberforce discussed 'real world' gains and losses, Lord Hoffmann considered it important to be careful when using such terms to avoid "unnecessary philosophical difficulties about the nature of reality". [164] Instead, he opines that "something may be real for one purpose but not another." [165] Thus, Lord Hoffman considered that the first step in applying a provision is to consider whether it is referring to a commercial or legal concept.

In *Westmoreland*, the critical word in the relevant provision was 'payment', which meant the "transfer of money, which discharges a debt." [166] In this case, given that WIL discharged its debt to the Pension Scheme in respect of the accrual interest, the transfer

[163] ibid 22.
[164] ibid 40.
[165] ibid.
[166] ibid 67.

of money to the Pension Scheme should be treated as a 'payment' for the purpose of the relevant legislation and therefore, a deduction should be available. As Lord Nicholls put it: "A genuine discharge of a debt cannot cease to qualify as a payment for the purpose of [the relevant provision] by reason only that it was made solely to secure a tax advantage." [167] As will be seen when *BMBF* is considered, later decisions of the House of Lords moved away from distinguishing between those concepts which should be given their commercial meaning and those that should be given their legal meaning.[168]

The next cases to consider is *Carreras v Stamp Commissioners,*[169] which arose from an appeal from the Court of Appeal of Jamaica and was heard by the Judicial Committee of the Privy Council. The taxpayer sought to dispose of one its subsidiaries to a third party, however, instead of selling for cash, which would have attracted Transfer Tax, it did so in exchange for an issue of debentures, which were due to be redeemed a few weeks later, thereby avoiding Transfer Tax. Lord Hoffmann, who gave the sole judgement of the Judicial Committee considered that the key question to consider was whether the 'transaction' in this case included the subsequent redemption of the debentures. Lord Hoffmann considered that restricting the view of the transaction would give rise to a result that would could not have been intended by the legislator. As a result of viewing the transaction as a whole, it was determined that the relevant exemption did not apply and therefore, Transfer Tax was due.

[167] ibid 15.
[168] Per Lord Nicholas, *Westmoreland* "certainly does not justify the assumption that an answer can be obtained by classifying all concepts a priori as either 'commercial' or 'legal'".(*BMBF (HL, 2004)* [n 45] [33]).
[169] *Carreras Group (PC, 2004)* (n 47).

The next Relevant Ramsay Case to be considered ins *BMBF v Mawson*.[170]. The facts of the scheme are highly complex, and involved BMBF entering into a sale and lease-back arrangement with Bord Gais Eireann, ('BGE') over an oil pipeline with security arrangements being put in place to enable to the proceeds from the sale to be retained by a company in the Barclays group. Although BMBF did entered into sale and lease-back agreements as part of its trade, the sole benefit of this scheme was to enable BMBF to claim capital allowance on the costs of this pipeline. The question that the House of Lords needed to consider was whether the Ramsay Principle applied such that BMBF was unable to claim capital allowances on the expenditure it incurred on the pipeline.

Lord Nicholls, with whom the other Lords agreed, began by noting there was uncertainty about the nature of the Ramsay Principle, and although his judgment would not remove all the difficulties he aimed to "achieve some clarity about [its] basic principles."[171] Lord Nicholls describes the Ramsay Principle as involving two elements. Firstly, one needs to consider the nature of the relevant provision and what type of transactions that provision seeks to tax. Secondly, one needs to consider whether the transaction is of the type that the provision seeks to apply to. It is this process that Lord Nicholls saw as encapsulated by Ribeiro's famous dictum in *Arrowtown*.[172]

When taking the approach Lord Nicholls, drawing on *Westmoreland*, made it clear that one needs to "avoid sweeping generalisations about disregarding transactions

[170] *BMBF (HL, 2004)* (n 45).
[171] ibid 28.
[172] "The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically" (*Arrowtown (HKFCA, 2003)* [n 48]).

undertaken for the purposes of tax avoidance." [173] In *BMBF,* Lord Nicholls found that the purpose of the capital allowance regime is to give tax relief to the person who suffers from the fact that assets reduce in value due to depreciation (in this case BMBF as lessor). As the relevant provision is not concerned with how the lessee used the asset or what they did with the proceeds from a sale and lease-back arrangement, these factors did not affect the nature of BMBF's expenditure. Indeed, Lord Nicholls found that the circularity of the funding was 'happenstance' and was not necessary for the schemes effectiveness. As BMBF acquired the pipeline in the ordinary course of its business the Ramsay Principle could not be used to prevent them claiming capital allowance on the expenditure incurred.

On the same day as Lord Nicholls gave his judgement in the *BMBF* case, he also gave the sole judgement in *Inland Revenue Commissioners v Scottish Provident Institution*[174] ('SPI'). The scheme in this case sought to take advantage of changes to the taxation of options and involved the following. Prior to the change SPI sold an option over gilts to a third party, creating non-taxable income, with the third party exercised their option after the change giving rise to an allowable loss for SPI. Arrangements were put in place to ensure that neither party made an overall gain or loss from the arrangements (except for fees payable for the facilitating the scheme) and securitisation arrangements were put in place such that no cash changed hands. The options were priced such that it could have been in the third party's interest not to exercise the option granted to it by SPI. Lord Nicholls notes that the Special Commissioners found, as a

[173] *BMBF (HL, 2004)* (n 45) [37].
[174] *Scottish Provident Institution (HL, 2004)* (n 51).

matter of fact, that although it was unlikely to be in the third parties' interest not to exercise its option, the 'no practical likelihood' test set out by Lord Oliver was not satisfied.

In order for this scheme to be successful, the third party needed to be entitled to gilts under the option. Although in isolation, the option gave the third party such an entitlement, if the broader arrangements were taken into consideration, no such entitlement would exist, leading the scheme to fail. Lord Nicholls found that although the 'no practical likelihood' test was not satisfied, this was because the options were deliberately structured so that there would remain a small chance they would be exercised. The sole reason for doing so was to ensure that there was no composite transaction, thereby preventing the Ramsay Principle from applying. Lord Nicholls opined that the value of the Ramsay Principle would be greatly diminished if it could not be applied to schemes that contained a "commercially irrelevant contingency".[175] This decision qualified the 'no practical likelihood' test set out by Lord Oliver in *Craven v White*, such that when applying the test, commercially irrelevant contingencies should be ignored.

The boundaries of the precedent set in *BMBF* were tested in *Tower MCashback LLP v HMRC*.[176] This scheme involved the individual taxpayers investing in Tower MCashback 2 LLP (the 'LLP'), which borrowed additional funds on non-recourse terms[177]

[175] ibid 23.
[176] *Tower MCashback (SC, 2011)* (n 54).
[177] A non-recourse loan is defined as a "loan secured by a charge on assets. If the borrower defaults and the security does not realise the full value of the loan, the lender cannot recover the shortfall from the borrower" (Practical Law, 'Glossary: Non-Recourse Loan' <https://uk.practicallaw.thomsonreuters.com/5-107-

from a company in the Tower Group PLC (‘Tower’) group and used all of its funds to purchase an element of the software owned by MCashback Limited. The loans made to the LLP were unlikely ever to be repaid and under the funding arrangements 82% of the software purchase price received by MCashback Limited had to be deposited with a named bank to act as security on the non-recourse loans. In addition, the purchase price of the software was greatly in excess of its market value The scheme was designed to allow the investors in the LLP to claim First Year Allowances on the software purchased, including the element which was debt funded, thereby creating a tax loss which the investors could use against their other income. The net effect was that investors were able to claim a loss equal to approximately four times the amount they had invested.

HMRC sought to argue that the Ramsay Principle applied such that the amount the LLP spent on acquiring the software, was not all incurred in acquiring a capital asset and therefore did not qualify for First Year Allowances. The LLP sought to defend their position by relying on the precedent set by *BMBF*, such that the only question to be considered was whether the LLP had incurred the expenditure of acquiring the software without reference to the broader context of the transaction.

Lord Walker SCJ, in his leading judgement, found that the precedent set by *BMBF* meant that the Ramsay Principle did not automatically apply to schemes where the financing was circular; instead an analysis of the facts was required. However, he distinguished the facts of *BMBF* from the current case. In particular, he noted that in *BMBF* the various transactions were undertaken on commercial terms, and although

6893?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1> accessed 24 March 2018).

BGE needed to deposit the purchase price as security, the arrangements benefited BGE. In contrast, MCashback did not receive most of the consideration paid, instead, it went directly into the security arrangements. Overall, Lord Walker concluded that, unlike in *BMBF*, the LLP "did not, on a realistic appraisal of the facts, meet the test laid down by the [Capital Allowances Act 2001], which requires real expenditure for the real purpose of acquiring plant for use in a trade."[178] That said, given that the LLP did incur some expenditure on acquiring the software, the court allowed the LLP to claim First Year Allowances that element. [179]

The final Ramsey case to be considered is the joint case of *UBS v HMRC* and *Deutsche Bank v HMRC*.[180] Although these cases were heard together and the scheme in both cases were similar, both schemes operated independently. They were designed to allow these banks to pay their employees a bonus, which would be subject to capital gains tax, rather than income tax.[181] As part of this scheme, the employees were given shares which were designed in such a way to ensure that they qualified as restricted securities. Ordinarily, when an employee is given a restricted security, where the restrictions are due to be lifted within five years, there is an option to defer the charge to income tax until the restrictions are lifted. Although this would normally only defer the tax charge, the scheme in this case was designed to prevent a tax charge from arising

[178] *Tower MCashback (SC, 2011)* (n 54) [80].
[179] Although normally the determination of the amount spent on acquiring the software would be a question of fact for the FTT to consider, Lord Walker decided not to send the case back to the FTT, instead allowing the LLP to claim First Year Allowance on 25% of the expenditure (i.e. the amount the investor invested).
[180] *UBS & DB (SC, 2016)* (n 44).
[181] All the parties agreed that, if these bonuses were subject to income tax, National Insurance Contributions would also be due.

by ensuring that the lifting of those restrictions qualified for a specific exemption applied.

After a brief discussion of the Ramsay Principle, with a focus on the precedent set by *BMBF*, Lord Reed SCJ, with whom the other Supreme Justices agreed, went on to consider whether a purposive interpretation of the relevant provisions was possible. Counsel for UBS & DB sought to argue that a purposive interpretation was not possible because the relevant legislation contained no explanation of its purpose and the scheme was not prevented by any of the specific anti-avoidance provisions included. As a result of this, and the fact that the relevant legislation was "extensive and highly detailed, counsel [for UBS & DB] argued that it was impossible to attribute to Parliament an unexpressed intention to exclude schemes of the present kind from the ambit of [the relevant legislation]." [182] Although Lord Reed acknowledged that there were forceful arguments, he viewed the relevant provisions in their broader background and found that they were designed to operate within a commercial context and were not intended to apply where non-commercial terms were included to ensure an exemption applied.

Based on this analysis, Lord Reed concluded that when determining whether a security is a restricted security, one should only take account of those restrictions which have a commercial purpose. Given the facts, Lord Reed found that the redeemable shares were not restricted securities and, therefore, a tax charge arose at the point the shares were allocated to employees.

[182] *UBS & DB (SC, 2016)* (n 44) [73].

HMRC proposed that the Supreme Court went one step further by treating the employees as having received cash bonuses instead of shares, however, Lord Reed found HMRC's arguments in this regard unpersuasive

V.3 *Mayes*

Although *Mayes*[183] is not referred to in *UBS*, and is an income tax case rather than a loan relationship case (or even corporation tax case), it is important to consider since it shows the limitations of the Ramsay Principle. Furthermore, the Aaronson Report pointed to the failure of HMRC to defeat this scheme as one of the reasons why the UK needed a GAAR. Whilst it is open to question whether the GAAR would prevent schemes of this type, a detailed discussion of this case is relevant to later considerations.[184]

This scheme is highly complex, involving a number of life insurance policies being transferred between various individuals and corporate entities. Steps 3 and 4 of the scheme were critical to its success; these involved a Luxembourg company paying a 'topped-up' premium on the scheme then partially surrendering the policies to obtain their 'topped-up' premium back. The last step was for the taxpayer to buy the policies for market value then surrender them in full. A literal application of the relevant provisions led to the conclusion that the taxpayer was able to claim a significant income tax loss that could be set against their other income. HMRC sought to challenge this position by invoking the Ramsay Principle to allow HMRC to disregard Steps 3 and 4 when determining how the taxpayer should be taxed. According to HMRC, these steps should be disregarded on the basis that these "two steps were a single, wholly self-

[183] *Mayes (CA, 2011)* (n 127).
[184] See Section VIII.3.2.

cancelling, pre-ordained transaction for tax avoidance purposes having no commercial purpose whatsoever."[185]

The taxpayer argued that the Ramsay Principle was not helpful to HMRC in this case due to the nature of the provision in question. In his preliminary comments, counsel for the taxpayer argued that the relevant provisions were capable of "producing results counter to commercial reality." .[186] Furthermore, counsel for the taxpayer describes the provisions "as a highly prescriptive way of exacting tax on the basis of a formulaic arithmetical approach to transactions.[187]

Hollis described the operation of the relevant tax provisions thus:

> *the statute permitted the offset of only a small proportion of the premiums paid where amounts were withdrawn early in the life of a policy, with a true-up on its final surrender. Where all the holders of the policy were U.K. residents, the legislation resulted in the right amount of tax being paid over the life of the policy, although not necessarily in the hands of the correct holders; i.e., there could be "phantom gains" and "phantom losses."*[188]

Using Hollis's terminology, this scheme was designed to produce that a non-taxable 'phantom gain' in the Luxembourg company with the matching 'phantom loss'

[185] *Mayes (CA, 2011)* (n 127) [32].
[186] ibid 38.
[187] ibid.
[188] James Hollis, 'The End of the Road? The "Ramsay Principle" and a GAAR for the U.K.' (2012) 10 (2) Journal of Taxation of Financial Products 4, 4–5.

being realise by the taxpayer when he was a UK tax resident, thereby giving rise to a deductible income tax loss.

In respect of the Ramsay Principle, counsel for the taxpayer sought to argue that the Ramsay Principle "does not allow legal events to be deprived of their legal or fiscal effects simply because they are inserted for a tax saving purpose."[189] Mummery LJ agreed with the taxpayer that the Ramsay Principle could not be used to prevent the scheme from obtaining the desired result. After noting that the relevant provisions "do not readily lend themselves to a purposive commercial construction", [190] Mummery LJ found that:

> *[Steps 3 and 4] were genuine legal events with real legal effects. The court cannot, as a matter of construction, deprive those events of their fiscal effects … because they were self-cancelling events that were commercially unreal and were inserted for a tax avoidance.*[191]

Both Thomas and Toulson LJJ 'reluctantly' concurred with Mummery LJ's decision. Toulson LJ acknowledged that allowing this scheme to succeed "instinctively seems wrong, because [the result] bears no relation to commercial reality and results in a windfall which Parliament cannot have foreseen or intended."[192] He goes on to identify that:

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[189] *Mayes (CA, 2011)* (n 127) [64].
[190] ibid 78.
[191] ibid.
[192] ibid 101.

> *The root problem in this case from the viewpoint of HMRC lies in the structure of the relevant statutory scheme. … Inherent in the [legislative] scheme is the possibility of a disconnection between what would be regarded as a gain on an ordinary commercial view and what is to be treated as a gain for the purposes of the statute.*[193]

V.4 Summary of key points

- This chapter has shown how the Ramsay Principle has developed since the House of Lords handed down this judgement in *Ramsay.*
- The authors of the Aaronson Report considered that the Ramsay Principle was not sufficient to prevent tax avoidance schemes from being successful. The outcome of the *Mayes* case was an important factor in arriving at this conclusion.
- The primary challenge that HMRC faced when applying the Ramsay Principle in *Mayes* was that the relevant tax provisions were not designed to tax 'real world' gains and losses. Instead, it was designed to tax phantom gains and losses like those the scheme gave rise to.
- Following these preliminary chapters, the next chapter will seek to introduces the Loan Relationship Regime, which is at the heart of this dissertation.

[193] ibid 102–103.

CHAPTER VI: INTRODUCTION TO THE LOAN RELATIONSHIP REGIME

VI.1 Introduction

The loan relationship regime was first introduced in Finance Act 1996 and as part of the Tax Law Rewrite Project became Part 5 of CTA 2009. The regime provides a holistic regime within which loan relationships held by companies are taxed. Given that this dissertation is focused on tax avoidance schemes involving loan relationships, it is important to understand how the regime works, including the relevant anti-avoidance provisions. The regime contains numerous sections dealing with a variety of issues concerning loan relationships and not all of the provisions can be discussed in detail within this chapter, however, those areas of particular relevance will be briefly introduced.

Although there are similarities between the taxation of loan relationships and derivative contracts[194] the dissertation focuses on provisions within the loan relationship regime. As such, it will not discuss the derivative contact rules although the conclusions may also apply to the derivative contract regime.

This chapter begins by outlining the underlying principles of the loan relationship regime before moving on to consider a number of the key provisions within the regime, principally the group continuity rules. The purpose of this overview is to contextualise

[194] HMRC, 'Modernising the Taxation of Corporate Debt and Derivative Contracts' (2013). These similarities not only concern the fundamental principles behind both regimes, but also the anti-avoidance legislation contained within then, including a modified version of the unallowable purpose rule (compare Section 441 et seq CTA 2009 with Section 690 et seq CTA 2009) and the LR TAAR (compare Section 455B et seq CTA 2009 with Section 698B et seq CTA 2009).[194]

the discussions of avoidance schemes in later chapters. The group continuity rules are particularly important to introduce at this stage because a number of the tax avoidance schemes that will be considered involve intragroup loan relationship transfers which were designed to give rise to asymmetrical results. [195]

The second section of the chapter moves on to consider two of the main anti-avoidance provisions contained within the loan relationship regime, namely Section 441 and the LR TAAR at 455B-455D, CTA 2009. Although there are a significant number of other anti-avoidance provisions, Section 441 and the LR TAAR can apply in a range of situations. In contrast, many of the other provisions target specific schemes, for instance, Section 445A, which was designed to prevent schemes involving the derecognition of loan receivables,[196] similar to the scheme in *Fidex*.[197] Others are designed to address the manipulation of specific provisions, for instance, Section 363A is designed to prevent the manipulation of the deemed release rules. Furthermore, as will be seen, there is an argument that the LR TAAR is in effect a 'mini-GAAR'.

The final section will review a number of recent loan relationship related avoidance cases to understand how loan relationships are being used as part of tax avoidance schemes. As will be seen, although the courts were able to defeat most of these schemes, often this required a detailed review of how the scheme was accounted for and whether the accounts of the relevant companies were GAAP compliant. In addition, a number of cases sought to argue that the debits and credits from a scheme

[195] Cf. *Greene King (CA, 2016)* (n 24).
[196] HC Deb 6 December 2010, Vol 52, Col 1WS.
[197] *Fidex (CA, 2016)* (n 22).

did not 'fairly represent' the profit or loss accruing to a company from a loan relationship (for instance *Stagecoach*[198] and *Smith and Nephews*[199]*)*.

VI.2 The Loan Relationship Regime

The loan relationship regime provides a holistic framework under which all loan relationships that a company is party to are taxed and, subject to a small number of exceptions, takes priority over all other sections of the tax legislation.[200] That is to say, debits and credits arising from loan relationships can only be subject to corporation tax in accordance with the loan relationship regime. The regime only applies to companies and other entities subject to corporation tax.

A loan relationship is defined as a 'money debt' arising out of a transaction of the lending of money.[201] Broadly speaking, a 'money debt' is a debt that falls to be settled by the payment of money, the issuance or transfer of shares, or the transfer of another money debt. In addition, a money debt not arising out of the lending of money is to be treated as a loan relationship if the debtor issued an instrument representing security for the debt or the creditors' right in respect of the debt.[202]

The general principle of the loan relationship regime is that debits and credits arising from loan relationships are taxable or deductible if they arise in a company's

[198] *Stagecoach (FTT, 2016)* (n 16); Heather Self, 'Stagecoach, Loan Relationships and the "fairly Represents" Rule' *Tax Journal* (1 April 2016) 19.
[199] *Smith and Nephew (FTT, 2017)* (n 16); Heather Self, 'Smith & Nephew: A Rare Taxpayer Win on "Fairly Represent"' *Tax Journal* (31 March 2017).
[200] Section 464, CTA 2009
[201] Section 302, CTA 2009
[202] Section 303, CTA 2009

profit and loss account ('P&L').[203] As such, the tax treatment of an item of income or expense should be determined by how that item is accounted for, unless the loan relationship regime explicitly requires an alternative treatment to be adopted.[204]

Unlike other parts of the legislation, there "is no rigid divide between capital and income."[205] Furthermore, Section 320 provides that where a loan relationship debit or credit is capitalised as part of an asset or liability on a company's balance sheet in accordance with GAAP, that debit or credit should be brought into account for tax purposes as if it were a P&L debit or credit. For instance, when a company borrows money to fund a construction project, GAAP may allow the company to capitalise that interest as part of the cost of that asset such that that interest does not give rise to a P&L expense. However, for tax purposes, relief for the expense can be obtained when the interest expense is incurred. Indeed, Self noted that the purpose of this section was to ensure such capitalised interest would remain deductible.[206]

Before moving on, one final aspect of the loan relationship regime should be introduced, namely, the group continuity rules contained within Chapters 4 – 8 of Part 5. Where there is an intragroup financing arrangement, both the creditor and debtor companies are required, for tax purposes, to account for that relationship using

[203] Debits and credits arising within other comprehensive income are not brought into account under the loan relationship regime until they are recycled into a company's P&L (Section 307 & 308, CTA 2009).
[204] For the avoidance of doubt, this principle only applies where the relevant accounts are prepared in accordance with Generally Accepted Accounting Principles ('GAAP'). Where the relevant accounts are not GAAP compliant, Section 309, CTA 2009 requires that only those debits and credits that would have arisen had the accounts been GAAP compliant are brought into account. Hereafter, unless otherwise stated, references to a company's accounts will assume that those accounts are GAAP compliant.
[205] *Ghosh, Johnson and Miller on the Taxation of Corporate Debt and Derivatives* (Issue 17 November 2017) para C2.2.
[206] Self, 'Stagecoach, Loan Relationships and the "fairly Represents" Rule' (n 198).

amortised cost accounting.[207] In addition, where there is a debt release between connected companies, although the debits arising in the creditor company are non-deductible, the credits arising in the debtor company are not taxable.[208] Broadly speaking, the purpose of these rules, is to ensure symmetry between the debits and credits arising in the creditor and debtor companies.[209]

As will become evident in Section V.6 of this chapter, a significant number of the loan relationship avoidance schemes that have come before the courts have attempted to manipulate or side step the group continuity rules to ensure that an asymmetrical result arose from intra-group financing arrangements.

VI.3 Section 441

Section 441[210] is designed to prevent companies from obtaining a tax deduction from a loan relationship debit where the company is party to it for an 'unallowable purpose'. According to HMRC, the purpose of the loan relationship regime is to provide tax relief for costs arising from loan relationships "incurred in pursuit of genuine commercial objectives: it should not provide relief for amounts attributable to unallowable purposes."[211]

Section 442 defines an unallowable purpose as a one "which is not amongst the business or other commercial purposes of the company."[212] A company has an

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[207] Section 329, CTA 2009
[208] Section 354 & 358, CTA 2009
[209] *Ghosh, Johnson and Miller on the Taxation of Corporate Debt and Derivatives* (Issue 15 December 2016) para D4.1.
[210] Prior to the Tax Law Rewrite Project, this rule was contained within Paragraph 13 of Schedule 9, FA 1996.
[211] HMRC, 'Modernising the Taxation of Corporate Debt and Derivative Contracts' (n 194) para 14.25.
[212] Section 442(1)

unallowable purpose for being party to a loan relationship where either the company is party to it for the furtherance of activities not within the scope of corporation tax, or for a tax avoidance purpose. Specifically, a loan relationship has an unallowable purpose if the main purpose, or one of the main purposes, of the company being party to it is to secure a tax advantage for itself or another person.[213] Where a company is party to a loan relationship for multiple purposes, then only those debits that are attributable, on a just and reasonable basis, to that unallowable purpose are disallowable.[214]

On first appearance it may seem that this rule is straightforward to apply, however, in practice, it can be complicated, especially in group situations, as can be seen in a number of tax cases. One such complication is the vexing "question of whose purposes are relevant – the borrower's, as the legislation would suggest or, as the FTT in *A.H. Field* would have it, those of 'all the stakeholders' in the borrower, including shareholders and advisers?"[215] This is an important question because the fact that a group arranges for an intra-group loan to be entered into for tax avoidance purposes does not necessarily mean that the debtor company does not have a good commercial purpose for being party to the loan relationship. This question arose in *Versteegh*[216] where HMRC argued that Para 13 was applicable. Lane's answer to his own question is that whilst one should ordinarily look at the borrower's purpose,

[213] Section 442(4)
[214] Consideration of how a taxpayer should apportion the debits arising on a loan relationship between the allowable purposes and the unallowable purposes on a just and reasonable basis is beyond the scope of this dissertation.
[215] Mike Lane, 'Taking Stock of Unallowable Purpose' *Tax Journal* (1 August 2014) 14 15.
[216] *Versteegh (FTT, 2013)* (n 28).

> *in certain circumstances, such as where the borrower does not appropriately address its mind to the transactions at hand, I can see that it may be appropriate to treat the borrower as having adopted the purposes of the person proposing the transaction to it.*[217]

The importance of the unallowable purpose rule focusing on the motive of the company in which the debit arose will be seen later when a number of loan related avoidance cases will be considered. These examples will show that even when a transaction is entered into to enable the interest arising on an intra-group debt to be non-taxable in the hands of the recipient, but still deductible in the payer's, it is not always possible for HMRC to challenge the deductibility of the debits using the unallowable purpose rule. For instance, in both the *Greene King*[218] and *Stagecoach*[219] cases, taxpayers sought to prevent credits arising from an intra-group loan relationship from being taxable without limiting the debtor company's ability to claim a tax deduction for the debits.

Before moving on, it is interesting to note one point arising from *Travel Document Services*[220]. In that case, the Court of Appeal found that Section paragraph 13 can also be used to deny a deduction for debits arising from a deemed loan relationship. The Court of Appeal held that when considering whether a company had an unallowable purpose for being party to a deemed loan relationship, one needs to considered the

[217] Lane (n 215) 15.
[218] *Greene King (CA, 2016)* (n 24).
[219] *Stagecoach (FTT, 2016)* (n 16).
[220] *Travel Document Service (CA, 2018)* (n 27).

purpose of that company being party to the actual relationship, which is treated as a loan relationship.

VI.4 The Loan Relationship TAAR

In 2013, HMRC issued a consultation document regarding the modernisation of the loan relationship and derivative contract rules within which they proposed the introduction of a new regime TAAR for loan relationships.[221] This consultation document was published as Finance Bill 2013, containing the GAAR, was making its way through Parliament[222]. Notwithstanding the imminent introduction of the GAAR, HMRC considered that combined the GAAR, Section 441 and the transfer pricing rules, were not sufficient to prevent taxpayers attempting to avoid tax using loan relationship. Such attempts "are to be expected in the absence of the deterrent and counteractive effects of fully functional and comprehensive anti-avoidance provisions." [223]

In particular, HMRC considered that:

> *The test of "abuse", for the purposes of the GAAR, is a high threshold, and while the GAAR may apply to certain arrangements … it does not seek to encompass the full range of tax avoidance activity. …. The need for specific legislation to protect against manipulation of the regime and inappropriate relief in respect of corporate debt and derivatives therefore remains.*[224]

[221] HMRC, 'Modernising the Taxation of Corporate Debt and Derivative Contracts' (n 194).
[222] Parliament, 'Bill Stages - Finance Act 2013' <http://services.parliament.uk/bills/2013-14/financeno2/stages.html> accessed 13 May 2017.
[223] HMRC, 'Modernising the Taxation of Corporate Debt and Derivative Contracts' (n 194) para 14.8.
[224] ibid 14.3.

The above passage is particularly important to the topic of this dissertation, as it shows that HMRC intended for the loan relationship TAAR to be able to counteract a broader range of loan relationship avoidance schemes than the GAAR could. Following on from the consultation document, the loan relationship TAAR was inserted into the loan relationship regime at Sections 455B-445D, CTA 2009 by FA (No 2) 2015. The LR TAAR applies to arrangements entered into on or after 18 November 2015.[225]

The TAAR seeks to counteract 'loan-related tax advantages' that arise out of 'relevant avoidance arrangements'.[226] The term loan-related tax advantage is defined by Section 455C(5) as including increasing the debits or decreasing the credits a company needs to bring into account. In addition, Subsection 455C(5)(e) allows HMRC to challenge schemes which are designed to manipulate the loan relationship regime to ensure that a debit or credit arises is in a particular period. For instance, a scheme may be designed to ensure a loan relationship credit arises in a specific period to enable that credit to be sheltered by a loss that would have otherwise gone unrelieved.

The term 'relevant avoidance arrangements' is defined as an arrangement[227] which has as its "main purpose, or one of their main purposes, is to enable a company to obtain a loan-related tax advantage".[228] However, some arrangements are excluded from this definition by Section 455C(4), which states:

[225] Para 111, Sch 7, FA (No.2) 2015
[226] Section 455B(1)
[227] The definition of an arrangement for these purposes "include any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable)" (Section 455C(2)). As noted in IV.2, this is the same definition of arrangement which is used on a number of occasions in the legislation.
[228] Section 455C(3)

if the obtaining of any loan-related tax advantages that would (in the absence of section 455B) arise from them can reasonably be regarded as consistent with any principles on which the provisions of this Part that are relevant to the arrangements are based (whether expressed or implied) and the policy objectives of those provisions.

Although this exclusion may appear similar to the wording used in the GAAR legislation, there are a number of subtle differences which have the potential to allow the TAAR to apply in a broader range of circumstances. These differences are discussed further at Section VII.2.4.

Section 455D moves on to provide some examples of outcomes which would indicate that the exclusion that Section 455C(4) provides would not apply. The indications of non-exclusion are as follows:

- Section 455(4)(a): The arrangement results in a profit being brought into accounts which is less than the company's economic profit.
- Section 455(4)(b): The arrangement results in a loss or expense being brought into accounts which is greater than the company's economic loss or expense.
- Section 455(4)(c): The arrangement prevents or delays a loan relationship item being recognised in a company's P&L.
- Section 455(4)(d): The arrangement causes a loan relationship to be accounted for in a different way than it would have been, absent of that arrangement.

- Section 455(4)(e): The arrangement allows a company to bring into account a debit for an exchange loss where a corresponding gain would not have been taxable (or a smaller amount of that gain would have been taxable).
- Section 455(4)(f): The arrangement allows a company to bring into account a debit for a fair value loss where a corresponding gain would not have been taxable (or a smaller amount of that gain would have been taxable).
- Section 455(4)(g): The arrangement causes the group continuity rules to apply in such a way that results in an overall reduction in the credits or increase in debits being brought into account.
- Section 455(4)(h): The arrangement allows a company to bring into account a debit in respect of the release or impairment of a connected party debit where, absent of the arrangement, Chapter 6 would have applied to prevent a deduction being obtained.

The indicators listed at Section 455D(1) are subject to subsection (2), which states that these examples are only indicators of non-exclusion, "if it is reasonable to assume that such a result was not the anticipated result when the provisions of this Part that are relevant to the arrangements were enacted."[229]

[229] Section 455D(2)

VI.5 The 'fairly represents' requirement

Reading the Relevant Cases, one can see that HMRC have attempted to use the 'fairly represents' requirement[230] in a number of loan relationship avoidance cases. Although HMRC have been relatively successful using the 'fairly represents' requirement in a number of recent tax avoidance cases, with the notable exception of *Smith & Nephew*, the 'fairly represents requirement' was repealed by FA (No.2) 2015[231] with effect from 1 January 2016. Given HMRC's success it could be seen as somewhat surprising that HMRC decided to repeal this provision. Before exploring HMRC's reasons for this decision, the development of the 'fairly represent' requirement briefly consider.

When the loan relationship regime was first introduced within FA 1996, Section 84(1) read:

> *The credits and debits to be brought into account in the case of any company in respect of its loan relationships shall be the sums which, in accordance with an authorised accounting method and when taken together, **fairly represent**, for the accounting period in question—*
>
> *(a) all profits, gains and losses of the company, ... and*
>
> *(b) all interest under the company's loan relationship and all charges and expenses incurred by the company.*[232]

As part of the Tax Law Rewrite Project, Section 84(1) was included in CTA 2009 as Section 307(2) and (3) and, broadly speaking, the language of Section 307(2) and (3)

[230] Self uses the phase in 'Smith & Nephew: A Rare Taxpayer Win on "Fairly Represent"' (n 199).
[231] This is the same Finance Act that introduced the LR TAAR.
[232] Emphasis added.

mirrors the language of Section 84(1). Most importantly for current purposes, during the rewrite, the phrase '… when taken together, **fairly represent**, for the …' was retained. Section 307 was not subsequently amended until the fairly represents rule was repealed as part of FA (No.2) 2015.

The leading case on the interpretation of the fairly represents requirement is *DCC Holdings*,[233] with the Supreme Court handing down its judgement in 2010. As this has been identified as one of the Relevant Cases, the facts of this scheme are outlined at Appendix D.4. In summary, the taxpayer sought to rely on an inconsistency in how sale and repurchase agreements are taxed. Specifically, when the taxpayer received interest income on the gilts it purchased as part of the scheme, they argued that whilst the entire amount of interest received gave rise to a deductible deemed manufactured payment, only a small proportion of the interest received was required to be brought into account as taxable income because they only had beneficial ownership of the gilts for a short period of time.

When the case came before the Court of Appeal, Moses LJ (with whom Rix LJ agreed) in his leading judgement explained that the fairly represents requirements;

> *poses a second statutory question, namely whether any particular sum when taken together with the other sums which fall to be brought into account fairly represents all the interest including that which is the mere product of a statutory fiction. That question is different and*

[233] *DCC Holdings (SC, 2010)* (n 21).

additional to the first question, whether the sums are in accordance with an accruals basis of accounting.[234]

Moses LJ goes on to reason that the essential function of deeming a manufactured payment to arise is to cancel out the income arising in the hands of the interim holder of the security, which is DCC Holdings in this case. Thus, although using an accruals basis of accounting, DCC Holdings was only required to recognise an element of the interest it received, but section 84(1) required DCC Holding to bring into account all the interest.

Rimer LJ dissented from the view of Moses and Rix LJJ. Although Rimer LJ's reasoning in this regard is not strictly relevant to the topic under discussion, as the Supreme Court also found in favour of HMRC, his reasoning does highlight an area of tension present in other cases, such as *Mayes*.[235] Rimer LJ commented although he would like to of agreed with Moses LJ as his reasoning ”clothes the relevant legislation with a garb of commercial sanity” he was did not do so as “Moses LJ's reasoning appears to me, with respect, to load on to the emphasised words a function that they cannot naturally bear and whose effect is promptly to deprive the opening provisions of the subsection of virtually all sense”.[236]

When it came before the Supreme Court, although Lord Walker SCJ, who gave the courts sole judgement, agreed “that the majority of the Court of Appeal were right to see the overwhelming need for a symmetrical solution”[237] he was of the view that the correct approach was to treat only a proportion of the deemed manufactured payment

[234] *DCC Holdings (UK) Ltd v HMRC* [2009] EWCA Civ 1165, [2010] STC 80 [63].

[237] *DCC Holdings (SC, 2010)* (n 21) [44].

as arising, rather than requiring DCC Holdings to bring into tax all the interest it received. Thus, the judgements of the Court of Appeal produced the same net result, where DCC Holdings was taxed on its commercial gain, albeit, the Supreme Court disagreed with the Court of Appeal over the way to achieve that result.

One further aspect of Lord Walker's judgement is of note. In Moses LJ's explanation of the fairly represents requirements, the key passage of which has been quoted above, Moses LJ opined that this requirement "poses a second statutory question".[238] However, Lord Walker "respectfully doubts Moses LJ's analysis … [instead] the crucial words in s 84(1) must be constructed as a composite whole."[239]

The 'fairly represents requirement' was discussed in a number of the Relevant Cases, including *Suez Teesside* and *Stagecoach*, which are discussed further in section VI.6 and VI.6.2, respectively. At this point it is sufficient to note that this requirement applied (or would have applied) to prevent the schemes in these cases from being successful.

One notable exception was *Smith & Nephew*, where the FTT found in favour of the taxpayer on the 'fairly represents' requirement. The FTT based their reasoning on Sir Terence Etherton C judgement in the *Greene King* case, where counsel for the taxpayer was seeking to rely on the 'fairly represents requirement' applying to prevent a taxable credit arising in the taxpayer. Given the FTT's reasoning is relatively short[240] and the FTT cannot create binding precedent, the author suggests that little weight is given to the

[238] *DCC Holdings (CA, 2009)* (n 234) [63].
[239] *DCC Holdings (SC, 2010)* (n 21) [35].
[240] Just over one page in the Simon's First-tier Tax Decisions case report, of which slightly under half is taken up by a quote from Greene King.

taxpayer's success in this case. Furthermore, HMRC have appealed the FTT's decision.[241] Self also noted that the FTT's decision was published a week before the UT issued its decision in *Suez Teesside*, which, in her view, improved HMRC's changes of succession in front of the UT.[242]

With this in mind, it appears that by repealing the fairly represents requirement, HMRC discarded a useful tool in preventing loan relationship avoidance schemes from being successful. To understand HMRC's, it is necessary to go back to the consultation document HMRC prepared in 2013 on modernising the loan relationship code, in which HMRC gave a number of reasons why they considered was considering repealing the fairly represents requirement. Firstly, HMRC noted that the requirement was "an area of disagreement between HMRC and taxpayers; nor has it provided definitive guidance to the courts."[243] This comment was made with particular reference to the *DCC Holdings* case where, as noted above, although the decisions of Court of Appeal[244] and Supreme Court[245] gave rise to similar outcomes, they arrived at that outcome in very different ways. Secondly, HMRC noted the difficulties in interpreting the concept of the word 'fair' in this context, particularly given a company's auditors are required to report on whether a company's financial statements give a 'true and fair' view of a company's financial position. Thus, HMRC was concerned that "a concept of 'fairness' in the tax

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[241] Tax Journal, 'Case Tracker: Your Quarterly A to Z Guide to the Status of Leading Tax Cases' *Tax Journal* (15 December 2017) 21.
[242] Self, 'Smith & Nephew: A Rare Taxpayer Win on "Fairly Represent"' (n 199).
[243] HMRC, 'Modernising the Taxation of Corporate Debt and Derivative Contracts' (n 194) para 3.17.
[244] *DCC Holdings (CA, 2009)* (n 234).
[245] *DCC Holdings (SC, 2010)* (n 21).

legislation may not provide a clear basis for an alternative outcome, where that is intended for tax purpose." [246]

It should be noted that at the time HMRC issued this consultation document, the FTT had yet to hear either *Suez Teesside* or *Stagecoach*, with the FTT issuing its decisions in these cases in August 2015 and February 2016, respectively. Indeed, by the time the FTT issued its decision in *Suez Teesside*, the bill that became FA (No.2) 2015 had already had its second reading.[247]Thus, although the fairly represents requirement appears now to have been useful in defeating loan relationship avoidance schemes, a substantial part of the evidence for this position only arose after HMRC had committed to its repeal and, therefore, HMRC decision should be viewed in light of the uncertainly created by *DCC Holdings*, rather than HMRC's success in *Suez Teesside* and *Stagecoach*. Furthermore, even two years after its repeal it had yet to be determined whether the UT's interpretation of the 'fairly represents requirement' will be upheld by the Court of Appeal.[248]

VI.6 Review of recent loan related avoidance activity

As Watson notes, the "loan relationship code has proved to be a fertile ground for tax planners, principally because accounting principles will not necessarily produce the 'right' answer from a tax perspective."[249] The truth of this comment is evidenced by numerous recent cases that have involved loan relationships, such as *Suez Teesside* and

[246] HMRC, 'Modernising the Taxation of Corporate Debt and Derivative Contracts' (n 194) para 3.20.
[247] Parliament, 'Bill Stages - Finance Act 2015' <https://services.parliament.uk/bills/2015-16/finance2015/stages.html> accessed 10 February 2018.
[248] Tax Journal (n 241).
[249] William Watson, 'The Regime TAAR for Loan Relationships' *Tax Journal* (2 October 2015) 12 12.

Fidex. In addition, this quote points towards a number of further insights that can be drawn from the Relevant Cases. Firstly, although instinctively most of these cases have given rise to the 'right' answer, the way those results have been achieved could be criticised. Secondly, although the loan relationship regime seeks to tax the loan relationship debits and credits arising in a company's accounts, HMRC are willing to challenge schemes where they consider those accounting debits and credits do not give rise to the 'correct' amount of taxable income. A case that exemplifies these two insights is *Suez Teesside*.[250]

In *Suez Teesside*, the taxpayer company, GDF Suez Teesside Limited ('Teesside') had various claims (the 'Claims') against companies within the former Enron group, which were subject to tax as loan relationships. The scheme involved Teesside incorporating a wholly owned subsidiary in Jersey called Teesside Recoveries and Investments Limited ('TRAIL') and then transferring the Claims to it. At the time of the transfer, because the Enron group was in a variety of insolvency proceedings, the taxpayer was unlikely to receive the full value of its Claims, instead a valuation of these claims indicated that their fair value was c.£200m. However, for accounting purposes, these Claims were treated as contingent assets and, as such, they were not recognised on Teesside's balance sheet. Teesside transferred the Claims to TRAIL in exchange for an issue of new shares, which were held on Teesside's balance sheet at the carrying value of the Claims prior to the transfer (that is to say nil). The transfer did not give rise to a gain as these Claims were treated as being disposed of at their carrying value, not

[250] *Suez Teesside (UT, 2016)* (n 23).

their fair value. This was justified on the basis that the value of the shares of TRAIL was wholly dependent on the value of the Claims and therefore, accounting for the disposal at fair value would have in effect, required Teesside to recognise a contingent asset at its fair value, which would be contrary to GAAP. When TRAIL received the claims they accounted for those Claims at their fair value of c.£200m but this did not give rise to a gain in TRAIL.

HMRC sought to bring into account the c.£200m gain that Teesside would have recognised if it had accounted for the disposal of the claims at fair value. The FTT[251] was asked to opine on four issues, which can be summarised by two questions: firstly, were Teesside's accounts GAAP compliant? and secondly, notwithstanding the answer to the first question, was Teesside required to bring into account a credit of c.£200m to ensure that Teesside's taxable profits fairly represented their profits? The FTT found that although Teesside's accounts were GAAP compliant, they were required to bring into account a credit of c.£200m to ensure that Teesside's taxable profits fairly represented their profits. On appeal, the UT upheld the substance of FTT's decision.

Referring back to the two insights outlined above, both clearly visible in this case. Firstly, there is an argument that the relevant accounting standards did not give rise to a 'fair' tax result, as it would appear fair that Teesside should be taxed on the c.£200m. That said, as discussed in Chapter III, there is a question over the role of 'fairness' in determining a person's liability to tax. Indeed, arguably, the concept of 'fairness' should be irrelevant to determining a person's liability to tax, for they should be taxed in

[251] *GDF Suez Teesside (Formerly Teesside Power Limited) v HMRC* [2015] UKFTT 413 (TC).

accordance with the law, rather than any subjective notion of what is 'fair'. It is interesting to note that although the UT found that the "FTT's error was to superimpose some vague and unarticulated concept of fairness, for which there is no warrant,"[252] they were still able to find technical grounds to bring the £200m into account.

This leads on to the secondly point raised above, namely, that although the loan relationship regime is designed to tax a company in accordance with debits and credits arising in their GAAP compliant accounts, HMRC are willing to challenge schemes where that correct accounting treatment does not give rise to the 'correct' tax result, in their view. In *Suez Teesside*, in addition to arguing that Teesside's accounts were not GAAP compliant, they also sought to argue that, notwithstanding whether the accounts were GAAP compliant, the c.£200m unrealised gain needed to be brought into account as a result of the 'fairly represents' requirement. Specifically, HMRC sought to override the accounting rules to bring into tax additional credits representing the unrealised gain arising from a contingent asset. As Boneham notes (commenting on the FTT's decision), "[s]trictly, the loan relationships were monetised only in the hands of TRAIL after the transfer: they were not 'monetised' by the transfer for shares".[253] This position could lead to HMRC having a privileged position in judging what is fair as one cannot see HMRC allowing a company to bring into account an unrealised loss in a similar situation. As noted above at IV.5, the 'fairly represents' rule was repealed by FA (No 2) 2015.

[252] *Suez Teesside (UT, 2016)* (n 23) [87].

The *Suez Teesside* case exhibits another common feature of loan relationship cases, namely that when HMRC identifies a new loan relationship avoidance scheme, in addition to challenging the effectiveness of the scheme in court, it also seeks to bring in new legislation to prevent similar schemes from being effective, thereby putting the issue beyond doubt going forward.[254] For instance, in 2008 Para 11B was inserted into Schedule 9 of FA 1996 (now Section 455, CTA 2009) to prevent the type of scheme used in *Suez Teesside* from being successful.[255] In addition, in other situations HMRC, through the relevant Minister, will announce changes to prevent a particular type of scheme from being effective, with the subsequent legislation applying retrospectively from the date of that announcement. An example of such a change is the introduction of Section 455A,[256] which was designed to prevent schemes similar to the one in the *Fidex.*[257]

VI.6.1 A tale of two cases: Part 1 – Greene King

Before moving on, it is useful to consider a couple of Relevant Cases in detail as it will illustrate the lengths that HMRC will go in order to defeat tax avoidance schemes. Furthermore, through considering these cases, it can be seen how complex and difficult it can be to challenge loan relationship related tax avoidance schemes. The two schemes that will be discussed, *Stagecoach* and *Greene King*, are both highly complex and were designed by one of the 'Big Four' accounting firms. Although HMRC were ultimately able

[254] For completeness, this is not unique to loan relationships. For instance, the employment related securities rules were updated to prevent them being used as part of tax avoidance schemes, such as the type considered in the *UBS* case (cf. *UBS & DB (SC, 2016)* [n 44] [19]).
[255] David Boneham, 'Suez Teesside and the "fairly Represent" Rule' *Tax Journal* (18 September 2015) 12.
[256] HC Deb 6 December 2010, Vol 52, Col 1WS (n 196).
[257] *Fidex (CA, 2016)* (n 22).

to prevent the schemes from achieving the desired result, they were required to use multiple technical arguments to challenge them.

The scheme in *Greene King* involved three companies within the Greene King group, Greene King PLC ('PLC'), Greene King Brewing and Retailing Limited ('GKBR', a direct subsidiary of PLC) and Greene King Acquisitions Limited ('GKA', an indirect subsidiary of PLC). In summary, this scheme involve PLC assigned the right to receive the interest payable on a loan receivable (the debtor being GKBR) to GKA in exchange for an issue of preference shares. GKA recognised the right to receive the interest as an asset on its balance sheet. The group sought to argue that when GKBR made payments to GKA in respect of the assigned interest it should be treated as a repayment of the balance sheet asset and therefore non-taxable. [258]

HMRC sought to challenge this scheme on multiple grounds. In respect of PLC, HMRC argued that PLC should have partially derecognised the loan receivable it held to reflect its net present value ('NPV') at the time of the assignment. HMRC argued that this derecognition did not give rise to a deductible debit as the debit should have increased PLC's investment in GKA, rather than being treated as a P&L debit.[259] The subsequent increase in NPV of the Loan over its remaining life would have given rise to taxable income in PLC. The net effect of the debit arising from the derecognition of the loan going to balance sheet and credits arising for the increase in NPV going to the P&L was that PLC would have realised a profit from the loan.

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[258] A more detailed summary of this case can be found at Appendix D.6
[259] PLC's accounting expert witness agreed with HMRC's accounting expert on this point (*Greene King PLC & Greene King Acquisitions Limited v HMRC* [2014] UKUT 178 (TCC), [2014] STC 2439 [72]).

In respect of GKA tax position, there was a question of whether the debits and credits arising as a result of its right to receive interest arose from a loan relationship and therefore fell to be taxed under the loan relationship regime (GKA argued there was a loan relationship, HMRC disagreed). Given this uncertainty, HMRC prepared two strains of argument to challenge the effectiveness of the scheme. HMRC's primary position was that there was no loan relationship, and therefore the sum payable to GKA should be brought into account in accordance with normal tax principles. HMRC's secondary position was that, even if there were a loan relationship, upon issue of the preference shares, GKA was not required to recognise the whole value of the interest it was due to receive as share premium.[260] Had HMRC successfully made this argument then the difference between the interest due to be received and the amount correctly recognised as share premium would have been taxable.

As HMRC's positions in respect of the correct tax treatment of the assignment in both PLC and GKA were largely independent, if they were successful in all their arguments, rather than avoiding paying tax on the interest assigned to GKA, a tax charge would have arisen in both PLC and GKA, thereby giving rise to double tax. As would be expected, HMRC was not sympathetic to this argument and argued that such a result would be "a consequence of the artificial transaction in which the Greene King group indulged."[261] Although FTT,[262] the UT[263] and the Court of Appeal[264] all found that the scheme did not produce the desired tax savings, unlike in the decision of the FTT and

[260] Heather Self, 'Greene King: Loan Relationships and Accounting Issues' *Tax Journal* (5 August 2016) 14.
[261] *Greene King (UT, 2014)* (n 259) [6].
[262] *Greene King (FTT, 2012)* (n 34).
[263] *Greene King (UT, 2014)* (n 259).
[264] *Greene King (CA, 2016)* (n 24).

UT, the Court of Appeal's decision did not give rise to the same income being taxable in both PLC and GKA.

In respect of PLC, the UT found that it should have partially de-recognised the Loan, to reflect the NPV at the time of the assignment. Although counsel for PLC sought to assert various arguments that a partial derecognition of the loan was not required, these were dismissed by Mann J. The Court of Appeal agreed that PLC should have partially de-recognised the Loan.

Of particular note in this regard is counsel for PLC's argument that Paragraph 14 of Schedule 9,[265] allows the balance sheet debit arising from the derecognition to be treated as a deductible P&L debit. Counsel for HMRC rejected this position on two grounds: firstly, the debit arising on the derecognition was not 'in respect of a loan relationship'; and secondly, even if it were treated as a P&L debit, Paragraph 13, denied PLC a deduction for this debit. In relation to the question of whether the debit arising on the derecognition was 'in respect of a loan relationship', Mann J, found that it should be treated as arising from a relationship between PLC and GKA and therefore, as there is no loan relationship between PLC and GKA, the debit arising from the derecognition cannot be 'in respect of a loan relationship'. Instead, the de-recognising "is an entry in the books which reflects the consequences of the transaction that was carried out with GKA in relation to the interest; but it is not 'in respect of' the loan relationship with GKBR."[266]

[265] Rewritten as Section 320, CTA 2009
[266] *Greene King (UT, 2014)* (n 259) [115].

From an accounting perspective, this argument seems counter-intuitive as the debit in question arose as a result of needing to de-recognise part of the loan. In effect, this argument requires one to deconstruct journal entries to determine what the nature of each element represents rather than viewing it in a holistic way. In this case, the court considered the credit as arising from the derecognition of the loan and the debit arising from a capital contribution, rather than viewing both the credit and the debit being necessary to properly reflect the derecognition of the loan. The Court of Appeal upheld Mann J's judgement in this regard. Furthermore, Sir Terence Etherton C, in his lead judgement in the Court of Appeal, cited a second reason for finding that Paragraph 14 was not applicable, namely that Paragraph 14 only applies where GAAP *allows* a debit to be capitalised, as opposed to where GAAP *requires* it, as was the case for PLC. Both points were considered in *Stagecoach*, which will be discussed shortly.

In relation to Paragraph 13, Mann J agreed with counsel for PLC, who argued that as HMRC did not assert this argument before the FTT and no evidence on this point was submitted to the FTT, it would be prejudicial to PLC for HMRC to assert this argument before the UT. The HMRC did not seek to challenge this finding in the Court of Appeal.

In respect of the tax position of GKA, Mann J found that as there was no loan relationship between GKA and GKBR, the right to receive the interest from GKBR did not arise from a loan relationship and therefore did not fall to be taxed under the loan relationship regime.[267] Mann J consider that although a literal interpretation of Section

[267] It is implicit within the judgements that GKA accepted that the consequence of the interest falling to be taxed outside of the loan relationship regime, was that the receipt of this income would have given rise to taxable income

81 may support GKA's argument that there was a loan relationship, the "relationship between GKA and GKBR is one which involves a debt, but as a relationship it does not, in any meaningful sense, involve a transaction for the lending of money as between the two of them". [268]

On this point, the Court of Appeal allowed GKA's appeal, holding that there was a loan relationship between GKA and GKBR. Although Counsel for HMRC sought to advance a number of arguments to support HMRC's positon that there was no loan relationship, in his leading judgement, Sir Terence Etherton C rejected these arguments. In his discussion, he noted that that the "loan relationship code embraced a wide category of corporate debt, which would not in ordinary legal or trade terms be categorised as a loan."[269] Furthermore, Sir Terence Etherton C rejected Mann J's attempt to distinguish between the situation where a company becomes the creditor (or debtor) to existing debt which includes the interest and principle elements, from a situation where the creditor obtains the rights to receive the interest arising from a debt but not the principle. This is on the basis the wording of does not support a distinction and "neither Mann J nor Mr Milne [Counsel for HMRC] identified any legislative purpose or policy which would justify such a deviation from the literal meaning of s 81(1)(b)."[270]

It was noted above that HMRC also put forward an argument regarding whether on receipt of the right to receive the interest, GKA was required to credit the whole amount of the NPV of the interest to share premium, or whether GKA was only required

[268] *Greene King (UT, 2014)* (n 259) [140].
[269] *Greene King (CA, 2016)* (n 24) [46].
[270] ibid 48.

to credit the 'minimum premium value', as defined by Section 132 of the Companies Act 1985, with the balance going to the P&L account. Mann J found that although GKA was only required to credit share premium by the 'minimum premium value', given that he had previously found that PLC should have partially de-recognised the Loan, the 'minimum premium value' in this instance was equal to the NPV of the interest receivable.

VI.6.2 A tale of two cases: Part 2 – Stagecoach

A second high profile loan relationship avoidance case was the *Stagecoach* case, which has a number of similarities with *Greene King*. At the time the scheme was entered into, one company within the group, Stagecoach Holdings Limited ("Holdings"), was technically insolvent. At that time Stagecoach Group PLC ("Group") held a loan receivable from another group company, The Integrated Transport Company Limited ('ITCO'). Group sought to recapitalise Holding using a Forward Subscription Agreement ('FSA'), whereby, Group agreed to contribute a proportion of the cash it would receive when ITCO repaid the amount due to Group. Upon entering into the FSA, under the relevant accounting standards, Group was required to de-recognise the element of loan due to be contributed to Holdings. This gave rise to a debit going to investments,[271] which Group sought to argue was deductible as a result of Section 320, CTA 2009. [272]

[271] The FTT's decision suggests that this debit when to Group's cost of investment in Holdings, thereby correcting the Statement of Agreed Facts submitted in the case, which states the debit when to Group's cost of investments in Transport (c.f. fns 47 & 49). Given that under the FSA Holding's issued shares to ITCO, it seems more likely that the Statement of Agreed Facts was correct, but it did not outline the intermediary accounting steps.

[272] A more detailed summary of this case can be found at Appendix D.6

HMRC sought to challenge the deductibility of the debit arising in Group for two main reasons. Firstly, HMRC argued that the debit arising from the derecognition of the Loan did not arise 'in respect' of a loan relationship within the scope of Section 320, CTA 2009 and therefore did not fall to be taxed in accordance with the loan relationship regime. Secondly, they argued that even if the debit fell to be taxed under the loan relationship regime, Section 320 was subject to the 'fairly represent' rule at Section 307(3) and therefore, as the debit did not 'fairly represent' a loss accruing to Group from its loan relationship, it should not be considered deductible. [273]

Considering HMRC's first argument, that the debit in question was not 'in respect' of a loan relationship that is within the scope of Section 320, CTA 2009, the FTT began by asking the question "do the basic facts, realistically assessed, fall within the scope of the statutory provisions, purposely construed?"[274]. Although the FTT do not cite *Arrowtown*,[275] this question closely mirrored Ribeiro PJ's statement of the Ramsay Principle, which was affirmed by Lord Nicholls in *BMBF*.[276] The FTT considered that the "debit is not a loss from loan relationships",[277] instead, "[p]roperly analysed, the debit to investments enhances the assets of the subsidiaries"[278]. Noting that the FSA did not have an impact on the group's consolidated accounts, the FTT considered that:

[273] In addition, HMRC sought to argue that the anti-arbitrage rules, contained within Part 6 of the Taxation (International and Other Provisions) Act 2010, applied in such a way to prevent this scheme from being successful. Given that the anti-arbitrage rules are not the focus of this dissertation, this element of the case will not be discussed further.
[274] *Stagecoach (FTT, 2016)* (n 16) [84].
[275] *Arrowtown (HKFCA, 2003)* (n 48).
[276] *BMBF (HL, 2004)* (n 45).
[277] *Stagecoach (FTT, 2016)* (n 16) [94].
[278] ibid 98.

> *It would be wrong in principle to recognise such re-arrangements as creating a tax allowable loss or debit without any corresponding charge to tax. This has been described as an unusual intra group transaction and there is no obvious reason to conclude that Parliament intended that the general principle of tax symmetry should be violated which would be the result if the appeal were to be allowed.*[279]

In support of the final sentence, the FTT referred to *BMBF* and *DCC Holdings.* In respect of Section 320 the FTT sought to draw a distinction between where the relevant accounting standards *allows* an expense to be capitalised and where it is *required.* The FTT found that Section 320 is only relevant where accounting standards allow an expense to be capitalised but does not require it. As such, where an item is required to be recognised on the balance sheet and therefore "would never appear in the profit and loss account as an item of relievable expense, s320 cannot magically transform it into a relievable expense." [280]

In addition to considering the purpose of Section 320, the FTT also considered if the debit in question arises in respect of a loan relationship. Whilst they acknowledged that as part of double entry book keeping "a single event is recorded twice in the accounts" [281] the FTT consider that the key question is what that event was, rather than what is the effect of the event. The FTT found that the event in *Stagecoach* was the recapitalisation of the subsidiaries rather that the derecognition of the loan (and

[279] ibid 99 (citations omitted).
[280] ibid 102.
[281] ibid 111.

therefore, the debit was not ‘in respect’ of a loan relationship). Although the taxpayer sought to argue that the relevant debit was in respect of both the derecognition of the loan and the recognition of the subsidiaries, the FTT considered “that *in respect of* will not bear such duality.”[282] This position seems counter-intuitive from an accounting perspective, given that, as Self notes, any loan relationship credit will necessarily give rise to a matching debit.[283]

In respect of the ‘fairly represents requirement’ FTT considered three questions. Firstly, whether a debit within the scope of Section 320 is only deductible to the extent it fairly represents a profit or loss arising to the company from its loan relationships. Secondly, whether it “requires … debits and credits to be tested to establish their nature.” [284] Thirdly, whether the relevant debits in this scheme fairly represent a loss arising to Group.

The FTT found, on the basis the inclusion of the phrase “the credit or debit is to be brought into accounts … **in the same way** [as other loan relationship credit or debit],”[285] that credits and debits arising under Section 320 are subject to the ‘fairly represents’ requirement. With respect to the second question, the taxpayer argued that Section 307(3) should not be read as a:

[282] ibid 115 (emphasis in original).
[283] ‘Stagecoach, Loan Relationships and the “fairly Represents” Rule’ (n 198).
[284] *Stagecoach (FTT, 2016)* (n 16) [118].
[285] Section 320(2) (emphasis added). Although Section 320 was rewritten by FA (No 2) 2015, the phase ‘in the same way’ was used within the new Section320(2).

> *broad anti-avoidance rule applying a generalised notion of fairness; rather, it should not be read in isolation at all but as an element in the process of identifying the relevant accounting debits and credits.*[286]

Although the FTT rejected the effect of accepting such a position would have, it side-stepped the issues by noting that, given the answer to the third question, the precise interpretation of the fairly represents rules was not relevant.

With respect to the third question, of whether the relevant debit 'fairly represents' a loss to the Group, the FTT found that there was "no loss to *Group* in any real sense" [287] as it gave rise to Group's investment in its subsidiaries increasing. Indeed, the FTT commented that is was counter-intuitive to say a loss arose given that the debt was repaid in full.

VI.7 Summary of key points

- Part 5 of CTA 2009 provides a holistic regime for the taxation of loan relationships help by companies. The starting point of the regime is that a company is subject to tax with reference to the loan relationship debits and credits which appear in their accounts.
- The loan relationship regime contains a number of anti-avoidance provisions, including the unallowable purpose rule at Section 441. In addition, the courts have taken to use 'fairly represents requirement' in

[286] *Stagecoach (FTT, 2016)* (n 16) [126] (citations omitted).
[287] ibid 134.

Section 307 as an anti-avoidance measure, although this provision has been repealed effective from 1 January 2016.

- FA (No.2) 2015 introduced the LR TAAR (at Section 455B-D) to counteract tax avoidance using loan relationships. Broadly speaking, the LR TAAR is designed to counteract loan relationship avoidance that results in an outcome which is inconsistent with the purposes of the relevant provisions.
- Although the GAAR had already been enacted when the LR TAAR was introduced, HMRC considered it to be required because they considered the LR TAAR necessary to counteract a broader range of loan relationship related avoidance schemes.
- As can been seen from a review of the discussion of three of the Relevant Cases, a number of the loan relationship schemes that companies have recently entered into are highly complex and HMRC has needed to use multiple argument to ensure that they are defeated.
- In this chapter and the two previous ones, the dissertation has considered the GAAR, Ramsay Principle and the LR TAAR in insolation. The next chapter will move on to consider how they interact.

CHAPTER VII: APPLICATION TO LOAN RELATIONSHIP AVOIDANCE SCHEMES

VII.1 Introduction

Chapters IV - VI considered the provisions relevant to this dissertation in isolation. This chapter will compare and contrast how they apply to loan relationship avoidance schemes, drawing on examples from the Relevant Cases. The purpose of doing so is to gain a greater understanding of how these different provisions may apply to tax avoidance schemes. Particular focus will be given to considering whether, and to what extent, one provision may apply but another may not; for instance, would it be possible for the GAAR to apply to a loan related avoidance scheme but not the loan relationship TAAR (or vice versa)?

This chapter begins with a close comparison of the LR TAAR and GAAR legislation. They have a very similar structure and it is possible to compare them side-by-side, thereby highlighting the key differences between them. As will be seen, a number of the differences relate to issues raised within the Aaronson Report[288] and have been discussed in Chapter IV. Some differences point to more conceptual questions, which will be discussed further at Chapter VIII.

Following this, consideration will be given to the Ramsay Principle and will seek to argue that the Ramsay Principle has a limited role in preventing loan related avoidance. The main justification is that the loan relationship regime is based on accounting

[288] Aaronson (n 80).

principles and therefore it would be challenging to purposefully interpret it in a way that allows the courts to look beyond the debit and credit arising in a company, to consider the 'real world' income and expenses arising. Furthermore, as accounting standards take a substance over form approach, there is unlikely to be a significant divergence between the 'real world' gain or loss arising from a transaction and the account gain or loss reported.

The final part of this chapter will consider the role of Section 411 in preventing loan related avoidance. Although it is clear that Section 441 is necessary to prevent relatively simplistic tax avoidance (for instance, a group leveraging a company to obtain interest deductions, without the debt having a commercial purpose, such as was attempted in *A.H. Field*[289]), its role in preventing complex tax avoidance schemes is open to question.

As previously mentioned, references will be made to the Relevant Cases. The purpose of these references is to gain an understanding of how the relevant provisions may apply in practice, by drawing on the insights gained from considering how they may apply to actual loan relationship avoidance schemes.

VII.2 A close reading of the TAAR and GAAR

VII.2.1 Step one: Is there an arrangement?

As noted above at IV.2, the definition of an 'arrangement' for the purposes of the GAAR, as defined at Section 214, is the same as is used in a number of other places in

[289] *A.H. Field (FTT, 2012)* (n 18).

the legislation. The term ‘arrangement’ is also defined in the same way in the LR TAAR, at Section 455(2).

Given that the same definition is used in both sets of legislation, if there is an arrangement for the purposes of the GAAR, it should also be an arrangement for LR TAAR and vice versa. Furthermore, given the broad nature of this definition, all the schemes in the Relevant Cases should be considered ‘arrangements’.

VII.2.2 Step two: Is there a tax advantage?

The second step required to determine if the GAAR or the LR TAAR applies, is to assess whether there is a relevant tax advantage. The term ‘tax advantage’ is defined within the GAAR legislation at Section 208 as ‘including’

(a) relief or increased relief from tax,

(b) repayment or increased repayment of tax,

(c) avoidance or reduction of a charge to tax or an assessment to tax,

(d) avoidance of a possible assessment to tax,

(e) deferral of a payment of tax or advancement of a repayment of tax, and

(f) avoidance of an obligation to deduct or account for tax.

The use of the word ‘including’ implies that the list set out in Section 208 is not exhaustive and other types of tax advantage may fall within the definition of that term for the purposes of the GAAR. The GAAR Guidance states that when determining if a tax advantage has arisen, the tax result of the scheme should be compared with the result of the scheme that would have been undertaken in the absence of a tax motivation.[290]

Looking at the definition within the LR TAAR legislation, two differences are immediately apparent. Firstly, the LR TAAR only applies to 'loan-related tax advantages' and secondly, the use of the word 'if' in Section 445C(5) means that the list that follows at (a) to (e) is an exhaustive list of potential 'loan-related tax advantage'.

Section 455C(5) reads:

> *A company obtains a "loan-related tax advantage" if—*
>
> *(a) it brings into account a debit to which it would not otherwise be entitled,*
>
> *(b) it brings into account a debit which exceeds that to which it would otherwise be entitled,*
>
> *(c) it avoids having to bring a credit into account,*
>
> *(d) the amount of any credit brought into account by the company is less than it would otherwise be, or*
>
> *(e) it brings a debit or credit into account earlier or later than it otherwise would.*

[290] HMRC, '2018 GAAR Guidance' (n 96).

(6) In subsection (5), references to bringing a debit or credit into account are references to bringing a debit or credit into account for the purposes of this Part.

As one may expect the definition within the GAAR legislation is relatively broad, whereas the one within the LR TAAR is more specific. Specifically, subsection (6) makes it clear that the only types of tax advantages that fall within this definition are those which arise within the loan relationship regime.

These two definitions give rise to a number of interesting questions that should be considered. Firstly, would the LR TAAR apply to those schemes which are designed to prevent the loan relationship regime from applying? The answer to this question would appear to depend on whether that potential loan relationship gives rise to debits or credits. If the relationship gives rise to credits, which would be taxed outside the loan relationship regime, then there would be a loan-related tax advantage. As this scheme aimed to ensure that the company avoided being required to bring into account a loan relationship credit subsection (c) is likely to apply. However, if the potential loan relationship gives rise to debits which fell to be taxed outside of the regime, then it would appear unlikely that the LR TAAR could apply because there would not be a loan-related tax advantage per the above definition. This may be beneficial if, for instance, the taxpayer was concerned that a deduction for that debit would have been denied under the loan relationship regime.

This position can be contrasted with the definition of ‘tax advantage’, where the focus has shifted from how debits and credits are brought into account for the purposes of one particular regime, to whether the scheme as a whole gives rise to the company paying less tax. As such, the GAAR would only apply to a scheme which was designed to prevent a potential loan relationship being taxed in accordance with the loan relationship regime, if the scheme as a whole gave rise to a company paying less tax. That said, it would only make sense for a company to implement such a scheme, if that gave rise to an overall tax advantage for the company and, although this difference is interesting to note, it is likely that the GAAR would apply to those schemes designed to prevent debits being taxed in accordance with the loan relationship regime. The ability of the GAAR to challenge such a scheme is important otherwise a tax planner may seek to design such schemes that bypass specific anti-avoidance provisions contained within the loan relationship regime (such as Section 441, CTA 2009).

This also points to a further difference between the GAAR and LR TAAR. The LR TAAR is focused on the debits and credits brought into account for tax purposes, whereas the GAAR appears to be more focused on whether the company pays more or less tax. That is not to say that the GAAR could not apply to those schemes designed, for instance, to give rise to losses, but rather there appears to be a focus on whether the scheme allows the taxpayer to pay less tax than it otherwise would have. Evidence for this argument can be seen in the language of the legislation, particularly the use of terms such as ‘relief from tax,’ ‘increased repayment of tax’ and ‘deferral of a payment of tax’. One potential explanation for this difference is that the loan relationship regime is primarily concerned with the amount of debits and credits brought into account for tax purposes, and therefore the LR TAAR’s focus is on debits and credits brought in account, rather than the tax charge they produce.

One question that arises from this discussion is how would the GAAR and LR TAAR apply to schemes designed to increase relief for foreign taxes incurred? Given the reference to foreign tax in Section 207(4)(c), it would appear reasonable to assume that schemes designed to increase the amount of double tax relief available would give rise to a 'tax advantage' for the purposes of Section 208. Even if a taxpayer was to argue that a scheme does not fall within any of the subsections (a) to (f), the use of the term 'including' implies that the list is not an exhaustive one and, therefore, HMRC would not need to argue that such an advantage fell within the strict wordings to be treated as a tax advantage for the purposes of the GAAR. This can be contrasted with the LR TAAR, which would appear not to apply to some schemes designed to increase the amount of double tax relief available. This is because the effectiveness of such schemes is not dependent on bringing more debits or less credits into account, but rather the ability to credit foreign taxes paid against the tax payable as a result of a company's loan relationship income.

That said, the LR TAAR could be applied to other such schemes which involve the manipulation of the debits and credits reported in a company's accounts. For instance, the LR TAAR could apply where the effectiveness of a scheme depends on credits arising from a loan relationship recognised in an earlier period than they would otherwise have been. The fact that the LR TAAR is likely to only apply to some schemes designed to increase the amount of double tax relief available may be justified from a policy perspective on the basis that the rules concerning double tax relief on loan relationships are not contained within Part 5 of CTA 2009, but rather the Taxation (International and Other Provisions) Act 2010.

Similarly, schemes designed to allow a company to pay interest without withholding tax ('WHT') do not give rise to a 'loan-related tax advantage' for the purposes of the LR TAAR, whereas Section 208(1)(e) specifically includes such avoidance within the definition of a 'tax advantage' for the purposes of the GAAR. Again, this difference can be justified by the fact that WHT is a form of income tax rather than corporation tax, and therefore the WHT legislation is contained within the Income Tax Act 2007 rather than Part 5 of CTA 2009.

With respect to the Relevant Cases, it is clear that the schemes in question gave rise to a tax advantage for the purposes of both the GAAR and LR TAAR. Indeed, had they not been so designed, there would have been no incentive for the taxpayers to enter into these schemes and less incentive for HMRC to challenge them. However, this step does raise two interesting questions. Firstly, is a tax advantage obtained when a scheme is designed to prevent a tax disadvantage arising, for instance by preventing the same income from being taxed twice? Secondly, could the application of the LR TAAR be limited by the 'in respect of' argument that the FTT developed in *Stagecoach*? Each of these questions is considered further below.

VII.2.2.1 Discussion of tax disadvantages

Taking a step back, a more conceptual question which is asked of both definitions of 'tax advantage' is whether a scheme designed to avoid a tax disadvantage arising would give rise to a 'tax advantage' for the purposes of the TAAR or the GAAR. In this context, a tax 'disadvantage' arises where a commercial transaction gives rise to a disproportionate amount of tax or that transaction is caught by a specific provision which it is not designed to do. A good example is *Joost Lobler*.[291] Lobler purchased a number of life insurance policies as investments and when he sought to withdraw his investment, rather than surrendering a number of policies in full, he partially surrendered all his policies. As a result of partially surrendering, Lobler was subject to tax on the majority of the cash he withdrew, even though he made no commercial profit, which the FTT considered an "outrageously unfair result."[292] Although in this case, had Lobler taken tax advice, it would have been relatively simple to avoid the tax charge, in other situations it could have been more complex to ensure that a commercial transaction did not give rise to an 'outrageously unfair tax result'.

It could be argued that the scheme in *Smith & Nephew*[293] was, at least partially, designed to prevent a tax disadvantage from arising. The group's original purpose was to help simplify their tax compliance affairs by ensuring that three otherwise dormant companies did not need to file tax returns to impute interest income on interest-free loans. The barrier to simply releasing the loans was that HMRC declined to give clearance that the proposed transaction would not give rise to adverse capital gains consequences.[294]. Had the group designed a scheme to prevent these CGT consequences applying, would it have given rise to a 'tax advantage' for the purposes of the GAAR? Given this was a CGT 'disadvantage' the LR TAAR would not have been relevant, although a taxpayer could, conceivably, be in a similar position with respect to a loan relationship credit. A strict reading of the underlying legislation would appear to

[291] *Joost Lobler v HMRC* [2013] UKFTT 141 (TC); *Joost Lobler v HMRC* [2015] UKUT 152 (TTC).
[292] *Lobler (FTT, 2013)* (n 291) [3].
[293] *Smith and Nephew (FTT, 2017)* (n 16).
[294] Presumably, the group was concerned with one or both of the value shifting rules or the depreciatory transaction rules.

suggest that the removal of a tax 'disadvantage' would give rise to a 'tax advantage' per the above definitions. This is because the relevant test is applied with reference to what would have been the case, had the scheme not been implemented, without reference to whether that outcome was fair or consistent with the purpose of the relevant provisions. That said, it does not necessarily follow that the GAAR or the LR TAAR would have applied to counteract that 'tax advantage.' Specifically, in respect of the GAAR, it may be possible to argue that implementing a scheme to avoid a 'tax disadvantage' could be 'reasonably regarded as a reasonable course of action.'

The concept of a tax 'disadvantage' could be contested both from a theoretical perspective and a practical one. From a theoretical perspective, it could be argued that taxation is merely a mechanism of transferring property to the state which rightly belongs to it,[295] thereby making it logically impossible for a tax 'disadvantage' from arising. Had a negative CGT result arisen for the taxpayer in *Smith & Nephew*, it would be due to the wording of the relevant legislation and therefore could not give rise to a tax 'disadvantage.' From a practical perspective, HMRC could seek to argue that the legislation was designed to apply in specific situations and, therefore, in that particular instance the tax charge arising was legitimate.

VII.2.2.2 'in respect of' argument

As discussed above at VI.6.2, in *Stagecoach* and *Greene King*, the courts have considered whether certain accounting entries are 'in respect of' loan relationships. For instance, in *Stagecoach*, the critical journal entry arising out of the scheme gave rise to

[295] cf. Murphy (n 74).

a debit to investments in respect of the recapitalisation of a subsidiary and a credit to loan receivables in respect of the derecognition of a loan. The FTT found that the "debit reflected by the anticipated price payable for the shares to be issued under the FSA, cannot in any sense be properly described as being in respect of the pre-existing loan relationship."[296] Although the FTT cannot create binding precedent, in his leading judgement in *Greene King*, Sir Terence Etherton C noted that he finds the analysis of the FTT in *Stagecoach* on this point "compelling."[297]

Although in both *Stagecoach* and *Greene King* this argument was used to challenge the effectiveness of a tax avoidance scheme, if this logic is upheld, then it may affect how the LR TAAR applies. For instance, if a scheme gives rise to a debit, the taxpayer could argue that the relevant debit is not 'in respect of' a loan relationship and therefore the LR TAAR cannot be used to prevent the scheme from being effective (albeit, the GAAR would remain relevant). Although this line of reasoning would not have assisted the taxpayer in either *Stagecoach* or *Greene King*, as the schemes in these cases relied on the debits being brought into tax under the loan relationship regime, it is conceivable that the argument could be used to ensure a debit falls to be taxed outside of a loan relationship regime.

In the event that a scheme involves using this argument to ensure that a credit falls to be taxed outside of the loan relationship regime the LR TAAR analysis is more complex as a result of Section 455C(5)(c), which allows the LR TAAR to apply to schemes designed to avoid bringing into account a loan relationship credit. Specifically, if a

[296] *Stagecoach (FTT, 2016)* (n 16) [115].
[297] *Greene King (CA, 2016)* (n 24) [83].

scheme is designed to ensure a credit is not 'in respect of' a loan relationship, then the LR TAAR may be applicable. However, if the scheme merely relies on a credit not being 'in respect of' a loan relationship without any specific steps being implemented to ensure that outcome, then it may be the case that the LR TAAR cannot apply. The reason for this is that the credit would not be subject to the loan relationship regime in any case and, therefore, the scheme would not be designed to prevent a loan relationship credit arising.

VII.2.3 Step three: Is the arrangement a tax avoidance arrangement?

Both the GAAR and the LR TAAR contain motive tests whereby they can only apply when the arrangements were designed to create a tax advantage. As such, neither should apply where an arrangement was undertaken solely for commercial reasons. The motive test, in both pieces of legislation is broadly similar, except that the GAAR test requires one to have "regard to all the circumstances" and draw a reasonable conclusion. The full wording of Section 207(1) is:

> *Arrangements are "tax arrangements" if, **having regard to all the circumstances, it would be reasonable to conclude that** the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements. [Emphasis added]*

This can be compared to the wording of Section 455C(3), which reads thus:

> *[Subject to Section 455C(4),] Arrangements are "relevant avoidance arrangements" if their main purpose, or one of their main purposes, is to enable a company to obtain a loan-related tax advantage.*

There is a question of whether the additional words in the motive test for the GAAR make a significant difference to how these provisions will be applied in practice. In order to argue that these additional words modify this test, one would need to show that when applying the motive test contained within the LR TAAR only a limited list of circumstances needed to be considered in determining the purpose of an arrangement or to apply the motive test with reference to a different standard of proof. With respect to the first point, that Section 455C(3) does not explicitly state what should be taken into account in determining the purpose of the arrangement, it appears reasonable to conclude that one would need to look at all the circumstances rather than merely a limited but undefined range of circumstances.

With respect to the second point, given that the standard of proof in civil cases, including tax cases, is on the balance of probabilities, adding the phrase “it would be reasonable to conclude” would seem unlikely to change the standard of proof when applying the motive test. To put it another way, it would appear that adding this phrase makes explicit what is already implicit in the LR TAAR’s motive test.

Turning to the Relevant Cases, a number of the taxpayers had some level of commercial purpose for undertaking the transactions that formed part of the schemes. That said, in most of these cases it could be argued that tax avoidance was a key driver, or became a key driver, for the scheme. The GAAR Guidance makes it clear that for a scheme to have tax avoidance as one of its main purposes, it is not necessary for it to be altered in an obvious way. Instead, simple and subtle tax driven changes to a scheme could give rise to tax avoidance being one of its main purposes.[298]

The question of whether tax avoidance is the main purpose, or one of the main purposes, of the transactions in the Relevant Cases tends only to be fully considered by the courts where Section 441 is potentially applicable. In non-Section 441 cases, the question of purpose, although sometimes mentioned, is not fully explored. For instance, in *Suez Teesside*, the judgements do not explore the purpose of the transaction, other than noting that it was disclosable under the DOTAS regime.

Part of the reason for this is that HMRC's arguments in these cases do not rely on the purpose of the taxpayer undertaking the transaction, but instead rely on technical arguments that apply regardless of the purpose of the scheme. A notable exception to this rule is the *Stagecoach* case in which the issue of purpose was discussed in some depth as HMRC also sought to challenge the effectiveness of the scheme using the UK anti-arbitrage rules which do contain a purpose test. [299]

Although many of the schemes in the Relevant Cases appear primarily tax driven, the taxpayers had limited reason to elaborate on the commercial purposes of the transaction or to present relevant facts to support their position. As such, it is not possible to reach a definitive conclusion regarding whether tax avoidance was the main purpose, or one of the main purposes of the transactions in the Relevant Cases. It would

[298] HMRC, '2018 GAAR Guidance' (n 96).
[299] *Stagecoach (FTT, 2016)* (n 16).

seem reasonable to assume that the anticipated tax savings were one of the key drivers behind the schemes.

One interesting observation is that although a scheme may begin with a genuine commercial purpose, as the design evolves an anticipated tax saving can subsequently become an important feature and can drive the design of the scheme. For instance, in *Stagecoach*, the initial commercial driver was to recapitalise a trading subsidiary, which was technically insolvent. However, after advice had been obtained from KPMG, "the possible tax savings had become a significant feature of the whole exercise."[300] In other cases, the commercial purposes of undertaking a transaction are less clearly defined. In *A.H. Field*, the taxpayer argued that the purpose of paying a leveraged dividend with a loan from its shareholders was to improve the certainty of cash flows to its shareholders and to improve the company's return on capital employed. However, the FTT found that there was a lack of evidence to support the existence of these purposes and neither was actually achieved.

These two examples show that when determining whether the purpose, or one of the main purposes, of a scheme is tax avoidance, one not only needs to show that the transaction had commercial drivers but also that the anticipated tax savings remained of a secondary concern. The FTT *A.H. Field* cited Lightman J's comment in *Serna Pension* that "[o]bviously if the tax advantage is mere 'icing on the cake' it will not constitute a main object,"[301] before commenting that in *A.H. Field*, the tax advantages gained were

[300] ibid 50 (emphasis removed).
[301] *Inland Revenue Commissioners v Trustees of the Sema Group Pension Scheme* [2002] EWHC 94 (Ch), [2002] STC 276 [53].

"more than mere icing and that in fact this transaction produced a preponderance of icing and very little cake."[302] Continuing with this analogy, a scheme with commercial drivers needs to ensure that any tax benefits obtained can be seen as merely 'icing on the cake' in order to avoid the risk that obtaining a tax advantage is considered one of the main purposes of this scheme.

In addition to looking at whether a scheme gives rise to a tax advantage, the courts also consider the specifics of the design of the scheme to determine whether tax avoidance was the main purpose, or one of the main purposes of the scheme. *Iliffe*[303] is a good example of this point. In this case, when Iliffe News and Media Limited ('INML') licenced some IP back to its subsidiary for a 5-year period, it did so for an up-front lump sum, rather than for a yearly royalty (this design feature was critical to achieving the desired tax result). The FTT considered that the schemes commercial objectives would have been more effectively achieved had INML charged a yearly royalty. In this regard, the FTT distinguished *Brebner*,[304] in which the House of Lords found that where there are two ways of carrying out a transaction, choosing the lower tax option did not necessarily mean that tax avoidance was one of the main purposes of the transaction.

It could be argued that *Stagecoach* also exemplifies this point. Although the FTT found that the transaction achieved a commercial purpose, there were other ways it could achieve that purpose. The FTT appears to emphasise that they viewed it as

302 *A.H. Field (FTT, 2012)* (n 18) [178].
303 *Iliffe News & Media (FTT, 2012)* (n 34).
304 *Inland Revenue Commissioners v Brebner* [1967] All ER 779 (UKHL).

important that the sole reason for linking the amount recovered from a loan to the amount to be used to subscribe for shares was to obtain a tax advantage.

VII.2.4 Step four: Is the arrangement 'abusive' or a 'relevant avoidance arrangement'?

Both the GAAR and the LR TAAR, seek to distinguish normal tax planning from aggressive tax avoidance arrangements and both seek to apply principle to more aggressive arrangements. Specifically, the GAAR is only intended to apply to arrangements that are 'abusive' whereas the LR TAAR seeks to distinguish the more aggressive tax avoidance schemes by defining the term 'relevant avoidance arrangements'. There are a number of similarities between the test applied by the GAAR and the LR TAAR to determine if a scheme is abusive or relevant, respectively. At the centre of both tests is consideration of the relevant tax provisions which the scheme relied upon and a consideration of their purpose. The following discussion will presuppose that one can talk meaningfully about the purpose of a piece of legislation).

Although there are similarities between the tests used by the GAAR and the LR TAAR, there are also a number of key differences. The most important difference is that, when applying the GAAR, HMRC is required to show that a tax arrangement is 'abusive' whereas when applying the LR TAAR, all tax arrangements are considered 'relevant' unless the taxpayer is able to show that they are not relevant.[305] This can be seen by looking at the wording of the relevant sections.

[305] For completeness, it should be noted that in other tax cases, the burden of proof rests on the taxpayers. As noted at IV.3.1, the authors of the Aaronson Report considered that shifting the burden of proof onto HMRC in GAAR cases was an important safeguard for taxpayers.

Sections 207(2) provides:

Tax arrangements are "abusive" if they are arrangements the entering into or carrying out of ***which cannot reasonably be regarded as a reasonable course of action in relation*** *to the relevant tax provisions, having regard to all the circumstances including—*

(a) whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions,

(b) whether the means of achieving those results involves one or more contrived or abnormal steps, and

(c) whether the arrangements are intended to exploit any shortcomings in those provisions. *[emphasis added]*

This can be contrasted with Section 455C(4):

But arrangements ***are not*** *"relevant avoidance arrangements" if the obtaining of any loan-related tax advantages that would (in the absence of section 455B) arise from* ***them can reasonably be regarded as consistent*** *with any principles on which the provisions of this Part that are relevant to the arrangements are based (whether expressed or implied) and the policy objectives of those provisions. [emphasis added]*

As previously discussed at Section IV.2 the double reasonable test contained within the GAAR ("which cannot reasonably be regarded as a reasonable course of action in relation") is seen as an important safeguard. The authors of the Aaronson Report considered that in the event that there is a dispute over whether the GAAR applies:

> *the Tax Tribunal will decide in the taxpayer's favour not only if the judge himself regards the arrangement as a reasonable exercise of choices of conduct but also, where he does not himself take that view, he nonetheless considers that such a view may reasonably be held.*[306]

Although final GAAR legislation does not employ the concept of a 'choices of conduct,' the double reasonableness test still applies like this.[307] In this regard, HMRC's Guidance states that just because a tax practitioner considers a course of action to be reasonable, it does not necessarily mean that the GAAR cannot apply, as the practitioner may have an extreme view. [308] Furthermore, HMRC considers that this principle would still apply if that extreme view was commonly held. The lack of the double reasonable test in the LR TAAR means that the courts should only find in favour of the taxpayer when the judge considers the results of the scheme can reasonably be regarded as consistent with principles underlying the relevant provisions.

A review of the Relevant Cases show that the courts tend to view avoidance in a relatively negative way and, therefore, it may be challenging for a taxpayer to

[306] Aaronson (n 80) para 6.3.
[307] C.f. HMRC, '2018 GAAR Guidance' (n 96) para C5.10.2.
[308] HMRC, '2018 GAAR Guidance' (n 96).

successfully argue that their scheme results in an outcome that can be reasonably regarded as being consistent with the principles of the underlying legislation. In contrast, within the GAAR, HMRC would need to show that the relevant outcome in not consistent with the relevant provisions. There is an argument that the lack of a double reasonableness will make the LR TAAR easier to apply compared to the GAAR because the burden of proof is shifted towards the taxpayer.

Some, such as Watson, consider that the lack of the double reasonable test in the LR TAAR is a positive development, as it allows the LR TAAR to "avoid the great weakness of the GAAR – the hopelessly vague 'reasonable course of action'."[309] Furthermore, as well as being vague, one could also question whether the double reasonableness test will have any effect in practice. Although Aaronson's hypothetical Judge is sufficiently reflective to acknowledge that although he does not consider an arrangement as a reasonable choice of conduct, that position can be reasonably held, there is a question over how likely, in practice, a judge will be able to come to such a conclusion, particularly if his own perspective and frame of reference is likely to feature uppermost in his deliberations.

When considering whether the schemes in the Relevant Cases are consistent with the purpose of the underlying provisions, although some cases clearly are designed to give rise to an inconsistent result, others require a more nuanced analysis. An example of the former category would be *Greene King*, where it would be hard to argue

[309] Watson (n 249) 13.

that the relevant provisions applied in a way that was consistent with the purpose of those provisions. This can be contrasted with *Suez Teesside*[310] and *Iliffe*.[311]

Beginning with *Suez Teesside*, the scheme relied on the ability of the taxpayer to transfer a valuable asset offshore at a time when, for tax purposes, it had a limited value. Although, from HMRC's perspective, this did not give rise to the 'correct' tax result, given that the loan relationship code is based on an accounting principle, it would appear consistent with the relevant provisions that the value of the asset being transferred offshore is determined in accordance with accounting principles. Arguably, for HMRC to suggest otherwise, they would need to disregard the central tenets of the loan relationship regime. This argument would seem to apply equally to both the TAAR and the GAAR. For a case such as *Suez Teesside*, it would appear that, for the first part of the test, the LR TAAR and GAAR legislation apply in the same way.

Iliffe gives rise to an interesting question, namely, to what extent it is allowed to choose between two different courses of actions on the basis of the tax implications of each? Given the principle set out in *Brebner*[312] it could be argued, by analogy, that where a taxpayer has two options for carrying out a transaction, choosing the option that produces a tax advantage should not give rise to a result which is inconsistent with the purpose of the relevant provisions. Such a principle would naturally fit within the GAAR as choosing the lower tax option should be considered a reasonable course of action. Whether such a principle would apply when applying the LR TAAR is more complex to

[310] *Suez Teesside (UT, 2016)* (n 23).
[311] *Iliffe News & Media (FTT, 2012)* (n 34).
[312] *Brebner (HL, 1967)* (n 304).

determine as the key question is whether obtaining the tax advantage is consistent with the relevant tax provisions and is likely to depend on the wording of the relevant provision.

In addition to the GAAR containing the double reasonableness test, there are also three other differences between the GAAR legislation and the LR TAAR legislation. Firstly, when considering whether the GAAR applies, one needs to have regard to whether the scheme involves one or more abnormal or contrived steps[313]and whether it exploits a 'shortcoming' in the relevant provision.[314] Secondly, the GAAR is primarily concerned with whether a *course of action* is reasonable, whereas the LR TAAR is concerned whether the *obtaining of the loan-related tax advantage* is reasonable (i.e. focusing on the outcome). Thirdly, when considering whether a scheme is considered abusive, Section 207(3) requires that where a tax arrangement forms part of a broader arrangement, "regard must also be had to those other arrangements." The first two points will be considered further below. However, before doing so, the third point is considered briefly.

One could question whether the requirement to have regard to the broader arrangements a scheme is part of will have any practical impact on the application of the GAAR. The only way it could have a practical impact is if it was normal practice for the courts to look at a scheme in isolation, without considering its wider context, which is not the case. Thus, the inclusion of this language within the GAAR legislation may

[313] Section 207(3)(b)
[314] Section 207(3)(c)

merely make explicit a requirement which is implicit.[315] Given this, the lack of the same phrase in the LR TAAR legislation is unlikely to have a practical impact on how the LR TAAR will apply because the courts will naturally have regard to the broader context of a scheme.

VII.2.4.1 Contrived steps

Although the GAAR legislation requires one to take account of whether a scheme includes one or more contrived steps and whether it attempts to exploit shortcomings in the relevant legislation, it could be argued that these tests are implicit in the LR TAAR legislation. This argument is straightforward in respect of the latter, for it would appear extremely unlikely that a scheme could exploit a shortcoming in a piece of legislation and, at the same time, the outcome of the scheme, if successful, would be consistent with the principles on which the legislation is based.

It could be argued that a number of these schemes are clearly designed to exploit a shortcoming in a provision. The two best examples of this are *Bank of Ireland*[316] and *Cater Allen*,[317] both of which concerned the taxation of repos. In *Bank of Ireland*, Collins LJ commented that: "It is true in this case a tripartite scheme has been devised which takes advantage of a mismatch between the two sets of provisions."[318] Although Collins LJ refers here to two sets of provisions, it should be noted that both dealt with the same subject matter and therefore this mismatch can be described as a shortcoming in the

[315] As similar point was made in [VII.2.1] in relation to the inclusion of the phase “having regard to all the circumstances” in Section 207(1).
[316] *Bank of Ireland (CA, 2008)* (n 19).
[317] *Cater Allen (FTT, 2015)* (n 20).
[318] *Bank of Ireland (CA, 2008)* (n 19) [44].

taxation of repos. That is to say, the mismatch was not caused by how two sets of unrelated provisions interact, but rather an inconsistency in how the underlying regime worked.

Although the taxpayers in *Bank of Ireland* and *Cater Allen* were clearly seeking to rely on a shortcoming in the relevant tax provision, one could question whether other schemes were also seeking to exploit a shortcoming in the relevant provision, as opposed to merely relying on how those provisions applied.[319]

The argument in respect of whether a scheme involves one or more abnormal or contrived steps when determining if the LR TAAR applies is slightly more complex. Given that the LR TAAR is focused on the outcome of a scheme, the question is whether that outcome is consistent with the purpose of relevant legislation. In the event that the designed tax outcome is only able to be achieved by the use of contrived or abnormal steps, then that would indicate that the outcome is not consistent with the purpose of the relevant legislation. Had those abnormal or contrived steps been omitted then the relevant provisions would have applied as intended and would have given rise to a different result.

This argument is exemplified by the scheme in *Versteegh*.[320] Given that the Borrower has a commercial need for the funding, in the absence of a tax avoidance motive, the lender could lend the necessary funds to the borrower, leading to a symmetrical result with the interest expense being deductible in the borrower and the

[319] Cf. *Suez Teesside (UT, 2016)* (n 23).
[320] *Spritebeam (UT, 2015)* (n 28).

interest income taxable in the lender. Alternatively, the lender could have equity funded the borrower, which again would have given rise to a symmetrical result as neither taxable credits nor debits would have arisen in either the borrower or lender. Both results would have been consistent with the purpose of the relevant tax provisions. However, in an attempt to obtain a tax advantage, an abnormal and contrived step was inserted into the scheme whereby instead of paying interest to the lender, the borrower issued preference shares to the third company. It is reasonable to assume that the insertion of this additional step was designed to give rise to a result which was not consistent with the relevant provision. As such, the fact that this scheme contains an abnormal and contrived step helps to show that the result of scheme in not consistent with the relevant provisions.

This logic may work well where the inserted step significantly changes the nature of the transaction and there is a clear alternative transaction. However, this is not always the case, particularly in a complex transaction. In such cases, it may be difficult, if not impossible, to identify a definitive alternative transaction which would allow the taxpayer to achieve its commercial objectives, without obtaining a tax advantage. Furthermore, it could be the case that although a complex transaction is being undertaken for commercial purposes, aspects of that transaction may be modified slightly to enable a favourable tax treatment to be obtained. The question then becomes whether those modifications are so significant that they are treated as giving rise to a contrived step. This question would arise in a scheme similar to the ones in *Stagecoach* and *Iliffe* where certain elements were modified to ensure an advantageous tax result was obtained.

VII.2.4.2 Action or outcome

As noted above, when determining whether the GAAR applies, the main focus is whether a *course of action* is reasonable, whereas when determining whether the LR TAAR applies, it is whether the outcome of the scheme is consistent with the purpose of the relevant provisions. The existence of this linguistic difference gives rise to the question of whether it will have a practical impact on how the GAAR and LR TAAR apply. This difference may seem relatively minor given the close relationship between a course of action and the end result, however such a change in focus could have an impact on how a scheme is viewed.

For example, in *Suez Teesside*, the scheme relied on the fact that the taxpayer could transfer a commercially valuable asset overseas at a time when, for tax purposes, it had a negligible value. There would be a good argument to say that it is a reasonable course of action, especially given that the taxpayer did not artificially create a situation where there was a significant difference between the assets commercial value and its tax value. However, from an outcome perspective, given the scheme enabled the taxpayer to transfer an asset worth c.£200m out of the UK without giving rise to a tax charge, it is straight forward to argue that this outcome cannot be consistent with the relevant provision.

Although Section 207(1) requires one to consider whether a course of action is reasonable, the focus of Sections 207(2) and (3) is on the outcome of the arrangement. As such, one is required to take account of the result of the arrangement. Furthermore, to argue that this difference is significant, one would need to assume that judges are able to consider whether a course of action is reasonable in isolation, without reference to the outcome; it seems unlikely that in practice that a judge can do so.

VII.2.4.3 Application to simple schemes

One further question arises when considering whether a scheme is abusive or relevant, namely, are some schemes so simple that the GAAR or LR TAAR cannot apply to them? When reviewing the facts of the Relevant Cases, the analysis proceeds on the assumption that the courts had determined that the relevant technical provisions had not applied. In a subset of cases, this assumption leads to difficulties because the scheme in question can only be considered a tax avoidance scheme by virtue of the application of the relevant provision.

This point can be best illustrated by the scheme in *A.H. Fields*. The taxpayer sought to claim a deduction for interest arising on a shareholder loan where the main purpose of putting a loan in place was to create a deductible loan relationship debit. Based on the finding of facts made by the FTT, Section 441 clearly applied to prevent a deduction being obtained for loan relationship debits. However, had Section 441 not existed, it would be difficult to argue that claiming a deduction for the loan relationship debits arising was not consistent with the loan relationship regime and therefore the GAAR or LR TAAR could not apply. Indeed, arguably, if Section 441 did not exist the scheme in *A.H. Fields* should not be described as a tax avoidance scheme, instead, is was merely sensible and legitimate tax planning.

One way to resolve this issue is simply to accept that the GAAR and LR TAAR are not designed to prevent simple schemes, such as in *A.H. Fields*, from being successful.

Instead, both are designed to catch complex schemes. As such, where the straightforward application of a set of tax provisions allow a deduction for a certain type of expense, in the event that HMRC do not wish taxpayers to be able to claim a deduction, then the most appropriate way for them to rectify the situation is for them to introduce legislation, similar to Section 441, to deny taxpayers a deduction for that type of expense. The role of Section 441 in preventing loan related avoidance is discussed further at VII.4.

VII.2.5 Step five: Is an indicator of abusiveness or non-exclusion present?

Both the GAAR and LR TAAR legislation list a number of indicators[321], which if present, would show that a scheme is abusive for GAAR purposes, or non-excluded from the scope of the LR TAAR. The factors have previously been discussed at IV.2 and VI.4 in respect of the GAAR and the LR TAAR. As would be expected, the list contained within Section 455D is tailored to particular features of the loan relationship regime and highlights areas where HMRC considers avoidance possible. For instance, the indicator listed at Section 455D(1)(g) is concerned with the manipulation of the group continuity rules to allow a company to obtain an impairment loss for an intra-group debt. These additional indicators within Section 455D(1) should provide additional certainty when considering whether the LR TAAR applies, as it makes explicit a number of applicable situations. Given that the GAAR is designed to apply to a range of tax matters, the list of indicators at Section 207(4) are necessarily more generic.

[321] Although Section 455D uses the term 'examples' rather than the term 'indicators', given that the GAAR uses the latter for simplicity, this dissertation will use the term 'indicators' to describe the example provided at Section 455D(1).

Section 207(6) states that the list of indicators at subsection (4) is not exhaustive. As such, in the event that HMRC seeks to use the GAAR to counteract a loan relationship scheme, HMRC should to be able to strengthen their position by showing that one of the indicators at Section 455D(1) is present and support the argument that the arrangement is abusive.

Although two of the three factors listed at Section 207(4), namely subsection (a) and (b), are replicated within Section 455D(1), subsection (c) is not replicated. Section 207(4)(c) reads:

> *the arrangements result in a claim for the repayment or crediting of tax (including foreign tax) that has not been, and is unlikely to be, paid*

As previously noted, the LR TAAR is primarily concerned with the calculation of a company's taxable profit rather than the resulting UK tax payable on that profit, whereas the focus of the GAAR is the tax actually payable by the company. The inclusion of this subsection with the GAAR legislation and not within the LR TAAR legislation further supports this thesis.

With regard to the indicators listed within both pieces of legislation, they only indicate abusiveness or non-exclusion if the result was not that which was reasonably anticipated when the provisions were enacted. The wording of this overriding provision within LR TAAR mirrors the corresponding provision within GAAR and it is only modified for context. This can be seen by comparing the two provisions side-by-side, as shown below with the differences in bold:

[Section 207(4): …] but in each case only if it is reasonable to assume that such a result was not the anticipated result when the ***relevant tax provisions*** *were enacted.*

[Section 455D(2):] But in each case ***the result concerned is only capable of indicating that section 455C(4) is not available*** *if it is reasonable to assume that such a result was not the anticipated result when the* ***provisions of this Part that are relevant to the arrangements*** *were enacted.*

One distinctive feature of the GAAR legislation compared to the LR TAAR is that Section 207(5) states that, if at the time that the scheme was entered into it accorded with standard practice, and HMRC had accepted that practice, it may indicate that the scheme should not be considered abusive. This means that the GAAR should not apply to schemes which have been used for a number of years without them being challenged by HMRC. A similar provision is not contained within the LR TAAR legislation.

VII.3 How does the Ramsay Principle apply to Loan Relationships?

None of the Relevant Ramsay Cases discussed at V.2, concerned the loan relationship regime, although *Westmoreland* would have done so if the scheme had been undertaken after the introduction of the regime. In order to consider to what extent the Ramsay Principle has applied to the Relevant Cases, this dissertation has reviewed the cases cited and the judgements of each. Specifically, each Relevant Case was reviewed to identify whether it either cited *Ramsay* or *BMBF*. *BMBF* was included as it is considered a key recent case on the Ramsay Principle. The results of this analysis can be found in Appendix C.

As can be seen from this analysis, there are limited references to either *Ramsay* or *BMBF*. In addition, in none of these cases did HMRC explicitly use the Ramsay Principle as a primary argument to defeat it. The closest that the courts came to using the Ramsay Principle was when the UT in Vocalspruce noted that it was accepted by HMRC and the taxpayer that the relevant provisions should be construed purposively in accordance with the guidance set out by *BMBF*.[322] Although, arguably Vocalspruce is an example of the Ramsay Principle being used against a loan relationship avoidance scheme, HMRC did not seek to rely on the fact that this was a marketed avoidance scheme to support its arguments. [323] Given that the Ramsay Principle is concerned with tax avoidance schemes, it would appear that HMRC were seeking to rely on the normal principles of statutory construction, rather than relying on a Ramsay type argument.

References to the Ramsay Principle also appear in the FTT's decision in *Fidex* and *Iliffe*. In *Fidex*, it was used to support the proposition that the FTT needed to apply "orthodox methods of statutory construction to a realistic view of the facts. "[324] In *Iliffe*, counsel for the taxpayer cited the limitations on the Ramsay Principle to re-characterise transactions following the precedent set by *Westmoreland*. The final case to briefly consider is *Stagecoach*. Although the FTT does not explicitly cite the Ramsay Principle, it looks at the purpose of Section 320, CTA 2009 when determining whether the debit

[322] *Vocalspruce Ltd v HMRC* [2013] UKUT 276 (TCC), [2014] STC 2261.
[323] Per Gross LJ's comment at [32] (*Vocalspruce (CA, 2014)* [n 29]).
[324] *Fidex Limited v HMRC* [2013] UKFTT 212 (TC), [2013] SFTD 964 [175].

arising for the derecognition of the loan arose 'in respect' of a loan relationship. Furthermore, the FTT cited *BMBF* to support the position that Parliament did not intend to enable tax avoidance schemes to succeed where they give rise to an asymmetrical result.

The fact that HMRC has not used the Ramsay Principle to explicitly defeat a loan relationship related tax avoidance scheme gives rise to the question of why this may be the case. It seems unlikely that it was because HMRC considered that their other arguments were sufficiently strong that seeking to apply the Ramsay Principle was considered superfluous, particularly given that the Ramsay Principle has been applied in conjunction with other technical arguments and HMRC normally use multiple arguments when seeking to defeat a tax avoidance scheme. As such, an alternate answer needs to be found. One potential alternative is that there is weakness in the Ramsay Principle which limited its role in defeating loan relationship avoidance schemes.

The Ramsay Principle does not allow courts to completely disregard the language of the legislation; instead, it requires the court to interpret the legislation purposively to the facts when viewed realistically. Although this principle in its original formulation allowed the House of Lords to interpret the capital gains legislation in a way that only gave relief to 'real world' losses, as Lord Hoffmann notes in *Westmoreland*, "something may be real for one purpose but not another."[325] As such, the question is what is 'real' for the loan relationship regime. As the LR regime is based on accounting principles, it would seem logical to assume the reality for loan relationship purposes is the world of

[325] *Westmoreland (HL, 2001)* (n 52) [40].

accounting principles. If this is the case, it would be difficult to argue that the Ramsay Principle could apply in a way the relevant provisions could be interpreted purposively such that taxes transactions in accordance with their ‘real world’ substance where the relevant accounting standards require an alternative treatment.

Given the tax treatment of a transaction is driven by the accounting treatment adopted, and that treatment is usually determined by a substance over form approach, by default the taxation of a transaction is determined with reference to facts viewed realistically. Of course, a taxpayer could still enter into a convoluted transaction which enabled an item to be accounted for in a different way, however, it may be difficult to determine what it would mean in such cases to view the relevant facts realistically. This is particularly challenging given, as noted above, reality for these purposes is the world of accounting standards.

Although none of the Relevant Ramsay Cases concern the loan relationship regime, as noted above, had the scheme in *Westmoreland* been implemented after the introduction of the loan relationship regime, it would have concerned loan relationships, which raises the question is: how would the application of the Ramsay Principle affect the above analysis? This is a challenging question to answer because the introduction of the loan relationship regime significantly changed how interest payable would be taxed. Assuming that interest payable to the pension scheme would still only be deductible on a paid basis, the analysis set out by Lord Hoffmann is likely to be unaffected. That is because, although the loan relationship regime is based on accounting standards, only providing a deduction on an accruals basis would be a deviation from the normal rules.

That would in turn require one to consider the type of transactions designed to fall within the exception. In *Westmoreland*, it was found that the exemption was designed to apply with reference to a legal concept. Although the Ramsay Principle could have applied if the House of Lords determined the term 'payment' should be given its commercial meaning (albeit, Lord Hoffmann expressed scepticism this would be possible), it is highly unlikely that the loan relationship regime would contain many exemptions which, although they did not rely on the normal accounting rules, sought to tax a transaction in accordance with its commercial reality.

Formerly two notable exceptions to this rules were Section 455 and the 'fairly represent requirement'. [326] Section 455 sought to bring into account the consideration a company received from the disposal of a receivable, where that consideration was not required to be fully recognised under GAAP. Although both sought to ensure that a company's economic profits are brought into tax even if those profits were not recognised for accounting purposes, the cases involving the 'fairly represents requirement' demonstrated the complexities of doing so. It is significant to note that the leading case on the fairly represents requirement, *DCC Holdings*,[327] involved a piece of legislation which did not seek to tax the debits and credits arising in taxpayer accounts. Indeed, the result of the application of the 'fairly represents requirement' in this case gave rise to the taxpayer being able to claim a deduction equal to the accounting loss it recognised.

[326] Both of these sections were repealed by FA (No.2) 2015. The rationale behind the repeal of the 'fairly represents requirement' has already been discussed as VI.5. Section 455 was repealed on the basis that is was superseded by the LR TAAR (Explanatory Notes to Finance (No. 2) Act 2015.).
[327] *DCC Holdings (SC, 2010)* (n 21).

Since the *DCC Holdings* case, the fairly represents requirement has been used in cases where the underlying legislation seeks to tax a taxpayer on the profits arising on its accounts, most notable in *Suez Teesside*.[328] However, as already discussed at VI.6 the UT's decision in this case has been questioned by some[329] and is subject to appeal.[330]

Given the above arguments and the fact that HMRC has not attempted to use the Ramsay principle to defeat the schemes in the Relevant Cases, it would appear reasonable to conclude that going forward, the Ramsay Principle is unlikely to play a significant role in defeating loan relationship avoidance schemes.

VII.4 What is the role of Section 441 in preventing loan related avoidance?

Of the 13 Relevant Cases, only 7 referred to Section 441. This fact alone would appear to indicate that it is not, by itself, sufficient to prevent loan related avoidance. One reason why Section 441 was only relevant in about half the cases is that it can only be used to challenge the deductibility of debits rather than bringing into tax credits that would otherwise fall outside the scope of tax. Many of the schemes in the Relevant Cases, sought to ensure that otherwise taxable credit would not need to be brought into account, rather than seeking to bring into account a larger debit than they would have otherwise been entitled.

Furthermore, a comparison of the schemes where a Section 441 argument was asserted with the others, indicates that the schemes tended to be less complex. Of course, the schemes in the Section 441 cases vary in complexity, ranging from the

[328] *Suez Teesside (UT, 2016)* (n 23).
[329] cf. Watson (n 249).
[330] Tax Journal (n 241).

straight forward, such as *A.H. Field* or *Fidex,* to the complex and convoluted, such as *Travel Document Services*. However, the schemes in the other 6 cases tend to be further towards the complex and convoluted end of the spectrum. In some of the non-Section 441 cases, although the schemes involved an inter-group debt, Section 441 could not be used to deny the debtor company a deduction for the interest payable because the debtor company borrowed the money for good commercial reasons. Indeed, the schemes in *Greene King* and *Stagecoach* both used pre-existing debts within their schemes. Furthermore, in *Versteegh*, the FTT found that even if a debt is specifically designed to enable a tax avoidance scheme, it does necessarily mean that the debtor has an unallowable purpose for being party to the debt.[331]

Although Section 441 may not, by itself be sufficient to prevent loan relationship related avoidance, it is likely that it is necessary in order to prevent loan related tax avoidance. As discussed above at VII.2.4.3, the GAAR and LR TAAR together are unlikely alone to allow HMRC to challenge schemes such as the one in *A.H. Field*. That is because, without Section 441, there would be nothing within the loan relationship regime to indicate that interest payable on some forms of debt are non-deductible. It is also interesting to note that the definition of an 'unallowable purpose' is broader than a 'tax avoidance purpose' since a debt is held for an unallowable purpose if it is used to fund activities not within the scope of corporation tax.[332]

[331] *Versteegh (FTT, 2013)* (n 28) [160].
[332] Section 442(2)

It could be argued that the role of Section 441 is more akin to the 'wholly and exclusively' rule[333] than either the GAAR or LR TAAR as its purpose is more about determining what counts as a legitimate business expense than attempting to prevent complex tax avoidance schemes. Conceptualised in this way, although Section 441 is necessary to prevent loan relationship related tax avoidance schemes from being successful, it is not sufficient to enable HMRC to defeat all the tax avoidance schemes that they would like to challenge.

VII.5 Summary of key points

- Although the GAAR and LR TAAR are structured in similar ways, there are a number of differences between them. Most notable, for the GAAR to apply, HMRC needs to prove that a scheme is abusive, whereas, the LR TAAR applies to a scheme, unless the taxpayer can prove that the result of the scheme is consistent with the relevant provisions.
- The Ramsay Principle has not been used as a major argument in any of the Relevant Cases. This dissertation has posited there is limited scope for the Ramsay Principle to be used to purposively interpret the loan relationship regime as seeking to tax anything other than the accounting gain or loss arising out of a transaction. Furthermore, given accounting standards tending to take a substance over form approach, when determining accounting treatment of a transaction, the facts of that transaction by default viewed realistically.

[333] Section 54, CTA 2009

- Although Section 441 is necessary, by itself, it is not sufficient to prevent loan relationships being used to avoid tax.
- Picking up some of the issues and themes raised in this chapter, the next chapter will consider a number of thematic issues arising in respect of the GAAR and LR TAAR.

CHAPTER VIII: THEMATIC DISCUSSION

VIII.1 Introduction

Following on from the previous detailed technical considerations, this chapter will take a step back and consider some of the issues arising from the GAAR and LR TAAR in a more thematic way. Even before a GAAR was proposed, there were a number of articles regarding the appropriateness of its introduction into the UK tax system.[334] Specifically, at that point, the literature debated the appropriateness of a General Anti-Avoidance Rule ('GAAvoidR'), although these arguments remain relevant when considering the GAAR as introduced. The commissioning and publication of the Aaronson Report brought fresh discussions and criticism of the GAAR from a wide range of perspectives, including those who do not think that the GAAR goes far enough and instead advocate a GAAvoidR. The prime example of the latter is Murphy, who drafted the Trade Union Conference's ('TUC') response to the GAAR.[335]

Given that the LR TAAR is more specialist, it is not surprising that it has gained less attention within the literature than the GAAR. However, a number of the points raised in respect of the GAAR are also relevant to the LR TAAR. Indeed, in some respects, contrasting how these questions and criticisms will affect the LR TAAR will further illuminate them. For instance, this dissertation considers the relative importance of the word 'abusive' within the GAAR legislation by contrasting with its absence from the LR TAAR legislation.

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[334] Cf. Freedman, 'Defining Taxpayer Responsibility' (n 66).

[335] TUC, 'The Deficiencies in the General Anti- Abuse Rule' (2013) <https://www.tuc.org.uk/sites/default/files/GAAR.pdf> accessed 3 June 2018.

In terms of structure, the following section will consider a number of criticisms of the GAAR, including those earlier criticisms in respect of the GAAvoidR.[336] When doing so, it will consider how and to what extent these criticisms may also apply to the LR TAAR. To ensure this analysis is grounded in practice rather than being purely theoretical in nature, where relevant, links will be made to the Relevant Cases.

VIII.2 Is the GAAR appropriately targeted?

The authors of the Aaronson Report did not consider that a GAAvoidR was appropriate because such a rule could undermine the ability of taxpayers to undertake "sensible and reasonable tax planning … [which is an] entirely appropriate response to the complexity of a tax system such as the UK."[337] This can be contrasted with one of the criticisms raised by Murphy in his TUC paper. Murphy argued that the UK needs a rule (although his preference would be to have a principle) that targets tax arrangements which give rise to tax 'avoidance,' rather than solely tax arrangements that are considered 'abusive.'[338]

Contrasting these two positions, a couple of interesting questions arise: firstly, should the UK GAAR attempt to counteract a broader range of tax avoidance activities; and secondly, what is the practical impact of having a GAAR as opposed to a GAAvoidR - that is to say will it affect how the GAAR is applied? The first of these questions, although interesting concerns politics and ideology and is considered beyond the scope of this dissertation.

[336] For the purposes of simplicity, unless specifically relevant, this dissertation will not highlight were an author was discussing the potential introduction of a GAAvoidR, as opposed to GAAR.'
[337] (n 80) para 1.5.
[338] TUC (n 335).

With respect to the second question, as discussed in Chapter II, the courts have previously tried to draw a distinction between tax avoidance and tax mitigation, however such distinctions have been rejected by some as being unhelpful.[339] Given this, one could question whether the introduction of the term 'abusive' is helpful as, in effect, it simply requires the courts to draw a distinction between acceptable tax planning and abusive tax planning which may be as difficult as drawing a distinction between tax avoidance and tax mitigation. Indeed, it could be argued that the same question is being asked in both cases, namely, is the tax planning in question considered acceptable or not? If this logic is accepted, although using the term 'abuse' may have a role in signalling to taxpayers the types of arrangement HMRC will attempt to use the GAAR to counteract, it is unlikely to have a practical impact on how the GAAR will apply.

HMRC appear to be concerned that the use of the word 'abusive' will limit the situations in which the GAAR will apply.[340] As already noted at VI.4, HMRC consider that the "test of 'abuse', for the purposes of the GAAR, is a high threshold".[341] While the concern may be justified at a policy level, the practical impact of this linguistic difference is dependent on the approach taken by the courts.

Looking at the Relevant Cases, one can see that the courts try, where possible, to ensure that tax avoidance schemes are not successful. This can be evidenced by the fact

[339] Judith Freedman, 'Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament' (2007) 123 Law Quarterly Review 53.
[340] HMRC, 'Modernising the Taxation of Corporate Debt and Derivative Contracts' (n 194).
[341] ibid 14.3.

that in a 10 out of 13 of the Relevant Cases[342] the courts found in favour of HMRC.[343] Looking more broadly, according to a report by the National Audit Office into the effectiveness of the DOTAS regime, HMRC's success rate in tax avoidance cases in 2011-12 was 86%.[344] The Law Society question, given HMRC success (other than in *Mayes*), "whether, ignoring the febrile political environment even at the time (and that had only worsened since that time) there was a real need for a GAAR."[345]

Furthermore, Way questions how the term 'abusive' interacts with the double reasonableness test. He writes that he:

> *understands that those driving the GAAR consider that the purpose of the double reasonable test is to find out, if you like, what the "reasonable man" considers is abusive. … The difficulty with that is that this moves us away from the pejorative expression, "abusive" to some extent, to the more benign word "reasonable"*[346]

In the event that Way is correct in this regard, it would further suggest that the use of the word 'abusive' in the GAAR legislation is not as significant as it first appears since the emphasis is shifted onto what is 'reasonable' rather than what is 'abusive'.

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[342] With one further case giving rise to a mixed result. Appendix C shows how each of the cases have been classified.

[343] For completeness, it should be noted that an alternative explanation of this result is that HMRC only pursue cases through the courts where they are confident that they will be successful. If this is the case, then HMRC's success rate would be a consequence of their decision only to challenge schemes where they have a high change of success. To be able to determine is this is the correct explanation, one would need to review the cases that HMRC decided not to pursue through the courts.

[344] National Audit Office, *HM Revenue & Customs - Tax Avoidance: Tackling Marketed Avoidance Schemes* (Cm 730, 2012-13) <https://www.nao.org.uk/wp-content/uploads/2012/11/1213730.pdf> accessed 20 December 2017.

[345] Economic Affairs Committee (n 93) Ev 182 (footnotes omitted).

[346] Way (n 32) 99.

Evidence arising from outside of the UK further supports this argument, for in most countries with a GAAvoidR there is a level of uncertainty about which transactions fall within its scope. This uncertainty "stems from the fine line that separates unacceptable tax avoidance from acceptable tax mitigation."[347] Although UK courts do not need to draw this distinction when applying the GAAR (or the LR TAAR), it could be argued that they still need to draw the distinction between what is acceptable tax planning, and what is considered 'unacceptable'. As such, using the term 'abusive' to describe 'unacceptable' tax planning may not make a significant difference to how the courts interpret the GAAR, compared to if there were a GAAvoidR in place.

Further support for this argument can be found in the International Monetary Fund's note on introduction of a GAAvoidR, which states that they should be designed to "strike down blatant, artificial or contrived arrangements which are tax driven" without catching "ordinary commercial transactions in respect of which taxpayers can legitimately take advantage of opportunities." [348]

This statement would also appear to summarise the policy intent behind the UK GAAR. It further supports the argument that the use of the word 'abuse' in the GAAR legislation may not be as significant as it first appears when it comes to how the GAAR will actually be applied. This is not to say that the use of the term 'abuse' serves no purpose. As the Chartered Institute of Taxation pointed out in its evidence to the

[347] Prebble and Prebble (n 125) 28.
[348] Christophe Waerzeggers and Cory Hillier, 'Introducing a General Anti-Avoidance Rule (GAAR): Ensuring That a GAAR Achieves Its Purpose' (IMF Legal Department 2016) Tax Law Technical Note 29016/1 1.

Economic Affair Committee "framing the GAAR as an anti-**abuse** rule is correct as that should signal its target (itself an important feature)."[349]

Applying a similar logic to the LR TAAR, by not using the word 'abusive' within the legislation, HMRC is intending to send the signal that they are particularly concerned with loan relationship related avoidance and are intending to aggressively challenge any schemes they consider to be in scope. Furthermore, HMRC could also be concerned that the courts will interpret the GAAR in a way that will limit the GAAR's applicability, in which case, the Loan Relationship TAAR may become more relevant. Although it is possible that the courts would also seek to interpret the LR TAAR narrowly, given their attitude towards the schemes and taxpayers in the Relevant Cases, this appears unlikely.

Given the above, there appears to be plenty of support for the argument that the use of the word 'abusive' in the GAAR legislation is less significant than it first appears. If this is the case, then this linguistic difference between the GAAR and the LR TAAR is likely less important than at first it appears. Ultimately, however, this thesis can only be truly tested once cases involving the GAAR and the LR TAAR have been considered by the courts.

VIII.3 Determining the intention of Parliament

Although neither the GAAR nor the LR TAAR refer explicitly to 'the intention of Parliament', a close reading of legislation indicates that this concept is being referred to in both. Specifically, there are three instances in the GAAR legislation and two instances in the LR TAAR where it refers implicitly or explicitly to the purpose of the relevant

[349] Economic Affairs Committee (n 93) Ev 78 (emphasis in original).

legislation, which can only be determined with reference to the intention of Parliament in enacting that legislation.

The first potential reference in the GAAR legislation is at Section 207(2)(a), which states that when considering whether an arrangement is abusive, regard needs to be had to “whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions.” Similar wording can be found within the LR TAAR legislation at Section 455D(4). In order to determine whether an arrangement is consistent with the principles and policy objectives of a particular provision, it is necessary to first to determine what those purposes are.

The second reference within the GAAR legislation follows shortly after the first at s207(2)(c), which states that regard needs to be given to “whether the arrangements are intended to exploit any shortcoming” in the relevant provisions.

According to the Oxford English Dictionary, the definition of ‘shortcoming’ is either a “[f]ailure to come up to a standard of excellence or to fulfil a duty; a defect” or “[f]ailure to reach the required or expected amount, a deficiency.”[350] Both of these definitions imply that there is an expected standard which has not been met. For the term ‘shortcoming’ to be meaningful in s207(2)(c), the underlying provision must have an identifiable purpose. So to say that an arrangement exploits a shortcoming in the relevant provision, the arrangement in question must be designed to manipulate the

[350] ‘Shortcoming’ <http://www.oed.com.ezproxye.bham.ac.uk/view/Entry/178595> accessed 1 December 2016.

provision so it does not achieve its intended purpose. As discussed at VII.2.4, a similar reference to shortcomings is not included within the LR TAAR legislation.

The third reference is at s207(4), which lists the tax results which might indicate that a tax arrangement is abusive. However, these results are only indicators of abusiveness "if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted." Again, similar wording can be found within the LR TAAR legislation at Section 455D(2). The use of the term 'anticipated' implies that the relevant provision has a purpose, as it indicates that the provision was intended to give rise to a particular result. Otherwise it would be meaningless to discuss whether an outcome is the anticipated result of a provision.

Although it appears relatively uncontroversial to say that a piece of legislation has a specific purpose (albeit some provisions may have a more complex purpose than others), the identification of that purpose can be problematic, both from theoretical and practical perspectives. From a theoretical perspective, the question is: how can the purpose of a piece of legislation be identified, given the complex process of drafting, debating and enacting it?[351] From a practical perspective, the question is: what happens if the purposes of a particular piece of legislation is unclear or appears arbitrary? Each of these are considered further below.

VIII.3.1 Purpose – a theoretical problem

As a starting point, it is important to understand the "role of legislation as an expression of the intention of Parliament as an institution rather than as a collection of

[351] Freedman, 'Interpreting Tax Statutes' (n 339); Ronald Dworkin, *Law's Empire* (Hart Publishing 1998).

individuals."[352] As such, the question arises of how to determine the purpose of a piece of legislation independently from those purposes which specific actors had in mind when proposing and enacting that legislation. As Dworkin points out, legislators may have a range of reasons for voting for a piece of legislation.[353] Within a tax context, the most important actors in introducing tax provisions are HMRC and HM Treasury, who draft the finance bills. Thus the question is: how should the purposes of a specific provision be identified given they should be considered separate and distinct from the purposes HMRC and HM Treasury had in mind when drafted the legislation?

Freedman,[354] drawing on Waldron,[355] argued that the fact that the intention of Parliament should be considered as separate and distinct from the actors involved supports the authoritative nature of the text of the legislation itself. That is to say, that the purpose of a particular provision should be determined by reference to what the legislation actually says. However, Freedman goes on to argue that this position does not prevent other statements made by individual members of the legislative being used to help guide the court's interpretation of Parliament, providing that those statements are intended for that purpose. For instance, following the decision in *Pepper v Hart*,[356] Ministerial statements can be used to aid constructing legislation where the text of the relevant legislation is ambiguous. Freedman argued that this position is constitutionally

[352] Freedman, 'Interpreting Tax Statutes' (n 339) 27.
[353] Dworkin (n 351).
[354] Freedman, 'Interpreting Tax Statutes' (n 339); Dworkin (n 351).
[355] Jeremy Waldron, 'Legislators' Intentions and Unintentional Legislation', *Law and Disagreement* (Oxford University Press 1999).
[356] *Pepper v Hart (HL, 1992)* (n 110).

justifiable as such statements may become "recognised as acts of the legislature, as a matter of policy."[357]

Although the GAAR legislation allows the courts to use a broader range of materials when determining whether it applies, it could be argued that similar principles should apply to these additional materials, that is to say, the courts should only take into account such statements where they clearly set out the purpose of a particular provision. For instance, an announcement from HMRC which states that they are going to bring before Parliament provision X to prevent tax scheme Y could be used to prevent provision Z from being manipulated to facilitate tax scheme Y. This position would be consistent with Freedman's opinion because HMRC is instrumental in drafting tax legislation and, therefore, when Parliament enacts a piece of legislation which has been drafted by HMRC, Parliament can be seen as implicitly accepting HMRC's rationale of its introduction. To take the previous example, if Parliament enacts provision Z on the recommendation of HMRC, Parliament can be taken as implicitly accepting and adopting HMRC's intention that provision Z is used to prevent scheme Y from being effective.

Although the GAAR legislation permits a broader range of materials, such as journal articles, to be used to determine if it should apply, one could question the role of such materials in determining the purpose of a piece of legislation, if they do not satisfy the above criteria. That is to say, those other materials need to be sufficiently clear and authoritative to be useful in determining the intention of Parliament in enacting a particular provision. It is conceivable that such materials could be useful, but

[357] Freedman, 'Interpreting Tax Statutes' (n 339) 72.

this may be relatively rare in practice given how far removed they are likely to be from the original intention of Parliament, except to the extent they show that HMRC accepted a practice when the scheme was entered into or they provide context to other material.

Given that Section 211, FA 2013 is not replicated within the LR TAAR legislation, when seeking to determine if it applies, the courts are constrained by *Pepper v Hart*.[358] This difference has the potential to give rise to some peculiar results in the event that the purpose of the relevant legislation can only be obtained from materials that fall outside of the scope of the *Pepper v Hart* principle.

As noted above, both the GAAR and LR TAAR legislation contain the term 'anticipated result'.[359] Although it is meaningful to say that an individual can anticipate a result, it could be questioned whether it is meaningful to talk about an institution anticipating a result, particularly if Freedmen is correct when she cites Waldron as saying that "an institution has no occurrent thought."[360] Dworkin may help resolve the apparent problems raised by this question.[361]

Dworkin described three potential ways to conceptualise "the role intention should play in constructing statutes."[362] The strong position is that a "statue can have no consequences the legislators did not have in mind," [363] with the weak position being "that a statute can contain nothing that the legislators intended that it did not contain."

[358] *Pepper v Hart (HL, 1992)* (n 110).
[359] At Section 207(4), FA 2013 and Section 455D(2).
[360] Freedman, 'Interpreting Tax Statutes' (n 339) 72.
[361] Dworkin (n 351).
[362] ibid 19.
[363] ibid.

[364] Between these two positions is what Dworkin calls the intermediary position, which is that a "statute does not have any consequence the legislator would have rejected if they had contemplated it." [365]

Interpreting the phrase 'anticipated result' in light of the Dworkin's intermediary position, would mean that, rather than considering what individual actors (including HMRC) anticipated when enacting a provision, one should consider whether, had Parliament as an institution known that the provision would have produced a particular outcome, they would have accepted that outcome. Conceptualising the phrase 'anticipated result' in this way should allow a meaningful discussion of whether an outcome is consistent with the anticipated results of a specific provision. Although this position may help relieve some of the conceptual issues raised, the question then becomes: how should one determine whether a provision has produced an outcome which Parliament would have accepted?

Extending Freedman's argument, what Parliament anticipated when enacting a piece of legislation must be determined with reference to the wording of the relevant legislation and any clear statements which function to indicate its intended purpose. The logical consequence of this argument is that when considering s207(4) it is irrelevant to consider what specific stakeholders (including HMRC and HM Treasury) anticipated the results of a particular provision would be, unless there was a clear statement to that effect during the legislative process.

[364] ibid.
[365] ibid.

In the context of tax avoidance, such considerations are important because tax avoidance schemes often rely on specific provisions applying in a way not originally considered by the drafter of those provisions. However, just because a provision is used in a way not intended by the drafter, it does not necessarily mean that it is being used in a way that is not consistent with the intention of Parliament. This situation could arise as a result of the legislation being poorly drafted or HMRC failing to fully work through the consequences of a provision. For example, Finance Act 2018, contained a number of amendments to the anti-hybrid rules inserted into the Taxation (International and Other Provisions) Act 2010 by Finance Act 2016 in order to ensure that the original provisions operated as intended.[366] Although in this instance, HMRC identified potential defects in the legislation and acted accordingly, in other situations HMRC may have either not noticed that the legislation did not apply as they intended or decided that the deficits were not sufficiently significant to warrant correcting them. In this regard it should be noted that the *Pepper v Hart* principle can only be used where the underlying legislation is ambiguous, and is not of assistance where the text of the legislation is clear but fails in its intended purpose.

VIII.3.2 Purpose – a practical problem

The second situation where application of the GAAR could be problematic is when the underlying purpose of the legislation is unclear or does not seek to tax commercial gains or losses arising from an arrangement. Although historically, the Ramsay Principle

[366] KPMG, 'Budget: Amendments to the Hybrids and Other Mismatch Rules' (26 November 2017) <https://home.kpmg.com/uk/en/home/insights/2017/11/tmd-budget-amendments-to-the-hybrids-and-other-mismatch-rules.html> accessed 6 January 2018.

has been used to defeat tax avoidance schemes, it can be challenging to apply when the purpose of a piece of legislation is unclear, or the legislation does not seek to tax commercial gains and losses. This is important to discuss because a major reason for the Aaronson Report[367] considered that a GAAR was required in the UK was that HMRC was unsuccessful in challenging the SHIPS 2 scheme in the *Mayes* case[368]. Indeed, Aaronson states that the SHIPS 2 scheme, "and other schemes like it, provides the answer to the question 'does the UK need a GAAR?'"[369]

As discussed in detail at V.3, the key reason why HMRC was unsuccessful in that case was that the provisions in question did not seek to tax commercial gains and losses and therefore, purposive interpretation could not be used to deny relief for a loss that did not give rise to commercial loss for the taxpayer. To use Hollis's terminology, although the taxpayer in the *Mayes* case claimed a deduction for a 'phantom loss,' the relevant legislative provisions were designed in such a way to give rise to taxable 'phantom gains' and deductible 'phantom losses'.[370]

Although the authors of the Aaronson Report believed that the GAAR could be used to counteract schemes like SHIPS 2, this case raises the question of whether the GAAR could be effective where the relevant provision lacks a clear purpose or where the tax treatment is driven by legal analysis. As Freedman points out, a "GAAR cannot rewrite the law where there is no clear objective because the essence of a GAAR is there

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[367] Aaronson (n 80).
[368] *Mayes (CA, 2011)* (n 127).
[369] Aaronson (n 80) para 3.23.
[370] Hollis (n 188).

to prevent abuse of the underlying legislation."[371] In this regard, it is illuminating to note the comment Mummery LJ made at the beginning of his discussion of the Ramsay Principle in his leading judgement in the *Mayes* case, which reads:

> *The reaction to SHIPS 2 noted by Proudman J [i.e. it should not succeed[372]] was instinctive and initial. Instinct informed by experience plays a role in decision-making, but does not relieve the court of the duty to reach a decision that is based on a proper understanding of the meaning of the legislation and of the facts that make up the transaction. Instinct has to be checked by the processes of construing the scope of the [relevant] provisions and analysing SHIPS 2.*[373]

Although instinct may suggest that a tax avoidance scheme should not be allowed to succeed, it may still be challenging for HMRC to prove that instinct is correct as a matter of law. The GAAR and the LR TAAR should give HMRC further tools to prevent such schemes from being successful, but those tools will have limited effectiveness where the relevant provisions are not effectively drafted. This is important because, as Freedman notes, "it is not the function of a GAAR, any more that of the judiciary, to fill gaps left by the failure to set out parliamentary intention."[374] A similar point could be made in respect of the LR TAAR.

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[371] Judith Freedman, 'Designing a General Anti-Abuse Rule: Striking a Balance' (2014) 167 Asia-Pacific Tax Bulletin 168 <http://papers.ssrn.com/abstract=2488541> accessed 10 September 2016.
[372] *Mayes (CA, 2011)* (n 127) [13]; citing *Mayes (HC, 2009)* (n 119) [45].
[373] *Mayes (CA, 2011)* (n 127) [68].
[374] Freedman, 'Interpreting Tax Statutes' (n 339) 74.

Considering the Relevant Cases, this point can also be illustrated by the *Bank of Ireland* case in which, although the Court of Appeal accepted that the scheme in question was designed to take advantage of how two sections interact, Lawrence LJ concluded that there is no “legitimate process of interpretation which would solve the Revenue’s problem. … [HMRC’s proposed solution] would amount to an unprincipled process of legislation gloss.”[375]

One could seek to challenge this argument by pointing out that the above discussion assumes a narrow view of purpose; that is to say, focusing at the purpose of the provision being considered. Some may argue that the UK tax system has a broader overriding purpose of raising money to fund HM Government. In the event that a broader purpose exists, it could be argued that all tax provisions have this as an underlying purpose, and therefore, use of any tax provision to lessen a person’s tax liability is always contrary to its purpose unless it explicitly provides for that reduction in tax liability. The challenge with taking this position is that the HM Government does not just use the tax system to raise revenue, it also uses the tax system to incentivise and disincentivise certain behaviours.[376]

VIII.4 The problem of closely articulated provisions

Although prima facia, it would seem clear that the GAAR and LR TAAR should be able to defeat schemes that are designed to manipulate the relevant provisions, there is a question over how the GAAR or LR TAAR should apply when the relevant provision contains a number of precise conditions. For instance, it may be easier to apply the GAAR

[375] *Bank of Ireland (CA, 2008)* (n 19) [44–45].
[376] Freedman, ‘The Tax Avoidance Culture’ (n 73).

or LR TAAR to a scheme similar to the one in the *Travel Document Services* case than the one in the *Bank of Ireland* case. Whereas the scheme in *Travel Document Services* sought to create a deemed loan relationship to exploit the fact that, on the taxpayer's argument, Paragraph 13 could not apply to deemed loan relationships, in *Bank of Ireland*, the scheme sought to exploit an inconsistency between a number of closely articulated provisions. Thus, whereas in *Travel Document Services*, the taxpayer was seeking to rely on an inherit limitation in Paragraph 13, in *Bank of Ireland*, the taxpayer merely created a situation where applying the rules gave rise to an advantageous result.

Within UK tax legislation there are a large number of provisions whose application is dependent on a number of detailed conditions, and these provisions tend to apply mechanically. Examples include the UK statutory residency test or the anti-hybrid rules (although specific anti-avoidance rules may be included in these types of regimes). Within the loan relationship regime, there are a number of provisions that contain closely articulated conditions, such as the deemed released rules. [377] These rules also contain a specific targeted anti-avoidance rule at 363A, CTA 2009.

The question of how the GAAR and LR TAAR apply to counteract tax schemes that rely on closely articulated provisions is an important point to consider because, as the Law Society notes:

> *HMRC persist in using very detailed legislation which provides little or no scope for a purposive interpretation, there is more risk of a*

[377] Section 361 to 363A, CTA 2009

> *"scheme" being effective than if HMRC were prepared to introduce shorter legislation not seeking to cover every eventuality.* [378]

In respect of the GAAR, the GAAR guidance state that:

> *If the statute specifies a particular period or set of conditions quite precisely, then taxpayers are entitled to assume that they are on the right side of the line if they have satisfied the statutory condition and there is no contrivance about what they have done.* [379]

That said Gammie, who argues that the GAAR goes no further than the normal rules of purposive construction, raises the question: "when is satisfaction of the conditions sufficiently contrived to deny their satisfaction notwithstanding that on a purposive construction you satisfy the requirements for the particular tax treatment"?[380]

Although a similar point could be made in respect of the LR TAAR, as already mentioned at VII.2.4.1, the LR TAAR legislation does not refer to contrived steps. As previously noted this may make sense, given that for the purpose of the TAAR all tax avoidance arrangements are considered 'relevant' unless shown to be otherwise. Thus, its impact may be more limited in practice, given that it is likely to be difficult to argue that a tax avoidance scheme containing contrived steps gives rise to a result which would be consistent with the relevant legislation.

[378] Economic Affairs Committee (n 93) 182 (fn. 44).
[379] HMRC, '2015 GAAR Guidance' (n 33) para D2.4.1.
[380] Gammie (n 132) 587.

VIII.5 Certainty for the taxpayer

When the GAAR was being proposed, two of the key themes that were discussed were: the need to give taxpayers a level of certainty on how the GAAR will apply; and whether a clearance system should be included as part of the GAAR legislation. The Aaronson Report discussed these themes and when designing the GAAR the requirement to give the taxpayer as much certainly as possible was taken into consideration. The authors sought to do this is two ways. Firstly, they considered that putting the burden of proof onto HMRC to show that an arrangement is abusive should "reduce the scope for doubt as to whether an arrangement falls within the intended target area of the GAAR".[381]. Secondly, they considered that it was "desirable for there to be some mechanism to enable doubts [about the scope of the GAAR] to be addressed as quickly as possible," [382] and they proposed the introduction of the GAAR Advisory Panel. As noted above at IV.3.2, part of the role of the Panel is to review schemes that HMRC wishes to use the GAAR against, to determine, in the panel's opinion, a 'reasonable' course of action.

The Aaronson Report considered that there would be two main advantages of the GAAR Advisory Panel. Firstly, since the majority of its members would not work for HMRC,[383] it would provide impartial oversight on how HMRC seeks to apply the GAAR. Secondly, if the Panel's decisions are published in a suitably anonymised format,[384] they would form a "body of guidance which would be used to calibrate their understanding

[381] Aaronson (n 80) para 5.24.
[382] ibid 5.25.
[383] Although this was the Aaronson report's recommendation, ultimately, it was decided the none of the Panel members should come from HMRC.
[384] Which does happen

of where the dividing line falls between responsible tax planning and abusive tax schemes.” [385]

In light of the fact that the burden of proof is on HMRC and the role of the GAAR Advisory Panel, the Aaronson Report considered that a general clearance system would be unnecessary, although it did consider it would be ‘sensible’ if clearance granted under other arrangements would include a comment on the inapplicability of the GAAR. These recommendations were accepted by HMRC, although the GAAR guidance states that if clearance is granted in respect of one aspect of a scheme, HMRC may use the GAAR against other aspects.[386]

The safeguards in place in respect of the GAAR have not been replicated in the LR TAAR legislation. In contrast to the GAAR, the burden of proof is on the taxpayer to show that the outcome of a scheme is consistent with the purpose of the relevant provisions and there is no independent panel which HMRC need to refer cases to. Furthermore, there is no formal clearance procedure which taxpayers use to seek confirmation whether the LR TAAR would apply to a transaction. [387]

Comparing many of the comments of the Aaronson Report quote above with the situation within the LR TAAR, the contrasts between the GAAR and the LR TAAR are highly visible. To take a couple of examples, the authors of the Aaronson Report thought that it was advantageous for the GAAR to contain a mechanism for disputes regarding its scope to be quickly resolved and within Schedule 43, FA 2013 there are strict time

[385] Aaronson (n 80) para 5.25(i).
[386] HMRC, ‘2015 GAAR Guidance’ (n 33).
[387] For completeness, most TAARs do not include a formal clearance procedure. One notable exception is the clearance procedure provided in Section 138, The Taxation of Chargeable Gains Act 1992.

limits for potential GAAR cases to be referred to the GAAR Advisory Panel. Although the Panel's decision is not binding, it provides the taxpayer and HMRC with an independent view on whether a scheme is potentially within the scope of the GAAR in a relatively short period of time. This compares to a number of the Relevant Cases which took years to come before the FTT and over a decade before they are finally resolved. For instance, the FTT's decision in *Greene King*, concerned the accounting period ending 30 April 2003 and 30 April 2004, was only released in 2012.[388] The first independent determination of whether a scheme is within the scope of the LR TAAR will not be until the case is heard by the FTT.

A second example is that, whereas the anonymised past opinions of the GAAR Advisory Panel can be used to work out where the dividing line falls between acceptable tax planning and abusive tax avoidance, a similar resource is not available to allow a taxpayer to work out where the line is drawn in respect of the LR TAAR. Although, cases involving the LR TAAR will be useful in this regard, it will take some time for the creation of such precedent. Furthermore, given that such precedent would also be available with respect to the GAAR, the fact that the Aaronson Report considered that the publication of the Panel's decisions is important would suggest their publication would provide additional guidance over and above judicial precedent.

[388] Although this may be an extreme example, the fact remains that it takes a significant period of time for cases to come before the FTT.

Looking at it from a different perspective, there is an argument that the introduction of the GAAR will increase overall level of certainty in the UK tax system. As the Aaronson Report noted, currently in tax avoidance cases:

> *Judges inevitably are faced with the temptation to stretch the interpretation, so far as possible, to achieve a sensible result; and this is widely regarded as producing considerable uncertainty in predicting the outcome of such disputes.*[389]

A review of the Relevant Cases showed that judges face these challenges and seek to ensure that tax avoidance schemes are defeated. These cases show that the courts have placed emphasis on certain words and phrases in the tax legislation in order to defeat tax avoidance cases. For instance, in *DCC Holdings*, the courts placed particular emphasis on the term 'fairly represents' in order to prevent a tax avoidance scheme from being successful. Although, as noted above at VI.5 this phrase had been in the legislation for a number of years without any focus being placed on it, that case lead to the development of what has been used by the FTT "as a proxy for an anti-avoidance rule".[390] It could be argued that this is not an example of the court 'stretching' the meaning of the legislation, but rather focusing on under-explored area of the legislation, and such developments give rise to uncertainty for taxpayers and HMRC.[391]

[389] Aaronson (n 80) para 1.7 (iii).
[390] Self, 'Stagecoach, Loan Relationships and the "fairly Represents" Rule' (n 198) 19.
[391] As noted at VI.5, HMRC cites the fact that the courts had not given definitive guidance on the 'fairly represents requirement' as one of the reasons for removing this term from the legislation (HMRC, 'Modernising the Taxation of Corporate Debt and Derivative Contracts' [n 194]).

Drawing on the insight in the Aaronson Report cited above, Freedman goes on to argue that where there is a "carefully formulated GAAR" in place, the courts "will be more inclined to interpret the legislation more narrowly but then look to the GAAR for guidance as to whether it should be subject to that anti-avoidance rule." [392] Although there is merit in this argument, the key phrase here is 'carefully formulated GAAR'. To the extent that the scope of the GAAR is clear and taxpayers have a level of certainty over its application, there could be more overall certainty within the tax system.

A similar argument could be made in respect the LR TAAR. Although HMRC has been successful in challenging most of the schemes in the Relevant Cases, there has been a level of uncertainty, perhaps inevitably, over whether a scheme will succeed. Furthermore, the courts' attempts to ensure that tax avoidance schemes are not successful have led to 'stretching' the interpretation of a word or a phrase to give it a significance which, arguably, it was not intended to have. For instance, with respect to the 'fairly represents requirement', part of the reason that Rimer LJ dissented from Moses LJ's leading judgement was that Moses LJ's reasoning appeared to "load on to the emphasised words a function that they cannot naturally bear".[393] A similar argument could be made in relation to the FTT's focus in *Stagecoach* on the expression 'in respect of' a company's loan relationships, particularly given that a fundamental tenet of accounting is that any accounting debits must be offset be a matching credit. However, others disagree, for instance Sir Terence Etherton C found the FTT's argument

[392] Freedman, 'Designing a General Anti-Abuse Rule' (n 371) 168.
[393] *DCC Holdings (CA, 2009)* (n 234) [85].

'compelling'.[394] In the event that the LR TAAR gives the courts less incentive to stretch such interpretations, this is likely to reduce the level of uncertainty regarding the application of the loan relationship rules.

One objection to Freedman's argument that the introduction of a GAAR will cause the courts to interpret statutes more narrowly is that this is only likely to happen if the courts have complete confidence where the GAAR will apply. If they are uncertain how the GAAR would apply, then they may continue to 'stretch' interpretation to ensure that the scheme in question is defeated. Again, this logic is likely to apply equally to the LR TAAR.

Although the authors of the Aaronson Report considered that their recommendations would lead to increased certainty regarding how the GAAR should apply, however, they note two further points. Firstly, they considered that 'inevitably' there would be cases that "test the outer limits of the centre ground [of acceptable tax planning], giving rise to uncertainty as to whether the GAAR applies." [395] As has been explored a number of times within this dissertation, whatever form of language is used, any broad anti-avoidance rule is required to draw a distinction between acceptable and unacceptable tax planning. Whenever such a distinction is drawn, it is indeed 'inevitable' that 'hard cases'[396] will arise where it is difficult to determine which side of the line a scheme falls. In response to this, the authors suggested that in such cases there would already be a degree of technical uncertainty over whether the scheme would have

[394] *Greene King (CA, 2016)* (n 24).
[395] Aaronson (n 80) para 5.29.
[396] To use a phase employed by Dworkin([n 351]).

succeeded even in the absence of the GAAR. The introduction of the GAAR would not increase the uncertainly that the taxpayer would need to accept when considering whether to enter into a tax avoidance scheme.

The second point they note is that there are some parts of the tax system "where the present statutory rules are extremely complex and can give rise to anomalous consequence".[397] The authors considered that this is not a reason against introducing a GAAR, but instead "calls for rationalisation of these rules". [398] Again, this theme has been explored on a number of occasions, with the obvious example being *Mayes*.

Thus, the question of certainty for the taxpayer has been factored into design of the GAAR. Although theoretically, Freedman's argument that the GAAR could provide more certainly to the taxpayer may have merit, there is a question of whether in practice the courts will start to interpret legislation more narrowly, particularly in the short term. Overall, it is probably fair to say that although the mechanisms put in place to provide taxpayers with certainty over the application of the GAAR should help, there will remain a level of uncertainty, particularly in the short run whilst the body of case law and GAAR Advisory Panel opinions are being built up.

In contrast there is a great deal of uncertainty over how the LR TAAR will apply, given the absence of similar mechanisms to assist taxpayers. Whether this uncertainty will materially decrease going forward is dependent on the extent to which the courts give comprehensive guidance on how the LR TAAR should be interpreted.

[397] Aaronson (n 80) para 5.30.
[398] ibid.

VIII.6 Summary of key points

- Although the use of the word 'abuse' is useful in signifying the type of scheme that HMRC will seek to use the GAAR against, it may not have a practical effect. Similarly, will the lack of the word 'abusive' in the LR TAAR legislation make it easier to apply.
- Both the GAAR and the LR TAAR require the purpose of the relevant provisions to be determined. Determining the purpose of a particular provision can be challenging both from a theoretical and a practical perspective. Although the ability of the courts to take into account a broader range of material when determining if the GAAR applies may help, it still relies of provisions having an identifiable purpose. As the *Mayes* case shows, provisions lacking a clear purposes gives rise to challenges to HMRC
- Similarly, there is a question over how the GAAR and LR TAAR will apply to areas which contain a number of closely articulated provisions.
- The requirement for taxpayers to be given as much certainty as possible over the application of the GAAR was a key concern from the authors of the Aaronson Report. Although some uncertainly remains with respect to how the GAAR will apply in practice, the safeguards introduced as part of the GAAR help to limit the uncertainly. The same cannot be said of the LR TAAR, which lack similar safeguards.
- The next and final chapter of this dissertation will seek to draw these arguments to a conclusion.

CHAPTER IX: CONCLUSIONS

IX.1 Introduction

In an article just three years after the introduction of the GAAR, Self asked whether, in light of HMRC's recent victories in tax avoidance cases, the GAAR would still be necessary to counteract tax avoidance schemes.[399] The same could be said of the LR TAAR today. Of the 13 Relevant Cases considered,[400] the courts found in favour of HMRC in 10 of them, with one further case giving rise to a mixed result.[401] That leaves two victories for the taxpayer, namely *Bank of Ireland*[402] and *Smith & Nephew*,[403] with the latter currently being appealed. Thus, it appears HMRC is relatively successful in defeating loan relationship avoidance even without the GAAR or LR TAAR, albeit, we do not know how many cases HMRC decided not to pursue because they are less confident in being able to challenge them.

That is not to say that either piece of legalisation is redundant, for they may have other roles. Firstly, it shows that HMRC are committed to prevent loan relationship related tax avoidance. This is an important signal to both taxpayers contemplating entering into a loan relationship related avoidance scheme and others who see large companies using such schemes to avoid tax. Secondly, as can be seen from the Relevant Cases, HMRC is currently required to assert a range of technical arguments to challenge loan relationship avoidance schemes, which may not be necessary going forward.

[399] Heather Self, 'Do We Still Need a GAAR?' *Tax Journal* (2 September 2016) 15.
[400] For the avoidance of doubt, all the schemes in the Relevant Cases were entered into before the GAAR and LR TAAR were enacted.
[401] See Appendix C for a summary of how each case has been classified.
[402] *Bank of Ireland (CA, 2008)* (n 19).
[403] *Smith and Nephew (FTT, 2017)* (n 16).

Thirdly, the GAAR and LR TAAR may give HMRC increased confidence in their ability to challenge loan related avoidance schemes, leading them to pursue more such schemes through the courts.

Before concluding on the specific questions posed, this dissertation will briefly discuss each of the anti-avoidance measures reviewed.

IX.2 Conclusions in respect of other measures

IX.2.1 Section 441

It was found that although Section 441 is a necessary part to defeat certain types of loan relationship avoidance, by itself, it is not sufficient. Its primary limitation is that it does not apply to schemes designed to prevent a company being required to bring into account a loan relationship credit. However, Section 441 is necessary to define what is legitimate business expenditure for loan relationship purposes, in a similar manner to the wholly and exclusively rule. Referring to the Relevant Cases, although Section 441 may not have a role in preventing the type of schemes in *Greene King*[404] or *Stagecoach*,[405] it is vital to defeat schemes similar to the one in *A.H. Field*.[406]

IX.2.2 The Ramsay principle

Although the Ramsay Principle has been used to counteract a broad range of tax avoidance schemes, it has not been raised as a main argument in any of the Relevant Cases. There are two explanations for this, neither of which are mutually exclusive. Firstly, although. the House of Lords found in *Ramsay*[407] that the capital gains regime

[404] *Greene King (CA, 2016)* (n 24).
[405] *Stagecoach (FTT, 2016)* (n 16).
[406] *A.H. Field (FTT, 2012)* (n 18).
[407] *Ramsay (HL, 1981)* (n 53).

sought to tax real world gains and losses, the loan relationship code seeks to address tax accounting credits and debits. As such, it would be challenging to argue using the Ramsay Principle that a provision should be construed purposively such that the accounting gains or losses arising out of a transaction should be disregarded and instead should be taxed in accordance with the real world gains or losses arising. Secondly, generally under accounting standards, a transaction is required to be accounted for in accordance with its economic substance and, therefore, it seems unlikely that the real world gain or loss arising from a transaction could be significantly different from the accounting gain or loss arising as a result of viewing the facts of a case realistically. One notable exception to this rule is where the transaction involves accounting for a contingent asset where, although it may have a commercial value, accounting standards prevent the company from assigning a value to that asset (such a situation arose in *Suez Teesside*[408]). However, even this position is open to question.[409]

Thus, the role of the Ramsay Principle in counteracting loan related avoidance is likely to be limited in the future.

IX.2.3 LR TAAR

Given HMRC's rationale for the introduction of the GAAR, going forward, it is likely that they will seek to apply the LR TAAR against loan relationship avoidance schemes. This may not necessarily mean that HMRC is more successful in defeating such schemes, for already HMRC have a high success rate in challenging them. However, the LR TAAR will give HMRC more certainty over their ability to challenge, which could lead to a

[408] *Suez Teesside (UT, 2016)* (n 23).
[409] Cf. Boneham (n 255).

greater number of loan relationship related schemes going through the courts. them. Furthermore, HMRC intend the LR TAAR to act as a deterrent,[410] thereby making it less likely that taxpayers will enter into loan relationship avoidance schemes in the first place.

Although HMRC may hope that the LR TAAR will be an effective measure, a number of challenges and criticisms raised in respect of the GAAR are likely also to apply to the LR TAAR. In particular, as discussed in Sections VIII.3 and VIII.4, the LR TAAR may be challenging to apply where the relevant provisions lack a clear purpose or they are closely articulated (or both), albeit there may be fewer of these types of provision in the loan relationship regime compared to other areas of the corporation tax legislation.

IX.3 Conclusions in respect of the GAAR

Given the likely role of the LR TAAR in defeating loan relationship avoidance schemes going forward, what role will the GAAR have for such schemes? At the time of proposing the LR TAAR in 2013, HMRC considered that the GAAR would not provide sufficient protection to prevent loan relationship avoidance schemes from being successful.[411] This suggests that the LR TAAR is a tougher measure that the GAAR, but how do they compare?

As can been seen from Section VII.2, both the GAAR and LR TAAR are structured in similar ways. Some of the differences between them could be described as purely

[410] HMRC, 'Modernising the Taxation of Corporate Debt and Derivative Contracts' (n 194).
[411] ibid.

linguistic or merely arising from the different contexts. However, others are more relevant, such as the shift in the burden of proof.

Within the GAAR legislation, the burden of proof is on HMRC, whereas in the LR TAAR legislation, the burden of proof is on the taxpayer (like in other areas of tax). This shift can be seen in two respects. Firstly, when applying the GAAR, one starts from the presumption that a tax avoidance scheme is acceptable, unless HMRC can show that it is abusive. In contrast, when applying the LR TAAR, one starts from the presumption that a tax avoidance scheme is relevant (i.e. the LR TAAR applies to it), unless the taxpayer can show that it is acceptable. Secondly, when considering the purpose of the relevant legislation, it is for the taxpayer to show that the result of the scheme is consistent with relevant provisions to prevent the LR TAAR from applying. Under the GAAR, it is for HMRC to show that the scheme cannot be reasonably regarded as a reasonable course of action.

In a similar vein, when applying the ‘double reasonableness test’, the taxpayer gets the benefit of the doubt as to which side of the line a scheme falls, which is not the case in respect of the LR TAAR. When considering the GAAR, if a court considers that a scheme is abusive, but acknowledges that it can be reasonably held that the scheme is not abusive, it must find that the GAAR does not apply. In contrast, when considering whether the LR TAAR applies, for the court to find in favour of the taxpayer, they need to find that the results of the scheme are positively consistent with the purpose of relevant provisions.

A final point to note is the role of the term *abusive* in the GAAR legislation which may not have a significant effect on how the GAAR applies in practice. Although the use of this term gives a flavour of the type of scheme the GAAR is designed to counteract, as Way pointed out, it is weakened by the 'double reasonableness test.'[412] Furthermore, as can be seen from Chapter III, there is uncertainty over the boundary between acceptable and unacceptable tax planning and the addition of the new term of 'abusive tax avoidance' only adds to the confusion.

The shifting of the burden of proof onto the taxpayer in LR TAAR cases should make it easier for HMRC to successfully argue that the LR TAAR applies to loan relationship avoidance schemes. However, HMRC may seek to use both the GAAR and the LR TAAR simultaneously to enable them to increase their chances of success. At least initially, the main benefit for HMRC to argue that the LR TAAR applies, but not the GAAR, is to prevent delays arising as a result of needing to obtain the opinion of the GAAR Advisory Panel.

IX.4 Broader implications for other corporation tax matters

The final section of this dissertation will seek to extend the conclusions drawn in respect of loan relationships to other corporation tax matters. Given the structural differences between the loan relationship code and other areas of the corporation tax, these conclusions are indicative only.

Firstly, the Relevant Cases show that HMRC aggressively pursues avoidance thorough the courts, with the courts viewing tax avoidance cases relatively

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[412] Way (n 32).

unsympathetically. Even in cases, such as *Mayes*,[413] where the taxpayer wins, the court makes it clear that instinctively it was the wrong result. Lord Reed, writing extra-judicially, commented that the GAAR's "practical importance depends on the extent to which the courts, applying ordinary legal principles, are otherwise tolerant of tax avoidance"[414]. Self makes a similar point, highlighting that in 2015 HMRC won 23 of 26 tax avoidance cases it took to court.[415]

Secondly, as the introduction of the LR TAAR shows, HMRC are unlikely to rely solely on the GAAR to counteract tax avoidance particularly where they perceive there to be substantial amounts of avoidance activity taking place. This goes against the original aims of the authors of the Aaronson Report, who hoped that the introduction of the GAAR would eventually lead to the simplification of current anti-avoidance rules.[416]

Thirdly, the GAAR does not solve one of the historical challenges that HMRC has faced in defeating complex tax avoidance scheme, namely, provisions which lack a clear purpose. *Mayes*[417] is the classic example of this. Although the Aaronson Report[418] considered that *Mayes* was one of the reasons why the UK needs a GAAR, it only provides half the solution in this regard. The other half is to ensure that the tax

[413] *Mayes (CA, 2011)* (n 127).
[414] Lord Reed, 'Anti-Avoidance Principles Under Domestic and EU Law' [2016] British Tax Review 288, 289.
[415] Self, 'Do We Still Need a GAAR?' (n 399).
[416] Aaronson (n 80).
[417] *Mayes (CA, 2011)* (n 127).
[418] Aaronson (n 80).

provisions have a clear purpose so that the GAAR and other measures are effective against such cases. Freedman has been advocating for this for a number of years.[419]

These comments have provided some insight into how the GAAR may apply to other areas of corporation tax, however, the ability to draw such insights has been limited by the following factors:

- Although the GAAR has been implemented for almost 5 years, there are a limited number of GAAR Advisory Panel opinions that can be considered (most of which have limited relevance to corporation tax matters) and there is no precedent on how the GAAR may apply. Until a body of relevant opinions and precedents have been created, there is significant uncertainty over how the GAAR will apply in practice.
- The introduction of LR TAAR means that the role of the GAAR in respect of loan relationship avoidance schemes is likely to be different to other areas of corporation tax. Going forward, it may be the case that there becomes a practical or political need to introduce regime TAARs in other areas of corporation tax, in which case, the conclusions drawn may become relevant to these areas.
- As the loan relationship regime is driven by accounting standards, arguably, there is less of divergence between the economic result of an arrangement and its tax result. This makes it easier to determine the 'correct' result of an arrangement (i.e. in the absence of a tax avoidance

[419] cf. Freedman, 'Defining Taxpayer Responsibility' (n 66).

motivation). As such, the insights suggested by this dissertation may be less relevant to other areas of corporation tax which are driven by legal concepts rather than accounting standards.

- Although this dissertation has mentioned the role of the Ramsay Principle in defeating loan relationship avoidance schemes, given the role of accounting principles in the loan relationship, it has concluded that the Ramsay Principle is of limited relevance to them. This is not the case in other areas of corporation tax and therefore, the interaction between the GAAR and the Ramsay Principle remains more relevant outside of loan relationships.

Given these limitations, to further develop and test the insights gained within the dissertation, the following further research could be undertaken:

a) Consideration of how the GAAR may apply in areas of corporation tax which are not primarily driven by accounting standards. In this regard, the chargeable gains regime could be profitably studied, especially given that there are a number of areas which contain closely articulated provisions, for instance the company reconstruction provisions at Section 135, Taxation of Chargeable Gains Act 1992, et sec.

b) A detailed consideration of how the Ramsay Principle and the GAAR might interact. In this regard, the Capital Allowance regime may be usefully studied as there are two important Ramsay principle cases that deal with the capital allowance regime, namely, *BMBF*[420] and *Tower MCashback*,[421] and HMRC's GAAR Guidance[422] contains a GAAR analysis of the facts of the *BMBF* case.

c) Review of whether internationally there may be lessons the UK could learn from other nations that could test or strengthen further our own approach to tax avoidance.

As Self noted, given how long it takes for tax cases to proceed through the courts, it may not be until the mid-2020's that the true impact of the GAAR is known. [423] This is likely also to be the case in respect of the LR TAAR. As such, the conclusions and insights developed within this dissertation, whilst helpful, will remain provisional until such time that sufficient judicial precedents are created against which they can be validated.

[420] *BMBF (HL, 2004)* (n 45).
[421] *Tower MCashback (SC, 2011)* (n 54).
[422] HMRC, '2018 GAAR Guidance' (n 96).
[423] Self, 'Do We Still Need a GAAR?' (n 399).

APPENDIX A: ANALYSIS OF WESTLAW SEARCH

A.1 List of results

Case name	Citations identified	Included
Abbey National Treasury Services Plc v HMRC	FTT: [2015] UKFTT 341 (TC), [2015] SFTD 929	No
A.H. Field (Holdings) Limited v HMRC	FTT: [2012] UKFTT 104 (TC)	Yes
Autoclenz v Belcher and Others	SC: [2011] UKSC 41, [2011] STC 745	No
Bank of Ireland v HMRC	CA: [2008] EWCA Civ 58, [2008] STC 398	Yes
Bowring and another v HMRC	UT: [2015] UKUT 550 (TCC), [2016] 816;	No
Cater Allen International Limited and another v HMRC	FTT: [2015] UKFTT 232 (TC), [2015] SFTD 765	Yes
Chappell v HMRC	FTT: [2013] UKFTT 98 (TC), [2013] SFTD 733 UT: [2014] UKUT 344 (TCC), [2015] STC 271 CA: [2016] EWCA Civ 809, [2016] STC 1980	No
Charlton v HMRC	FTT: [2011] UKFTT 467(TC), [2011] SFTD 1160	No
Cheshire Employer and Skills Development Limited v HMRC	UT: [2011] UKUT 329 (TCC), [2012] STC 69	No
DCC Holdings (UK) Limited v HMRC	HC: [2008] EWHC 2429 (Ch), [2009] STC 77 CA: [2009] EWCA Civ 1165, [2010] STC 80	Yes

Case name	Citations identified	Included
	SC: [2010] UKSC 58, [2011] STC 326	
Explainaway Limited and other v HMRC	FTT: [2011] UKFTT 414 (TC), [2011] SFTD 1105	No
Fidex Limited v HMRC	FTT (No. 1): [2011] UKFTT 713 (TC)	Yes
	FTT (No. 2): [2013] UKFTT 212 (TC), [2013] SFTD 964	
	UT: [2014] UKUT 454 (TCC), [2015] STC 702	
	CA: [2016] EWCA Civ 385, [2016] STC 1920	
GDF Suez Teesside Limited (formerly Teesside Power Limited) v HMRC	FTT: [2015] UKFTT 413 (TC)	Yes
	UT: [2017] UKUT 68 (TCC), [2017] STC 1622	
Greene King PLC and another v HMRC	FTT: [2012] UKFTT 385 (TC), [2012] SFTD 1085	Yes
	UT: [2014] UKUT 178 (TCC), [2014] STC 2439	
	CA: [2016] EWCA Civ 782, [2017] STC 615	
Hancock and another v HMRC	FTT: [2014[UKFTT 695 (TC), [2014] SFTD 1163	No
R. (on the application of Huitson) v HMRC	CA: [2011] EWCA Civ 893, [2011] STC 1860	No
Lankhorst-Hohorst GmbH v Finanzamt Steinfurt	ECJ: (Case C-324/00), [2003] STC 608	No

Case name	Citations identified	Included
Lloyds TSB Equipment Leasing (No 1) Ltd v HMRC	CA: [2014] EWCA Civ 1062, [2014] STC 2770	No
MJP Media Services Limited v HMRC	FTT: [2010] UKFTT 298 (TC), [2010] SFTD 1038 UT: [2011] UKUT 100 (TCC), [2011] STC 2290	No
Potts Executors	HL: [1951] 1 All ER 76 (HL)	No
R. (on the application of Shiner) v HMRC	CA: [2011] EWCA Civ 892, [2011] STC 1878	No
Smith and Nephew Overseas Limited and others v HMRC	FTT: [2017] UKFTT 151 (TC), [2017] SFTD 678	Yes
Stagecoach Group Plc and another v HMRC	FTT: [2016] UKFTT 120 (TC), [2016] SFTD] 982	Yes
Travel Document Services v HMRC[424]	FTT: [2015] UKFTT 582 (TC), [2016] SFTD 186 UT: [2017] UKUT 45 (TCC), [2017] STC 973	Yes
Verteegh Limited v HMRC (sub nom Spritebeam Ltd and others v HMRC and another)	FTT: [2013] UKFTT 642 (TC), [2014] SFTD 547 UT: [2015] UKUT 75 (TCC), [2015] STC 1222	Yes
Vocalspruce Limited v HMRC	CA: [2014] EWCA Civ 1302, [2015] STC 861	Yes

[424] For completeness, this search was undertaken prior to the Court of Appeal hearing this case.

A.2 Rationale for exclusion

With the exception of the *MJP Media*[425] and *Lankhorst-Hohorst*[426] cases, a review of each case indicated that loan relationships were not the primary subject matter. This determination was based on a review of the facts contained within Simon's Tax Cases summary introducing the judgement. Where the case was not included in Simon's Tax Cases, the summary used was either from Simon's First-tier Decisions and All England Law Reports. The below table outlines the primary subject matter of each case. The use of one of these two alternative sources is indicated by the abbreviations 'STFD' or 'All ER' as appropriate.

Case	Subject Matter
Abbey National Treasury Services Plc	Derivative contacts
Autoclenz v Belcher	Employment status
Bowring	Trusts
Chappell	Income tax – manufactured overseas dividend
Charlton	Discover assessments (SFTD)
Cheshire Employer and Skills Development Limited	National Insurance Contributions
Explainaway	Derivatives
Hancock	Capital Gains Tax – Qualifying Corporate Bonds (SFTD)

[425] *MJP Media (CA, 2012)* (n 42).
[426] Case C-324/00 *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt* [2003] STC 607.

Case	Subject Matter
Huitson [R. (on the application of Huitson)]	Income tax – double tax relief
Lloyds TSB Equipment Leasing (No 1) Ltd	Capital allowance
Potts Executors	Trusts (All ER)
Shiner [R. (on the application of Shiner)]	Income tax – double tax relief

With respect to the final two excluded cases, namely *MJP Media* and *Lankhorst-Hohorst*, although both involved money debts held by corporates, neither were considered relevant to this dissertation. The question in *MJP Media* was whether an intra-group debt arose from a transaction of the lending of money and therefore should be considered a loan relationship. There did not appear to be an avoidance motive involved, and instead it comes down to the question of whether the taxpayer could evidence whether the debts in question arose from a transaction of the lending of money (which they could not). *Lankhorst-Hohorst* is not considered relevant because it is a German tax case and it does not appear to involve tax avoidance.

APPENDIX B: STATUS OF THE RELEVANT CASES

Case name	Highest Court to date	Victory for	Current status
A.H. Field	UKFTT (2012)	HMRC	Final[427]
Bank of Ireland	EWCA Civ (2008)	Taxpayer	Final[428]
Cater Allen	UKFTT (2015)	HMRC	Final[429]
DCC Holdings	UKSC (2010)	HMRC	Final[430]
Fidex	EWCA Civ (2016)	HMRC	Final[431]
GDF Suez Teesside	UKUT (2017)	HMRC	Awaiting CA judgement[432]
Greene King	EWCA Civ (2016)	HMRC	Assumed final[433]
Iliffe News and Media	UKFTT (2012)	Mixed[434]	Final[435]

[427] As the FTT's decision was handed down in 2012, it seems reasonable to assume this case is no subject to appeal

[428] As CA's judgement was handed down in 2008, it seems reasonable to assume this case is no subject to appeal.

[429] As the FTT's decision was handed down in 2015, it seems reasonable to assume this case is no subject to appeal

[430] As the Supreme Court is the highest court in the UK, this can cannot be subject to further appeal.

[431] As this case is not shown as being subject to appeal in Tax Journal's Case Tracker and the CA's judgement was handed down in 2016, it seems reasonable to assume this case is no subject to appeal (Tax Journal [n 241]).

[432] HM Courts & Tribunals Service, 'Case Tracker for Civil Appeals [Re: Suez Teesside]' <https://casetracker.justice.gov.uk/getDetail.do?case_id=20171070> accessed 26 May 2018.

[433] As this case is not shown as being subject to appeal in Tax Journal's Case Tracker and the CA's judgement was handed down in 2016, it seems reasonable to assume this case is no subject to appeal (Tax Journal [n 241]).

[434] Overall, the FTT found in favour of HMRC, however, it was a mixed result on Section 441 issue as although the FTT found that the taxpayer had an unallowable purpose for being party to the loan relationship in question, the FTT found that on a just and reasonable basis, none debits arising from that loan relationship were attributable to that unallowable purpose.

[435] As the FTT's decision was handed down in 2012, it seems reasonable to assume this case is no subject to appeal

Case name	Highest Court to date	Victory for	Current status
Smith and Nephews	UKFTT (2017)	The taxpayer	UT was due to hear appeal in June 2018[436]
Stagecoach	UKFTT (2016)	HMRC	Unknown[437]
Travel Document Services	EWCA Civ (2018)	HMRC	Unknown
Verteegh (sub nom Spritebeam)	UKUT (2015)	HMRC	Final[438]
Vocalspruce	UKUT (2017)	HMRC5	Final[439]

[436] Tax Journal (n 241).
[437] Although this case is not shown on Tax Journal's Case Tracker, as it is not shown as listed as being subject to appeal on HM Courts and Tribunals Services website, it appears reasonable to assume that this case is no subject to appeal (ibid; 'Upper Tribunal (Tax and Chancery) Hearings and Register' <https://www.gov.uk/government/publications/upper-tribunal-tax-and-chancery-register-of-cases/upper-tribunal-tax-and-chancery-hearings-and-register-web-table> accessed 17 March 2018).
[438] Tax Journal (n 241).
[439] ibid.

APPENDIX C: REFERENCES TO RAMSAY IN THE RELEVANT CASES

Case	**Court**	**Referred to *Ramsay*[440]**	**Referred to *BMBF*[441]**
A.H. Field	UKFTT	No	Yes
Bank of Ireland	EWCA Civ	No	No
	EWHC (Ch)	No	No
	SpC	No	No
Cater Allen	UKFTT	No	No
DCC Holdings	UKSC	No	No[442]
	EWCA Civ	No	No
	EWHC (Ch)	No	No
	SpC	No	No
Fidex	EWCA Civ	No	No
	UKUT	No	No
	UKFTT	No[443]	Yes
GDF Suez Teesside	UKUT	No	No
	UKFTT	No	No
Greene King	EWCA Civ	No	No

[440] *Ramsay (HL, 1981)* (n 53).
[441] *BMBF (HL, 2004)* (n 45).
[442] Although BMBF is not cited in Lord Walker SCJ's sole judgement in this case, within the Simon's Tax Cases summary of this case, *BMBF* is lists as being referred to in the list of authorities.
[443] Notwithstanding that Simon's Frist Tier Decisions summary of this case indicates that that *Ramsay* case was cited, a review of the decision shows that although Ramsay principle was referred to, the *Ramsay* case was not explicitly cited.

Case	Court	Referred to *Ramsay*[440]	Referred to *BMBF*[441]
	UKUT	No	No
	UKFTT	No	No
Iliffe News and Media	UKFTT	No[444]	No
Smith and Nephews	UKFTT	No	No
Stagecoach	UKFTT	Yes	Yes
Travel Document Services	EWCA Civ	No	No
	UKUT	No	No
	UKFTT	No	No
Verteegh	UKUT	No	Yes
	UKFTT	No	No
Vocalspruce	EWCA Civ	No	No
	UKUT	No	Yes
	UKFTT	No	Yes

[444] Notwithstanding that Simon's Frist Tier Decisions summary of this case indicates that that Ramsay case was cited, a review of the decision shows that although Ramsay principle was referred to, the Ramsay case was not explicitly cited.

APPENDIX D: ANALYSIS OF THE RELEVANT CASES

Prior to outlining the analysis for each of the Relevant Cases, the structure of these analyses will be briefly considered. As noted in Section II.2.2, these case analyses are based on the examples provided in Part D of HMRC's GAAR Guidance.[445] Within Part D, HMRC's analysis of each example is structured as follows.

1. HMRC provide a summary of the background to the provisions which are relevant to the arrangement.
2. HMRC outlines the facts for each arrangement, noting the relevant provisions and the taxpayer's analysis.
3. HMRC undertakes a GAAR analysis on the arrangement by considering five questions, namely:
    a. Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?
    b. Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?
    c. Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?
    d. Does the arrangement include any of the indicators of abusiveness within s207(4) of FA 2013?

[445] HMRC, '2018 GAAR Guidance' (n 96).

   e. Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?

4. Finally, HMRC concludes on whether it is the type of arrangement they would seek to use the GAAR to counteract.

The structure of the case analyses contained within this appendix are similar:

1. First, the facts of the schemes are outlined, together with the taxpayer's analysis and a brief summary of the outcome of the case. These sections are largely based on the judgements of the courts in each of the cases. Although analyses do not contain a separate section detailing the background of each of the relevant provisions, their purpose is considered as part of the GAAR and LR TAAR analyses.
2. In order to consider whether the GAAR or LR TAAR would apply, six key questions are considered. Of these, the first four are the same as the first four questions, or slightly shorted versions, contained within HMRC's GAAR analysis. The two additional questions are:
   a. Does the arrangement exhibit any of the examples in Section 455D, CTA 2009? - This question mirrors one of the questions asked within HMRC's analysis (see question (d) above), except it refers to the examples Section 455D, rather that the indicators as Section 207(4).
   b. Does the LR have an unallowable purpose?

In addition to using the facts of the Relevant Cases, when answering these questions, particular emphasis is placed on any relevant comments made by the judges who heard the cases.

For completeness, these analyses have been undertaken on the assumption that these schemes do not accord with established practice and have never been accepted by HMRC.

3. The final section of the analyses concludes on whether HMRC would look to use the GAAR or LR TAAR against the schemes in question.

D.1 *A.H. Field*[446]

D 1.1 Outline of scheme

The scheme in this case is relatively simple. A.H. Field (Holdings) Limited ('Field') was a subsidiary of A.H. Field (Overseas Investments) Limited ('Overseas'), which in turn was owned by A.H. Field (Holding) Jersey Limited ('Holdings Jersey'). Field borrowed £2m for a bank, which was repayable in three days. This cash was used to pay a dividend to Overseas, which then paid a dividend to Holdings Jersey. Field then issued Jersey Holdings a discounted zero-coupon note (the 'ZCN') repayable in 363 days. The ZCN had an issue price of £2m and a nominal value of £2.15m. The proceeds from this bond issue were used to repay the bank.

Field claimed a tax deduction in respect of the unwinding of the discount on the ZCN. Although Holdings Jersey was taxable on the unwinding of the discount, at the

[446] *A.H. Field (FTT, 2012)* (n 18).

time, the corporation tax rate in the UK was 30%, whereas the corporation tax rate in Jersey was only 2%, this structure therefore gave rise to a tax saving of 28%.

D 1.2 Key elements of the tax analysis

D.1.2(a) Is the result consistent with the purpose of the relevant tax provisions?

This question is more complex that it first appears. This is because this case is so clearly within the scope of Section 441, to be able to undertake properly a GAAR or LR TAAR analysis in accordance with the methodology, it is necessary first to presuppose the reasons why Section 441 did not apply. There are two options why this may have been the case, either Section 441 did not exist or for some for some technical reason, Section 441 could not have been applied. However, the challenge undertaking an analysis on the basis of the second presupposition, is that it would depend on the reasons why Section 441 did not apply. For instance, is it because of a natural weakness in the legislation,[447] or did the taxpayer manipulate the situation to prevent Section 441 from applying, or something else? Given these challenges, the only reasonable basis to undertake a GAAR and LR TAAR analysis appeared to be to assume that Section 441 did not exist.

On the presumption that Section 441 did not exist, taking a deduction for the debits arising from the unwinding of the discount on the ZCNs would have been consistent with the purposes the loan relationship regime. That is because Fields was legally party to a loan relationship, giving rise to accounting debits in its P&L, which

[447] It is interesting to note Lord Walker SCJ's comment in DCC Holdings that HMRC did not seek to apply Section 441 in that case "partly it seems because of doubts (since removed by an amendment) as to its efficacy" (*DCC Holdings (SC, 2010)* [n 21] [22]).

prima facia should be deductible. Notwithstanding the ZCN were put in place with a tax avoidance motive in mind, without Section 441, there are no reasons why a deduction for such debits should be disallowed.

This position should be challenged by arguing it would be inconsistent with the broader purposes of the tax regime for a deduction to be claimed for a cost that did not have a valid business purposes. The difficulty with this position would be that had the loan relationship regime lacked Section 441 (or an equivalent), then relying on that deficit would not be seeking to exploit a shortcoming or 'loop-hole' but merely relying on the legislation applying as intended.

D.1.2(b) Does the arrangement involve one or more contrived or abnormal steps?

Although the taxpayer sought to argue that it had a commercial purpose for putting the ZCNs into place, the FTT found a lack of evidential support for this argument. Furthermore, the FTT found that "the structure set in place was largely self-cancelling."[448] As such, the answer to this question should be yes.

D.1.2(c) Does the arrangement exploit a shortcoming in the relevant provisions?

On the presumption that Section 441 did not exist, then the answer would probably be no, the scheme did not exploit a shortcoming in the relevant provisions. For without Section 441, the debits arising from a loan relationship would not need to be tested to determine if that relationship had an allowable purpose.

[448] *A.H. Field (FTT, 2012)* (n 18) [106].

D.1.2(d) Does the arrangement exhibit any of the indicators of abusiveness listed in Section 207(4), FA 2013?

No, from the taxpayer's point of view, the unwinding of the discount on the ZCNs gave rise to a commercial cost, for which a deduction was claimed. Even from a group perspective, the deduction claimed by Fields should have been offset set by matching income in Holdings Jersey, which were not subject to UK corporation tax.

D.1.2(e) Does the arrangement exhibit any of the examples in Section 455D, CTA 2009?

Again, the answer is no, for the reasons outlined above in respect of Section 207(4).

D.1.2(f) Does the LR have an unallowable purpose?

Given the analysis of *AH Fields* is being undertaken on the presumption that Section 441 did not exist when the transaction was entered into, this question is no longer relevant. That said, the FTT did find that the "ZCN had as one of its main purposes the obtaining of a tax advantage, namely the tax deductions available in the UK for the discount element of the ZCN."[449]

D 1.3 Summary of conclusions

D.1.3(a) GAAR

Although there was limited commercial rationale for entering into the scheme and, in effect, it was circular, in the event that Section 441 did not exist, the GAAR is unlikely to have applied. This is because none of the indicators of lists at Section 207(4)

[449] ibid 178.

are present and the outcome of the scheme was consistent with the purpose of the relevant provisions (in the absent of Section 441).

D.1.3(b) LR TAAR

In the absence of Section 441, the outcome of the scheme would have been consistent with the purposes of the loan relationship regime and none of the examples which would indicate non-exclusion were present. As such, the TAAR is unlikely to be applicable.

D.2 Bank of Ireland Britain[450]

D 2.1 Outline of scheme

The taxpayer in this case was Bank of Ireland Britain Holdings Limited ('BH'), which was a UK subsidiary of Bank of Ireland ('BI'), an Irish resident company. This scheme was sold by the Morgan Stanley group, and involved two Cayman Island companies within the Morgan Stanley group, MSDW Birkdale Limited ('Birkdale') and its subsidiary MSDW Portrush Limited ('Portrush'). The scheme involved the following:

1. Portrush issued preference shares to Birkdale for consideration of £225m.
2. On 10 November 2000, Birkdale, BI and BH agreed to enter into a tripartite sale and repurchase agreement in respect of the Portrush preference shares.
3. On 14 November 2000 BI acquired the preference shares from Birkdale for £225m. During the period that BI owned the preference shares, it received £3.6m of dividends.

[450] *Bank of Ireland (CA, 2008)* (n 19).

4. On 23 February 2001 BI sold the preference shares to BH for £225m.[451] During the period that BH owned the preference shares, it received £0.4m of dividends.
5. On 5 March 2001, Birkdale repurchased the preference shares for £225m plus the equivalent of 8.3% p.a. interest and breakage costs, less the dividends received by BI and BH divided by 0.7. The scheme was designed to ensure that these adjustments cancelled each other out such that the repurchase price was £225m.

BH sought to argue that the tax legislation worked such that it should be treated as making a deductible deemed manufactured payment of £4m (i.e. 8.3% pa interest on the deemed loan from Birkdale), whereas it should only be taxed on the dividend it received giving rise to a net deduction of £3.6m. Interestingly, this is one of the few cases where the taxpayer succeeded in their argument that the scheme gave rise to the desired result, with the Court of Appeal finding that:

> *it is true that in this case a tripartite scheme has been devised which takes advantage of a mis match between the two sets subsections. … But I do not consider that there is any legitimate process of interpretation which seeks to solve the revenue's problem.*[452]

[451] Under the terms of the preference shares, dividends were payable monthly, with the directors of Portrush having the discretion to pay special dividends at other times. These provisions were used during the scheme, such the when BH and BI sold the preference shares, they would receive a special dividend such that in total, the dividends accruing during their period of ownership were paid to them.
[452] *Bank of Ireland (CA, 2008)* (n 19) [44].

D 2.2 Key elements of the tax analysis

D.2.2(a) Is the result consistent with the purpose of the relevant tax provisions?

No, the Court of Appeal considered that the relevant legislation was designed to mirror the economic substance of the arrangement, that is to say, as if the repo gave rise to a loan. If BH was taxed in such a way, it would have realised a profit of £0.4m. However, as this scheme allowed BH to claim a deduction for a net loss of £3.6m, the result was not consistent with the purpose of the relevant legislation.

D.2.2(b) Does the arrangement involve one or more contrived or abnormal steps?

Although the Court of Appeal's judgement does not refer to why the scheme was entered into, based in the facts of the case, it seems reasonable assume that this scheme was contrived.

D.2.2(c) Does the arrangement exploit a shortcoming in the relevant provisions?

Yes, Collins LJ found that this is a case where "a tripartite scheme has been devised which takes advantage of a mismatch between two sets of section."[453]

D.2.2(d) Does the arrangement exhibit any of the indicators of abusiveness listed in Section 207(4), FA 2013?

Yes, the indicator listed at Section 207(4)(a) and (b) were relevant as the scheme allowed the company to claim a net deduction of £3.6m, whereas, in reality it made an economic profit of £0.4m.

[453] ibid.

D.2.2(e) Does the arrangement exhibit any of the examples in Section 455D, CTA 2009?

Yes, the examples listed at Section 455D(1)(a) and (b), for the reasons noted in respect of Section 207(4).

D.2.2(f) Does the LR have an unallowable purpose?

Although not mentioned by the Court of Appeal, given the scheme, it is likely that had there been a deemed loan relationship between BH and Birkdale, it would have had an unallowable purpose.

D 2.3 Summary of conclusions

D.2.3(a) GAAR

HMRC are likely to have sought to use the GAAR against the scheme in this case as it clearly sought to exploit a shortcoming in the relevant provisions and enabled BH to claim a loss of £3.6m, whereas, it realised a gain of £0.4m

D.2.3(b) LR TAAR

HMRC are likely to have sought to use the LR TAAR against the scheme in this case for the reasons mentioned in respect of the GAAR.

D.3 Cater Allen[454]

D 3.1 Outline of scheme

The taxpayer in this case, Abbey National Treasury Services plc ('ANTS), was a subsidiary of a Spanish bank, Banco Santander SA ('Santander'). Prior to entering into the scheme, ANTS had acquired two mortgage-backed floating-rate securities ('FRSs')

[454] *Cater Allen (FTT, 2015)* (n 20).

worth a total of €4.9bn from Santander for commercial reasons. As part of the scheme, in March 2007 ANTS and Santander entered into a sale and repurchase agreement[455] whereby ANTS sold the right to receive the interest accruing on the FRSs between January 2007 to July 2007 for €86m, with a repurchase date of no later than 2 July 2007 (the 'Repo'). During the period of the Repo, two interest payments were received by ANTS totalling €78m, which were passed onto Santander. ANTS then repurchased the right to receive the interest arising for €6m.

From an accounting perspective, ANTS was treated as continuing to be entitled to receive the income arising from the FRSs throughout the period of the Repo and the amount received by ANTS upon entering into the Repo was treated as secured loan. As ANTS continued to reconsider the FRSs on its balance sheet, the interest received by ANTS during the Repo period gave rise to a P&L credit.

ANTS sought to argue that the interest income it received was not taxable. Although ANTS submitted a number of arguments to support its position, there were two main ones. Firstly, the interest paid on the FRSs did not belong to ANTS and, secondly, the transaction should be taxed in accordance with its legal form. The FTT rejected ANTS's argument and found that the interest received by ANTS from the FRSs did give rise to taxable income.

[455] For completeness, the repurchase of the FRSs by ANTS was ensured as a result of the existence of cross options between ANTS and Santander, rather than the repurchase being pre-contracted.

D 3.2 *Key elements of the tax analysis*

D.3.2(a) Is the result consistent with the purpose of the relevant tax provisions?

No, the taxpayer's analysis led to a result which would have been inconsistent with the relevant provision. The taxpayer in this case sought to avoid needing to bring into account credits for tax purposes because they related to interest income that does not legally belong to ANTS. This can be contrasted with the FTT finding that the starting point for determining a company's loan relationship profits are those shown in its accounts and that "it is only in relatively unusual circumstances the tax legislation should move away from that."[456]

D.3.2(b) Does the arrangement involve one or more contrived or abnormal steps?

The FTT's decision does not specifically comment on whether the taxpayer undertook this scheme for commercial reasons and banks do enter repo transactions for bona fide commercial reasons. That said, the FTT does note that the scheme was notifiable to HMRC under the DOTAS regime, which would indicate that this scheme was at least partly tax driven. Given the lack of specific evidence it is difficult to conclude on this point, however, for the purposes of this analysis, it is assumed that the main reason ANTS entered into the Repo was the anticipated tax benefit.

D.3.2(c) Does the arrangement exploit a shortcoming in the relevant provisions?

The purpose of the loan relationship regime is to bring into account for tax purposes the accounting profit or loss arising from loan relationships. Given that repo transactions are accounted for in accordance with their economic substance, as

[456] *Cater Allen (FTT, 2015)* (n 20) [64].

opposed to their legal form, the loan relationship regime includes specific provisions to ensure that their treatment for tax purposes is aligned to how they are accounted for. For instance, Paragraph 16, Schedule 9, FA 1996 provides that the legal disposal of a loan relationship under a repo agreement is not considered a related transaction. The taxpayer in this case sought to exploit a shortcoming in the relevant provision by arguing the interest income it recognised in its accounts could not be brought into account because that interest did not arise from a loan relationship it was legally party to. However, it appears clear that the relevant provisions were intended to bring that interest income into tax.

D.3.2(d) Does the arrangement exhibit any of the indicators of abusiveness listed in Section 207(4), FA 2013?

Yes, specifically the example at Section 207(4)(a) as, on the taxpayer's analysis, although commercially it generated a profit from the interest it received, it did not need to bring all of the income into tax.

D.3.2(e) Does the arrangement exhibit any of the examples in Section 455D, CTA 2009?

Yes, specifically the example at 455D(1)(a), for the same reasons as in respect of Section 207(4)(a).

D.3.2(f) Does the LR have an unallowable purpose?

Although the FTT acknowledged that ANTS acquired the FRNs from Santander for commercial reasons, the FTT's decision does not comment on whether ANTS also had a commercial reason for entering into the repo. In any case, given that this scheme sought to prevent interest income from being taxable, Section 441 was not relevant.

D 3.3 Summary of conclusions

D.3.3(a) GAAR

On the assumption that ANTS did not have a good commercial reason for entering into the repo, it is likely that the GAAR would have applied to the scheme in this case, as it is clearly designed to allow the taxpayer to prevent a tax charge arising on the interest income it received on the FRNs.

D.3.3(b) LR TAAR

For similar reasons, it is likely that the LR TAAR would have applied. Although the LR TAAR does not specifically refer to 'shortcomings', given that the scheme is clearly intended to exploit a shortcoming in the loan relationship regime, it is would be difficult to argue that the overall result is consistent with the purposes of the loan relationship regime.

D.4 DCC Holdings[457]

D 4.1 Outline of scheme

The scheme in this case, like in *Bank of Ireland*, involved the use of a repo. DCC Holdings (UK) Limited ('DCC') undertook a series of transactions with Bank X (an overseas bank), in which DCC purchased gilts from Bank X for a total of £812.2m, with Bank X agreeing to repurchase the gilts for £785.2m approximately 18 ½ days later. Under the terms of the repo, DCC was entitled to retain any interest paid on the gilts

[457] *DCC Holdings (CA, 2009)* (n 234); *DCC Holdings (SC, 2010)* (n 21).

during its period of ownership, although the repurchase price would be reduced by the interest received. During DCC's ownership, it received £28.8m of interest from the gilts. The net result of these transactions was that DCC made a commercial profit of £1.8m.

The taxation of these transactions can be split into three elements. Firstly, how should the difference between the original purchase price and the repurchase price be brought into tax? In this regard, both DCC and HMRC agreed that when calculating the profit or loss arising to DCC, the interest received by DCC needed to be added to the repurchase price, such that DCC made a net taxable profit of £1.8m. Secondly, as under the relevant statutory provisions DCC was treated as paying a 'deemed manufactured dividend' equal to the interest received on the gilts; how should this deemed manufactured dividend should be brought into account? DCC sought to argue that under the relevant provisions, the whole of the deemed manufactured dividend should be treated as deductible. Thirdly, how should the interest income received by DCC be taxed? DCC sought to argue that as it only had beneficial ownership of the gilts for a short period of time, under an accrual's basis of accounting, it only needed to recognise the element of the interest which accrued during its ownership. This lead to the conclusion that DCC should only be required to bring into tax £2.9m of interest income, rather than the £28.8m it in fact received. Had DCC been successful in asserting its arguments, then it would have been able to claim a deduction for the whole deemed manufactured dividend, but only taxed on an element of the interest it received from the gilts.

HMRC successfully challenged this scheme by arguing that the amounts recognised by DCC did not 'fairly represent' the profits arising to DCC from its loan relationships. In the Supreme Court, Lord Walker considered "that the majority of the Court of Appeal were right to see the overwhelming need for a symmetrical solution"[458] whereby the taxable debits from the deemed manufactured dividend equalled the credits arising from the interest received on the gilts.

D 4.2 Key elements of the tax analysis

D.4.2(a) Is the result consistent with the purpose of the relevant tax provisions?

Lord Walker SCL, who gave the sole judgement in the Supreme Court, considered that the purpose of the relevant provisions was to tax the economic substance of the repo. That is to say, the relevant provisions were designed to apply in such a way that DCC Holding should be taxed on the £1.8m of income it generated. However, the scheme was designed to give rise to DCC Holding obtaining a net deduction of £24.1m, a result which was inconsistent with the relevant provisions.

D.4.2(b) Does the arrangement involve one or more contrived or abnormal steps?

As the repo agreement were only outstanding for a short period of time (an average of 18 ½ days), it seems reasonable to assume this scheme contained contrived steps.

D.4.2(c) Does the arrangement exploit a shortcoming in the relevant provisions?

Given that Lord Walker SCJ described the result of DCC Holding's analysis as absurd, it seems clear that the scheme was designed to exploit a shorting coming in the relevant provisions. Specifically, it was designed to exploit inconsistences between how the repo rules operated and the accruals basis of accounting.

[458] *DCC Holdings (SC, 2010)* (n 21) [44].

D.4.2(d) Does the arrangement exhibit any of the indicators of abusiveness listed in Section 207(4), FA 2013?

Yes, the indicator listed at Section 207(4)(a) and (b), as it was designed to allow DCC Holdings to claim a net deduction of £24.1m, whereas, in reality it made an economic profit of £1.9m.

D.4.2(e) Does the arrangement exhibit any of the examples in Section 455D, CTA 2009?

Yes, the examples listed at Section 455D(1)(a) and (b), for the reasons noted in respect of Section 207(4).

D.4.2(f) Does the LR have an unallowable purpose?

Lord Walker SCJ indicated that HMRC decided not to invoke Paragraph 13 in this case because of they had doubts whether Paragraph 13 was effective.

D 4.3 Summary of conclusions

D.4.3(a) GAAR

HMRC are likely to have sought to use the GAAR in the case because it attempted to exploit a shortcoming in the relevant provisions and enabled the DCC Holdings to claim a large tax deduction when in fact the company made an economic profit from the arrangement.

D.4.3(b) LR TAAR

HMRC are likely to have sought to use the LR TAAR in this case for the reasons outline above in respect of the GAAR.

D.5 Fidex[459]

D 5.1 Outline of scheme

This case involved a tax avoidance scheme designed by Swiss Re and involving Fidex Limited ('Fidex'), a company in the BNP Paribas Group. Under the scheme Fidex, a company which held a loan portfolio, issued five classes of preference shares to Swiss Re, the terms of which gave Swiss Re, 95% of the economic rights arising from Fidex's loan portfolio. At the time the shares were issued, Fidex's accounts were prepared under UK GAAP. At the end of 2005, Fidex decided to convert from UK GAAP to International Financial Reporting Standards ('IFRS'). As, under the terms of the preference shares, 95% of the economic rights associated with the loan portfolio were transferred to Swiss Re, upon conversion to IFRS Fidex was required to de-recognise 95% of the loan portfolio from its balance sheet.

Under the loan relationship regime, upon conversion to IFRS, if the value of an asset or liability changes, then the resulting debit or credit is to be brought into account for tax purposes. In Fidex's case, converting to IFRS gave rise to a €84m debit, which was treated as deductible.

HMRC challenged this scheme by arguing that Fidex had both an allowable purpose and an unallowable purpose for holding the loan portfolio at the time of the scheme, with the whole debit arising upon conversion to IFRS attributable to that

[459] *Fidex (FTT, 2013)* (n 324); *Fidex Limited v HMRC* [2014] UKUT 454 (TCC), [2015] STC 702; *Fidex (CA, 2016)* (n 22).

unallowable purpose, such that the debit was non-deductible as a result of Paragraph 13. The FTT agreed with HMRC's analysis in this regard.

D 5.2 Key elements of the tax analysis

D.5.2(a) Is the result consistent with the purpose of the relevant tax provisions?

The purpose of Paragraph 19A, appears to be to ensure that when a company converts to IFRS any credit or debit arising as a result of the conversion are subject to tax. This provision is necessary to ensure that either a non-taxable credit (which would be to the detriment of HMRC) or a non-deductible debit (which would be to the detriment of the taxpayer) does not arise. There is an argument that this scheme is consistent with the purpose of this provision as the debit in question only arises as a result of conversion to IFRS, albeit the decision to convert was tax driven.

However, this argument appears to be over reliant on taking a narrow view of the purpose of Paragraph 19A, given the specific transaction was designed to ensure that only debits arose. A broader view of this paragraph would see its purpose as ensuring that all debits and credits arising from loan relationships are brought into account where discontinuities could arise as a result of conversion. In effect, this is an attempt to ensure a 'fair' result arises upon conversion to IFRS. Although when it comes to tax matters, there is a broad range of views as to what is fair, the view that this scheme gave rise to an unfair tax result would be difficult to contest. As such, it would be reasonable to conclude that the outcome of this scheme was not consistent with the purpose of Paragraph 19A.

D.5.2(b) Does the arrangement involve one or more contrived or abnormal steps?

As this scheme was specifically designed to give rise to a tax deduction and there does not appear to be a commercial purpose for issuing the preference shares, this scheme should be considered wholly contrived. This position is further supported by the Court of Appeal's finding that the "debit arose from and was entirely attributable to Project Zephyr [the code name of the transaction]. But for this tax avoidance scheme there would have been no debit at all."[460]

D.5.2(c) Does the arrangement exploit a shortcoming in the relevant provisions?

It would be difficult to argue that this scheme exploited a 'shortcoming' in Paragraph 19A. Although arguably this paragraph was designed to produce a symmetrical result, whereas the scheme produced an asymmetrical result, it would appear reasonable to assume that the parliamentary draughtsman should have contemplated that some companies would convert to IFRS solely to obtain a tax benefit. Consequently, it seems unreasonable to conclude that the failure of this provision to prevent this kind of tax avoidance arrangement arose from the exploitation of a shortcoming.

[460] *Fidex (CA, 2016)* (n 22) [[74]].

D.5.2(d) Does the arrangement exhibit any of the indicators of abusiveness listed in Section 207(4), FA 2013?

Yes, this scheme “delivered a trading loss equal to the reduction in value of the bonds, without any economic loss being suffered.”[461] This language mirrors the language contained within Section 207(4)(a).

D.5.2(e) Does the arrangement exhibit any of the examples in Section 455D, CTA 2009?

Yes, for the reasons outlined above in respect of Section 207, this scheme exhibits the example listed at Section 455D(1)(a)

D.5.2(f) Does the LR have an unallowable purpose?

The Court of Appeal was “content to assume that Fidex would have held the bonds from the start of 2005 [the first year Fidex prepared its accounts under IFRS] irrespective of the unallowable purpose” arising from the scheme.[462]

D 5.3 Summary of conclusions

D.5.3(a) GAAR

This is the type of scheme to which HMRC would look to apply the GAAR. It would be difficult to argue that the scheme could reasonably be regarded as a reasonable course of action in relation to Paragraph 19A. This is because the issuance of the preference shares was clearly designed to allow most of Fidex’s loan portfolio to be derecognised on conversion to IFRS and therefore produce a deductible debit.

[461] ibid [16].
[462] ibid 74.

D.5.3(b) LR TAAR

Given that it would be challenging to argue that the result of this scheme is reasonably consistent with the purpose of the relevant provisions, HMRC would likely use the LR TAAR to try to counteract it, particularly given that the scheme appears to be the embodiment of one of the examples in Section 455D (namely 455D(1)(a)).

D.6 *Greene King*[463]

D 6.1 Outline of scheme[464]

The scheme in *Greene King* involved three companies within the Greene King group, Greene King PLC ('PLC'), Greene King Brewing and Retailing Limited ('GKBR', a direct subsidiary of PLC) and Greene King Acquisitions Limited ('GKA', an indirect subsidiary of PLC). At the time of the transaction, there was a £300m interest bearing debt between PLC, as lender, and GKBR, as borrower (the 'Loan'). Under the terms of the scheme, PLC assigned the right to receive the interest payable on the Loan to GKA in exchange for an issue of preference shares. GKA accounted for this transaction as giving rise to a receivable in respect of the interest due from GKBR with the associated credit going to share capital and share premium. Within PLC's accounts, the loan continued to be held at its face value of £300m. Thereafter, GKBR paid £21.3m to GKA in respect of the assigned interest, which was treated as a repayment of the interest receivable with the excess of £800k giving rise to a P&L credit. [465]

[463] *Greene King (FTT, 2012)* (n 34); *Greene King (UT, 2014)* (n 259); *Greene King (CA, 2016)* (n 24).

[464] This summary is based on the summary of the case in Section VI.6.1 and is replicated here for the sake of completeness and to assist the reader.

[465] This excess arose as a result of the interest due on the loan being originally recognised on GKA's balance sheet at a discount.

HMRC sought to challenge this scheme on multiple grounds. In respect of PLC, it argued that PLC should have partially derecognised the loan to reflect its net present value ('NPV') at the time of the assignment. HMRC argued that this derecognition did not give rise to a deductible debit as the debit should have increased PLC's investment in GKA, rather than being treated as a P&L debit (PLC's accounting expert witness agreed with HMRC's accounting expert on this point[466]). The subsequent increase in the NPV of the Loan over its remaining life would have given rise to taxable income in PLC. The Court of Appeal agreed that PLC should have partially derecognise the Loan in its accounts, thereby prevented this scheme from producing the desired tax saving.

This case is discussed further at Section VI.6.1.

D 6.2 Key elements of the tax analysis

D.6.2(a) Is the result consistent with the purpose of the relevant tax provisions?

It would be difficult to argue that the outcome of the scheme was consistent with the underlying purpose of the loan relationship regime as a whole since it gave rise to a situation where £20.5 million of interest expense was deductible in one group company, but the associated interest income was not taxable in another.

D.6.2(b) Does the arrangement involve one or more contrived or abnormal steps?

The Court of Appeal judgement references no commercial purpose for the scheme and, therefore, it seems reasonable to assume that the scheme was designed solely for the purposes of avoiding tax.

[466] *Greene King (UT, 2014)* (n 259) [72].

D.6.2(c) Does the arrangement exploit a shortcoming in the relevant provisions?

Although the overall result of the scheme is not consistent with the underlying purpose of the loan relationship regime, it would be difficult to argue that this scheme exploited a shortcoming in the relevant provisions. The reason the assignment of the interest did not give rise to a taxable credit in GKA was that Section 84(2)(a) specifically states that credits which go to share premium do not need to be brought into account. Although it seems reasonable to assume that this section was not designed to facilitate a scheme such as this one, the outcome of the scheme for GKA is perfectly consistent with the intention of this section (on a plain reading of the legislation).

D.6.2(d) Does the arrangement exhibit any of the indicators of abusiveness listed in Section 207(4), FA 2013?

Yes, the scheme was clearly designed to produce an abusive result because, had the scheme not been undertaken the full £21.3m would have been taxable rather than only £800k. This result is clearly within the scope of Section 207(4)(a).

D.6.2(e) Does the arrangement exhibit any of the examples in Section 455D, CTA 2009?

Yes, for the same reasons as in respect of Section 207(4)(a), the scheme exhibits the example listed at 455D(1)(a).

D.6.2(f) Does the LR have an unallowable purpose?

Although Section 441 could potentially be in point, in so far as the deductibility of the debits arising in GKBR could be challenged, the FTT noted in their judgement that GKBR was party to the loan for good commercial reasons.[467]

The Court of Appeal found that PLC should have derecognised a proportion of the Loan when it assigned the interest to GKA. It was their view that the corresponding debit should have gone to investments (i.e. the balance sheet) rather than to the P&L. Had the debit gone to P&L then potentially Section 441 would have been in point, however, as noted above, the FTT found that PLC had a good commercial purpose for being party to the Loan.

D 6.3 Summary of conclusions

D.6.3(a) GAAR

HMRC would most likely seek to apply the GAAR to schemes like this one. The result of the scheme is clearly abusive and given that there does not seem to be any commercial rationale for undertaking it, this is exactly type of scheme that HMRC designed the GAAR to counteract.

D.6.3(b) LR TAAR

This scheme would clearly be within the scope of the LR TAAR. Although HMRC was able to successfully challenge it, had the LR TAAR been in force at the time it was implemented, HMRC would have found it significantly easier. Indeed, had the LR TAAR been in force it would have been unlikely that the scheme would have been

[467] *Greene King (FTT, 2012)* (n 34) [8]-[9].

implemented due to the likelihood of the LR TAAR applying. HMRC succeeded in the Court of Appeal, not on the basis of a legal argument, but rather on the basis that it found that as a matter of fact PLC had not adopted the correct accounting treatment.

D.7 Iliffe[468]

D 7.1 Outline of scheme

Iliffe involved a scheme designed to shift profits to Iliffe News & Media Limited ('INML') from its subsidiaries. Both INML and its subsidiaries were tax resident in the UK. The desire to shift profits to INML was commercially driven as having profitable subsidiaries increased the risks of competitors entering the market and risked giving more leverage for the unions to use in wage negotiations. The profits were shifted into INML as a result of the subsidiaries transferred the unregistered trademarks they held to INML at net book value (which was nominal), then acquired a 5-year licence to use those trademarks from INML for up-front premium using cash lent to them by INML.

A tax benefit arose from this scheme as a result of the fact that relicensing the trademarks to the subsidiaries gave rise to the intellectual property ('IP') becoming New IP for the purposes of the Intangible Fixed Assets Regime Part 9, CTA 2009 (i.e. it was created on or after 1 April 2002) in the hands of the subsidiaries and therefore they could claim a deduction for the amortisation of the premium. On the other hand, the IP remained Old IP for INML and therefore, the premium it received was treated as giving rise to a part disposal of the IP, which did not give rise to a tax charge as a result of Section 171, the Taxation of Chargeable Gains Act 1992.

[468] *Iliffe News & Media (FTT, 2012)* (n 34).

HMRC challenged the effectiveness of this scheme on multiple grounds including by using non-tax arguments concerning IP law and Company IP. From a technical perspective, HMRC sought to argue that the anti-avoidance provision at Paragraph 111, FA 2002 applied as a result of the scheme having as one of its main purposes a tax avoidance motive. The application of Paragraph 111 would result in the subsidiaries not being able to claim a deduction for the amortisation of the premium. The FTT found in favour of HMRC for a number of reasons, including that the transfer of the IP to INML in the first place was void because unregistered trademarks can only be transferred along with the goodwill of the business to which they relate. Furthermore, the FTT found that even if the transfer was valid, Paragraph 111 would have applied as a result of the scheme having as one of its main purposes a tax avoidance motive, and therefore, the amortisation of the premium in the subsidiaries would not have been deductible.

Although this scheme primarily involved the transfer of an intangible fixed asset, it also considers one loan relationship point, namely, did Paragraph 13 apply to deny the subsidiaries a deduction for the interest payable to INML on the loan used to fund the payment of the premium paid to acquire a licence to use the IP? On this point, the FTT found in favour of the taxpayer, finding that although the loan relationship has an unallowable purpose, it also had an allowable purpose and on a just and reasonable basis all of the debits should be attributed to that allowable purpose. Consequently, the application of Paragraph 13 did not prevent the subsidiaries claiming a deduction for the interest they paid to INML.

D 7.2 Key elements of the tax analysis

Note: the below summary is only concerned with the loan relationship aspects of this case.

D.7.2(a) Is the result consistent with the purpose of the relevant tax provisions?

On the basis that Paragraph 13 did not apply to this debt, then allowing the subsidiaries to claim a deduction for the interest they paid to INML would be perfectly consistent with the relevant provisions. Assuming that there were not trapped losses in INML, then although the subsidiaries were able to claim a deduction for interest paid, INML was required to recognise an equal amount of interest income.

D.7.2(b) Does the arrangement involve one or more contrived or abnormal steps?

Although the FTT found certain aspects of the scheme were altered to ensure that a tax benefit was obtained, these alterations did not affect the nature of the loan relationships. Therefore, although the scheme as a whole may have contained abnormal steps, those steps are not relevant to the loan relationship analysis.

D.7.2(c) Does the arrangement exploit a shortcoming in the relevant provisions?

No, for the reasons noted above, the loan relationship provisions applied as expected in this case.

D.7.2(d) Does the arrangement exhibit any of the indicators of abusiveness listed in Section 207(4), FA 2013?

No, although the subsidiaries were able to claim a deduction for the interest arising on the debits, the deduction was equal to the economic loss they suffered. Furthermore, that income was fully taxable in the hands of INML.

D.7.2(e) Does the arrangement exhibit any of the examples in Section 455D, CTA 2009?

No, for the same reasons as mentioned in respect of Section 207(4).

D.7.2(f) Does the LR have an unallowable purpose?

The FTT found that the subsidiaries had both allowable and unallowable purposes for being party to the debt. However, on a just and reasonable basis, the debits arising were wholly attributable to the allowable purpose and therefore, no disallowance arose.

D 7.3 Summary of conclusions

D.7.3(a) GAAR

HMRC are unlikely to have sought to use the GAAR to counteract the loan relationship aspects of this case. This is because the ability of the subsidiaries to claim a deduction for interest arising on the debit is consistent with the purposes of the loan relationship regime and the loan relationship aspects of this case are not contrived.

D.7.3(b) LR TAAR

HMRC are unlikely to have sought to use the LR TAAR against the scheme in this case for the reasons outlined above in respect of the GAAR.

D.8 Smith & Nephew[469]

D 8.1 Outline of scheme

Although the scheme in this case gave rise to a deductible foreign exchange loss in three companies within the Smith & Nephew group (the 'SN Group') headed by Smith & Nephew PLC ('SN PLC'), given that the transactions undertaken by each were broadly

[469] *Smith and Nephew (FTT, 2017)* (n 16).

similar, this summary focuses on the transactions undertaken by the lead taxpayer, Smith & Nephew Overseas Limited (‘SN Overseas’).

SN Overseas would have been a dormant company, except for the fact that it held an interest free receivable of £1.63bn due from Smith & Nephew Investment Holdings Limited (‘SNIH’). Although SNIH was incorporated in the Cayman Islands, at the material times it was UK tax resident. At the time, the SN Group had two main trading groups. The first, comprised of the group’s international operations, used US dollars as its functional currency, with the second ‘UK sub group’ comprising of its UK operations, using sterling at its functional currency.

The first step involved SNIH selling SN Overseas to SN PLC for cash. This resulted in SN Overseas functional currency changing from sterling to US dollars as it moved out of the UK sub group. The second step of the scheme involved PLC transferring the shares of another group company to SN Overseas, which had the effect of reducing SN Overseas’s net intra-group receivable to $200k.[470] As a result of changing functional currencies, SN Overseas recognised a foreign exchange loss of $877m, which it claimed a deduction for. HMRC challenged the deductibility of this loss on three grounds: firstly, SN Overseas accounts were not GAAP compliant; secondly, it loss was not an ‘exchange loss’ for the purpose of Section 103, FA 1996; and thirdly, the loss did not fairly represent the losses arising to the company from its loan relationships. The FTT found in favour of SN Overseas on all three grounds.

[470] The FFT’s decision does not explain the precise mechanism by which the effect was produced.

In addition to outlining the facts of this case, it may be informative to explore some of the background. Prior to entering into the scheme, SNIH wrote to HMRC to seek clearance that it could waive the loan between SNIH and SN Overseas without giving rise to adverse tax consequences. Self considered that:

> *the proposed transaction appears to have been a sensible proposal: the balances would be waived, with no taxable credits or allowance debits for loan relationship purposes, and with the debt waivers being disregarded for capital gains tax purposes. In other words, the balance sheets would be tidied up on a tax neutral basis.*[471]

Although HMRC confirmed that no taxable loan relationship credits or debits would arise if the debt was waived, they refused to grant clearance that the transaction would be ignored for capital gains tax purposes. As a result, the SN Group considered alternative methods to eliminate the debt.

> *Initially, PwC came up with a 'proposal' which would have resulted in tax deductible losses. The proposal involved moving the subsidiaries into another part of the group, with US dollar functional currency, and then entering into a 'non-hedging derivative transaction'. Perhaps unsurprisingly, the PwC proposal was considered to be too complex and to give rise to a high risk of HMRC challenge.* [472]

[471] Self, 'Smith & Nephew: A Rare Taxpayer Win on "Fairly Represent"' (n 199) 13.
[472] ibid.

It was only at this point that SN Group decided to enter into the scheme considered by the FTT.

D 8.2 Key elements of the tax analysis

D.8.2(a) Is the result consistent with the purpose of the relevant tax provisions?

The FTT found that the provisions dealing with foreign exchange gains and loss are designed to tax arithmetical differences arising when translating amounts from one currency to another currency at different points in time. Given that the FTT found that the foreign exchange losses in this case arose as a result of factors outside of the group's control, obtaining a deduction appears consistent with the purposes of the relevant legislation.

D.8.2(b) Does the arrangement involve one or more contrived or abnormal steps?

As this question was not relevant to the matters discussed by the FTT, it made no relevant comments in this regard. Although the scheme was designed to achieve a commercial purpose, it seems reasonable to assume that elements of it were changed to ensure that it achieved the desired tax benefits.

D.8.2(c) Does the arrangement exploit a shortcoming in the relevant provisions?

If the FTT's view of the purpose of the relevant provisions are upheld, then the results of this scheme were consistent with the relevant provisions and, therefore, this scheme did not seek to exploit any shortcomings in the relevant provisions.

D.8.2(d) Does the arrangement exhibit any of the indicators of abusiveness listed in Section 207(4), FA 2013?

To answer this question, one must first answer what Section 207(4)(b) means when it refers to an economic loss. Although these foreign exchange losses were recognised in the taxpayer's accounts, they did not give rise to a loss in the group's consolidated accounts. This would point to no economic loss incurring. However, if one accepts the FTT's finding that the relevant provisions are designed to tax arithmetical differences, then the taxpayers are simply claiming a deduction for such a difference. Following the FTT's logic would lead to the conclusion that none of the indicators of abusiveness are present, however, this conclusion is open to question.

D.8.2(e) Does the arrangement exhibit any of examples in Section 455D, CTA 2009?

The most likely answer is no, for the reasons given in respect of Section 2017(4)(b). For completeness, there is an argument that the example listed at Section 455D(d) is present as this scheme is designed to ensure that the taxpayers changed their functional currency to US dollars. However, there is a counter argument that this did not affect how the loan relationship was accounted for; it simply affects the basis on which the taxpayer prepares its accounts.

D.8.2(f) Does the LR have an unallowable purpose?

As HMRC did not raise Paragraph 13 before the FTT, it seems reasonable to assume that the debts were not held for an unallowable purpose.

D 8.3 Summary of conclusions

D.8.3(a) GAAR

Given the position of the FTT, it would be challenging to argue that one cannot reasonably hold the position that obtaining a deduction for these foreign exchange losses is consistent with the relevant provisions. As such, HMRC would be unlikely to apply the GAAR to the scheme in this case.

D.8.3(b) LR TAAR

Although, given the shift of the burden of proof in LR TAAR cases, it seems slightly more likely that HMRC would seek to use it to challenge this scheme, to do so, HMRC would need to robustly challenge the FTT's view of the relevant legislation.

D.9 *Stagecoach*[473]

D 9.1 Outline of scheme[474]

At the time the scheme was entered into, one company within the group, Stagecoach Holdings Limited ("Holdings"), was technically insolvent and, as part of the scheme, Stagecoach Group PLC ("Group") sought to recapitalise it using a Forward Subscription Agreement ("FSA"). At the time, there was a loan of £88m between Group, as creditor, and its direct subsidiary Stagecoach Transport Holdings PLC ("Transport"), as debtor (the "Loan"). Under the FSA, Group contributed capital to Holdings of £20k plus a sum equal to 22.4% of the amount of the Loan which was repaid, capped at a total contribution of £20m, in exchange for Holdings issuing shares to its parent, The

[473] *Stagecoach (FTT, 2016)* (n 16).
[474] This summary is based on the summary of the case in Section VI.6.2 and is replicated here for the sake of completeness and to assist the reader.

Integrated Transport Company Limited ("ITCO", a direct subsidiary of Transport). Upon entering into the FSA, under the relevant accounting standards, Group was required to derecognise c.£20m of the Loan (i.e. the element of loan due to be contributed to Holdings[475]). This derecognition gave rise to a credit to loan receivables, with the corresponding debit going to investments.[476]

Group sought to argue that, notwithstanding the debit arising from the derecognition went to the balance sheet and therefore did not give rise to a P&L expense, Section 320, CTA 2009 provides that such LR debits should be brought into account as if they were P&L debit.

HMRC challenged the deductibility of the debit arising in Group from the derecognition of the Loan, for two main reasons. Firstly, HMRC argued that the debit did not arise 'in respect' of a loan relationship and therefore did not fall to be taxed in accordance with the loan relationship regime. Secondly, they argued that even if the debit fell to be taxed under the loan relationship regime, Section 320 was subject to the 'fairly represent' rule at Section 307(3) and, therefore, as the debit did not 'fairly represent' a loss accruing to Group from its loan relationship, it should not be considered deductible. The FTT found in favour of HMRC on both of these points.

[475] For completeness, £19,736k was derecognised rather than £19,980k (i.e. £20m less £20k). This difference arises as a result of the fact that the Loan was not due to be repaid for just under 3 months and therefore, the amount due to Holdings when the Loan was repaid needed to be discounted for accounting purposes.

[476] The FTT's decision suggests that this debit when to Group's cost of investment in Holdings, thereby correcting the Statement of Agreed Facts submitted in the case, which states the debit when to Group's cost of investments in Transport (c.f. fns 47 & 49). Given that under the FSA Holding's issued shares to ITCO, it seems more likely that the Statement of Agreed Facts was correct, but it did not outline the intermediary accounting steps.

This case is discussed further at Section VI.6.2.

D 9.2 Key elements of the tax analysis

D.9.2(a) Is the result consistent with the purpose of the relevant tax provisions?

As Ghosh points out, the purpose of this section is to allow a company to take a tax deduction for financing costs where the relevant accounting standards require those financing costs to be capitalised as part of the cost of a fixed asset.[477] Consequently, it would be difficult to argue that the purpose of Section 320 is to allow a company a deduction for the derecognition of a loan in this type of situation.

This position is further supported by the fact that shortly after the scheme was implemented, The Exchequer Secretary to the Treasury, David Gauke MP, announced new legislation to prevent this type of scheme from being effective, which had immediate effect.[478]

D.9.2(b) Does the arrangement involve one or more contrived or abnormal steps?

Although the FTT found that the scheme was designed to crystallise a tax benefit, the scheme also achieved a commercial purpose, namely, the recapitalisation of Holdings. Although they found that this recapitalisation could have been undertaken via alternative means, it did accept that “these [alternatives] may have been administratively more complex.”[479] That said, they found no commercial reason “for

[477] *Ghosh, Johnson and Miller on the Taxation of Corporate Debt and Derivatives* (n 209) para D1.205.
[478] HC Deb 6 December 2010, Vol 52, Col 1WS (n 196).
[479] *Greene King (CA, 2016)* (n 24) [78].

specifying the consideration for the shares by reference to a calculation of a proportion of the loan proceeds."[480]

As a result, the linking of the consideration payable for the shares with the interest payable on the Loan, should be considered an abnormal step.

D.9.2(c) Does the arrangement exploit a shortcoming in the relevant provisions?

Arguably, the scheme in this case sought to exploit two shortcomings in the relevant provisions. The first was, on the taxpayer's argument, that Section 320 allows a deduction to be obtained for the debit arising on the derecognition of the Loan, even though that debit went to the balance sheet. As noted above, the purpose of this section was to allow a company to take a deduction for capitalised interest, and therefore, the taxpayer would have needed to exploit a shortcoming in Section 320 to obtain this deduction. On the other hand, it could be argued that the taxpayer merely relied on how the section applied, and if HMRC wished to restrict the use of Section 320 to capitalised interest, it should have drafted the language of Section 320 differently.

The second shortcoming the taxpayer sought was that when a debit is treated as deductible as a result of Section 320, that debit is not subject to the fairly represents requirement.

D.9.2(d) Does the arrangement exhibit any of the indicators of abusiveness listed in Section 207(4), FA 2013?

Yes, the taxpayer in this case sought to claim a deduction for a loss where, from an economic perspective, no actual loss arises, which is an example of the indication

[480] ibid.

listed at Section 207(4)(b). This position is based on the FTT's finding that the relevant debit "[p]roperly analysed … enhance[d] the assets of the subsidiaries".[481]

D.9.2(e) Does the arrangement exhibit any of the examples in Section 455D, CTA 2009?

Yes, this scheme gives rise to a result which mirrors the example at Section 455D(1)(b) for the reason outlined above in respect of Section 207(4)(b).

D.9.2(f) Does the LR have an unallowable purpose?

As a finding of fact, the FTT found that the Loan was entered into for good commercial purposes. This fact was not in dispute and accepted by counsel for HMRC.

D 9.3 Summary of conclusions

D.9.3(a) GAAR

Although HMRC would have most likely sought to use the GAAR to challenge the scheme in this case, once could make an argument that it could be considered a reasonable course of action, particularly if one emphasised that Transport was technically insolvent and, as the FTT accepted, other methods to recapitalise would have been more administratively complex. On the other hand, the FTT also found that elements of the transaction were designed solely to ensure that a tax benefit would arise.

As such, the question becomes whether the insertion of these tax driven elements of the scheme are sufficiently significant to prevent the scheme from being reasonably regarded as a reasonable course of action. Had the GAAR been in effect when the

[481] *Stagecoach (FTT, 2016)* (n 16) [98].

scheme was entered in to, the FTT would probably have explored this area in further detail and made further findings of fact. However, given that this information is not contained within the FTT's decision, it is difficult to conclude on this point.

D.9.3(b) LR TAAR

Overall, it should be easier for HMRC to apply the TAAR to this scheme. This is because to prevent the LR TAAR from applying, the taxpayer would need to positively show that the result was consistent with the loan relationship regime, rather that HMRC needing to provide to opposite.

D.10 *Suez Teesside*[482]

D 10.1 Outline of scheme[483]

In *Suez Teesside*, the taxpayer company, GDF Suez Teesside Limited ('Teesside') had various claims against companies within the former Enron group, which fell to be treated as loan relationships. The scheme involved Teesside incorporating a wholly owned subsidiary in Jersey called Teesside Recoveries and Investments Limited ('TRAIL') and then transferring the Enron claims to it. At the time of the transfer, because the Enron group was in a variety of insolvency proceedings, the taxpayer was unlikely to receive the full value of its claims. However, a valuation of these claims indicated that their fair value was c.£200m. For accounting purposes, these claims were treated as contingent assets and, as such, they were not recognised on Teesside's balance sheet. Teesside transferred the claims to TRAIL in exchange for an issue of new shares, which

[482] *Suez Teesside (FTT, 2015)* (n 251); *Suez Teesside (UT, 2016)* (n 23).
[483] This summary is based on the summary of the case in Section VI.6 and is replicated here for the sake of completeness and to assist the reader.

were held on Teesside's balance sheet at the carrying value of the claims prior to the transfer (that is to say nil). The transfer did not give rise to a gain as these claims were treated as being disposed of at their carrying value, not their fair value. This was justified on the basis that the value of the TRAIL shares was wholly dependent on the value of the claims and, therefore, accounting for the disposal at fair value would have in effect, required Teesside to recognise a contingent asset at its fair value, contrary to GAAP. When TRAIL received the claims, they accounted for them at their fair value of c. £200m, although this did not give rise to a gain in TRAIL.

HMRC sought to bring into account the c.£200m gain which Teesside would have recognised if it had accounted for the disposal of the claims at fair value. The First Tier Tribunal was asked to opine on four issues, which in substance can be summarised by two questions. Firstly, were Teesside's accounts GAAP compliant; and secondly, notwithstanding the answer to the first question, was Teesside required to bring into account a credit of c.£200m to ensure that its taxable profits 'fairly represents' the profits arising. The FTT found that although Teesside's accounts were GAAP compliant, it was required to bring in a credit of c.£200m. On appeal, the UT upheld the substance of FTT's decision.

This case is discussed further at Section VI.6.

D 10.2 Key elements of the tax analysis

D.10.2(a) Is the result consistent with the purpose of the relevant tax provisions?

This complex question can be summarised as to what extent does the loan relationship provision respect the accounting treatment of a loan relationship, when that treatment gives rise to a tax result which is considered unfair. Ignoring the fairly represents requirement, the principles on which the loan relationship regime is based mean that the accounting treatment should be followed. That said, there is an argument that the scheme sought to exploit a shortcoming in the relevant provisions as it allowed the taxpayer to transfer a valuable asset out of the UK without giving rise to a tax charge.

D.10.2(b) Does the arrangement involve one or more contrived or abnormal steps?

As neither the UT nor FTT mention a commercial purpose for transferring the claims to TRAIL, it seems reasonable to assume that this scheme is wholly contrived.

D.10.2(c) Does the arrangement exploit a shortcoming in the relevant provisions?

According to the UT, Teesside sought to exploit the accounting rules to allow it to transfer the claims to TRAIL without giving rise to an accounting profit. This could be described an exploiting a shortcoming in the relevant provisions as, normally, when a company transfers an asset outside of the UK, it needs to recognise it as a disposal at market value. The UT made particular reference to the fact that, like "Schrodinger's cat, the Claims were dead and unrecognised in [Teesside], while simultaneously alive and well in TRAIL."[484] However, the counter-argument to this would be that the taxpayer simply relied on the loan relationship rules applying as they were designed to.

D.10.2(d) Does the arrangement exhibit any of the indicators of abusiveness listed in Section 207(4), FA 2013?

Arguably, the answer to this question is no. Although at the time of the transfer, the claims were valuable, the transfer of the claims did not allow Teesside to realise any

[484] *Suez Teesside (UT, 2016)* (n 23) [103].

value. Instead, Teesside swapped a contingent asset for shares, the value of which was wholly attributable to that contingent asset. Therefore, the transfer did not give rise to an economic gain for Teesside.

D.10.2(e) Does the arrangement exhibit any of the examples in Section 455D, CTA 2009?

No, for the reasons outlined in respect of Section 207(4).

D.10.2(f) Does the LR have an unallowable purpose?

No, the claims arose as a result of historical trading activities with the Enron group.

D 10.3 Summary of conclusions

D.10.3(a) GAAR

This is a borderline case. On the one hand, this scheme enabled Teesside to transfer a valuable asset out of the UK without giving rise to a tax charge. On the other hand, Teesside was seeking to rely on a plain reading of the legislation, which equated an asset's tax value to its accounting value. In addition, the transfer of the claims to TRAIL did not allow Teesside to crystalize any value from them. Although HMRC are likely to have attempted to use the GAAR against this scheme, it is questionable whether a GAAR challenge would have been successful if HMRC had used it.

D.10.3(b) LR TAAR

For the reasons outlined above in respect of the GAAR, HMRC are likely to have used the LR TAAR to challenge this scheme. As this would be a borderline case, due to the burden of proof being shifted to the taxpayer, the courts would have been more likely to find that the LR TAAR applied.

D.11 Travel Document Services[485]

D 11.1 Outline of scheme

This scheme involved a complex series of transactions involving a number of entities in the Ladbroke group, with the key steps being as follows. Travel Document Services ('TDS') entered into a total returns swap with Ladbroke Betting and Gaming Limited ('LB&G') in respect of the shares of TDS's subsidiary Ladbroke Group International ('LGI').[486] As a result of the total return swap, the shares held by TDS in LGI were treated as non-qualifying and therefore TDS's shareholding fell to be taxed as if it were a loan relationship which was accounted for at fair value. As a result of various inter-group transactions, including the novation of intergroup payables to LGI, the fair value of LGI decreased by £254m. TDS sought to argue that this decrease in fair value gave rise to a deductible loan relationship debit. Furthermore, LGI claimed a deduction for the interest it paid on the loans novated to it.

HMRC challenged the deductibility of the debits claimed by both TDS and LGI using Paragraph 13. TDS rejected HMRC's position on the basis:

> *that purposes referred to in para 13 are the subjective purposes of the company, and that it is not possible for a company to have subjective purposes for being party to a deemed loan relationship because the loan relationship is a legal fiction.*[487]

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[485] *Travel Document Service and Another v HMRC* [2015] UKFTT 582 (TC), [2015] STC 168; *Travel Document Service (UT, 2017)* (n 40); *Travel Document Service (CA, 2018)* (n 27).
[486] Both TDS and LGI are unlimited companies.
[487] *Travel Document Service (UT, 2017)* (n 40) [29].

LGI also sought to argue that Paragraph 13 should not apply to the debits it claimed. Of the three arguments it used to support its position, the most notable one is that, in the event Paragraph 13 applied to the debits claimed by TDS, then Paragraph 13 could not apply to LGI's debits as the scheme did not in fact give rise to a tax advantage.

The FTT found in favour of HMRC and therefore the debits claimed by both TDS and LGI were treated as non-deductible as a result of Paragraph 13. This decision was upheld by the UT[488] and Court of Appeal[489].

D 11.2 Key elements of the tax analysis

D.11.2(a) Is the result consistent with the purpose of the relevant tax provisions?

No, the existence of Paragraph 13 implies that one of the purposes of the loan relationship regime is to ensure that a company only obtains a tax deduction for expenses related to loan relationships taken out for good commercial reasons, which are within the scope of corporation tax. Given this scheme was intended to create a deductible debit, the scheme cannot be consistent with the purposes of the loan relationship regime.

D.11.2(b) Does the arrangement involve one or more contrived or abnormal steps?

This scheme was partially designed to effect a synthetic transfer of another Ladbroke company's business to LB&G. Although there were easier ways through which this could be done, there were some commercial difficulties in doing so due to a number

[488] *Travel Document Service (UT, 2017)* (n 40).
[489] *Travel Document Service (CA, 2018)* (n 27).

of property leases. The UT does not comment specifically on whether this scheme involved contrived or abnormal steps, although the answer is likely to be yes.

D.11.2(c) Does the arrangement exploit a shortcoming in the relevant provisions?

Yes, if the deemed loan relationship was a real loan relationship, then Paragraph 13 would have clearly applied to disallow the debit. The taxpayer sought to exploit a loophole in Paragraph 13 which meant that it could not apply to deemed loan relationships.

D.11.2(d) Does the arrangement exhibit any of the indicators of abusiveness listed in Section 207(4), FA 2013?

Yes, this scheme was designed to create a deductible fair value loss in a situation where that loss was attributable to value being shifted out of LGI into other group companies. This resulted in TDS being able to claim a tax deduction for a loss that, from the group's perspective, did not occur. This is an example of the indicator listed at Section 207(4)(b).

D.11.2(e) Does the arrangement exhibit any of examples in Section 455D, CTA 2009?

Yes, the example listed at 455D(b), for the same reasons mentioned in respect of Section 207(4)(b).

D.11.2(f) Does the LR have an unallowable purpose?

Yes, although the FTT accepted that TDS had commercial reasons for owning the shares of LGI, they also found that TDS had an unallowable purpose, namely obtaining a tax deduction for the fair value loss.

D 11.3 Summary of conclusions

D.11.3(a) GAAR

HMRC are likely to have sought to use the GAAR against the scheme in this case. This is because it is designed to exploit a shortcoming in Paragraph 13 and allow TDS to claim a deduction for a fair value loss that resulted from value being deliberately shifted out of LGI to obtain a tax advantage.

D.11.3(b) LR TAAR

HMRC are likely to have sought to apply the LR TAAR to this scheme as it is designed to give rise to a result which is inconsistent with the purposes of the loan relationship regime.

***D.12 Versteegh*[490]**

D 12.1 Outline of scheme

This scheme involved three companies, Versteegh Limited (the 'Lender') and its two subsidiaries Nestron Limited (the 'Borrower') and Spritebeam Limited (the 'Share Recipient'). Under the terms of the scheme, the Lender lent the Borrower £102m (the 'Loan'). Instead of charging interest on the debt, the Lender directed the Borrower to issue the Share Recipient preference shares equal to the value of the interest that would have being charged had it been a normal loan.

The taxpayers sought to argue that the interest arising on the loan was deductible with no corresponding taxable credit arising in the Lender. Furthermore, they sought to argue that the issue of shares to the Share Recipient did not give rise to taxable income.

[490] *Versteegh (FTT, 2013)* (n 28); *Spritebeam (UT, 2015)* (n 28).

The UT found that although the interest arising on the loan was not taxable in the hands of the Lender, it did give rise to taxable income for the Share Recipient.

For completeness, HMRC also challenged the deductibility of the debits arising in the Borrower. Although the FTT discussed the unallowable purpose rule, they commented that:

> *the way the issue has been put to us is a little unusual. We have not been provided with all the facts, nor have we heard evidence referable to the unallowable purposes issue. Instead, we are asked to determine whether HMRC's argument must succeed on the basis of certain agreed facts only, and irrespective of any other facts which we might have found had we been presented with further factual evidence.*[491]

Specifically, the FTT were asked to consider whether Paragraph 13 could disallow all of the debits arising on the loan as a result of the fact that the terms of the loan were purely tax driven, or whether the Borrower's commercial need for the funds also needed to be considered. The FTT found that the Borrower's commercial need of the loan did need to be considered. Given that HMRC acknowledged that the Borrower had a commercial need for the loan, the unusual situation the FTT was in meant that they did not consider the significance of that commercial purpose compared to the tax avoidance purpose of the loan.

[491] *Versteegh (FTT, 2013)* (n 28) [140].

D 12.2 Key elements of the tax analysis

D.12.2(a) Is the result consistent with the purpose of the relevant tax provisions?

One of the purposes of the LR regime is to ensure that intragroup financing arrangements are treated in a symmetrical manner (for instance, the purpose of requiring companies to account for intergroup financing on an amortised cost basis is to ensure that "the value of the loan cannot be artificially depressed and that debits in the one company are matched by credits in the other"[492]). Given that the scheme creates an asymmetrical result, it would be difficult to argue that the results of this scheme are consistent with the underlying purpose of the tax provisions.

D.12.2(b) Does the arrangement involve one or more contrived or abnormal steps?

Although the FTT's decision did not consider the purpose of the loan in detail, HMRC did accept that the Borrower had a commercial purpose for seeking the finance. That said, both parties agreed that the "only reason for the design, structure and terms of the Loan was to obtain a tax advantage"[493].

As such, this scheme did contain one or more abnormal step.

D.12.2(c) Does the arrangement exploit a shortcoming in the relevant provisions?

While the loan was drafted in a way to ensure that although a debit would arise in the Borrower, no credit would arise in any other group company, this was to ensure that the desired outcome was achieved from an accounting perspective rather than ensuring that certain tax provisions applied. That said once that accounting treatment had been

[492] Explanatory Notes to Corporation Tax Act 2009 para 1131.
[493] *Versteegh (FTT, 2013)* (n 28) [8].

achieved, the LR regime applied as intended, albeit the overall result was inconsistent with the purpose of the LR regime. As such, there is an uncertainty over whether this amounts to the exploitation of a shortcoming in the relevant provisions.

D.12.2(d) Does the arrangement exhibit any of the indicators of abusiveness listed in Section 207(4), FA 2013?

Yes, the factor at Section 207(4)(a) is present. This is because in effect this scheme allowed the Lender to make an interest-bearing loan to the Borrower without giving rise to taxable income for the Lender.

D.12.2(e) Does the arrangement exhibit any of the examples in Section 455D, CTA 2009?

Yes, the abusiveness factor listed at Section 455D(1)(a) is present in this scheme, for the reasons outlined above in respect of Section 207(4). Furthermore, there is an argument that the abusiveness factor listed at Section 455D(1)(d) is also present because had the Borrower issued the preference shares to the Lender then the associated credit arising in Lender is likely to have been subject to tax under the loan relationship regime. As such, changing the terms of the loan to require that the preference shares be issued to a third company in the group ensured that for accounting purposes the credit arose in a company not party to the loan relationship and, therefore, not taxable under the loan relationship regime.

D.12.2(f) Does the LR have an unallowable purpose?

Although the FTT discussed the unallowable purpose rule, as noted above the presentation of this issue was unusual. As a result, although the FTT acknowledged that the Borrower had a commercial need for the loan, they did not consider the significance of that commercial purpose compared to the tax avoidance purpose of the loan.

D 12.3 Summary of conclusions

D.12.3(a) GAAR

HMRC are likely to use the GAAR to challenge this type of scheme. Although they were able in this case to challenge this scheme using technical arguments, of the four technical arguments put in front of the FTT, HMRC only succeeded on one of them. However, had the GAAR being in force at the time, then HMRC's success would have been less dependent on a complex interpretation of legislation and case law.

D.12.3(b) LR TAAR

Given that this scheme was designed to create an asymmetrical tax result, it is likely that HMRC would seek to apply the LR TAAR to counteract the tax advantage gained.

***D.13 Vocalspruce*[494]**

D 13.1 Outline of scheme

This case involved Brixton PLC ('Brixton') and a number of its subsidiaries. As part of the scheme, Brixton subscribed for zero coupon loan notes (the 'ZC Loans'), issued at a discount by Brixton's subsidiaries. In total, the nominal value of the ZC Loans were £55.4m, with Brixton subscribing for these ZC Loans for £51.5m. Brixton then entered into a share subscription agreement with Vocalspruce Limited ('Vocalspruce'), whereby Brixton agreed to subscribe for ordinary shares in Vocalspruce with a nominal value of

[494] *Vocalspruce (UT, 2013)* (n 322); *Vocalspruce (CA, 2014)* (n 29).

£51.7m[495] and share premium of £3.7m (i.e. the difference between £51.7m and £55.4m). In satisfaction of Brixton obligations in respect of these share's nominal value, Brixton transferred the ZC Loans to Vocalspruce. With respect to the share premium, Brixton and Volcalspruce agreed that on redemption of the ZC Loans, the profits realised would be capitalised in satisfaction of Brixton's obligation to fund the share premium. From an accounting perspective, the income arising to Vocalspruce was first recognised in its P&L, before an amount equal to that profit being transferred to its share premium account.

Vocalspruce sought to argue that, as the income it generated from the ZC Loans needed to be recognised within its share premium account, Section 84(2)(a), FA 1996 applied such that the income from the ZC Loans was not taxable. HMRC challenged this position by asserting two arguments. Firstly, Section 84(2)(a) did not apply because the income arising did not arise from the ZC Loans, instead, it arose as a result of the share subscription agreement. As such, the initial recognition of the income within the P&L gave rise to a credit which was taxable under the loan relationship regime, with this position being unaffected by this credits subsequent transfer to share premium. HMRC's second argument was that group continuation rules applied such that transfer of the income to the share premium account should be disregarded when determining how the income should be taxed under the loan relationship regime.

[495] As the ZC Loans were issued in December and the share purchase agreement was entered into in January, is appears reasonable to assumed that the £0.2m difference between £51.5m and £51.7m relates to the element of the unwinding of discount attributable to the December period.

When this scheme came before the Court of Appeal, it found in favour of the taxpayer in respect of the HMRC's first argument, but found in favour of HMRC in respect of its second argument.

D 13.2 Key elements of the tax analysis

D.13.2(a) Is the result consistent with the purpose of the relevant tax provisions?

In the Court of Appeal, Gross LJ found that the purpose of the group continuity rules was to enable a group to transfer debts between group companies in a tax neutral way. Therefore, this scheme was designed to give rise to a result which was inconsistent with the purpose of these rules, since it aimed to ensure that the transfer of a ZC Notes between group companies allowed a loan relationship credit to be non-taxable. Furthermore, the group continuity rules are designed to ensure that when a debt is transferred between group companies, the company receiving the debt is taxed in the same way that the original company would have been - which is not the case in this scheme as Brixton would have realised taxable income from the ZC Notes.

D.13.2(b) Does the arrangement involve one or more contrived or abnormal steps?

As Gross LJ notes that the scheme was part of a marketed tax avoidance, it seems reasonable to assume that the scheme in this case is wholly contrived.

D.13.2(c) Does the arrangement exploit a shortcoming in the relevant provisions?

Yes, the scheme sought to rely on the fact that the group continuity applied such that although the disposal of the ZC Notes by Brixton should be disregarded, the transfer of income arising from the ZC Notes to share premium should be respected. In effect, this would lead to the transaction being treated differently in different entities, whereas the group continuity rules are designed to ensure there is symmetry in inter-company transactions.

D.13.2(d) Does the arrangement exhibit any of the indicators of abusiveness listed in Section 207(4), FA 2013?

Yes, specifically the indication listed at Section 207(4)(b). This is because the scheme was designed to avoid the income arising from the ZC Notes needing to be brought into tax.

D.13.2(e) Does the arrangement exhibit any of the examples in Section 455D, CTA 2009?

Yes, in addition to avoiding needing the bring a commercial profit into tax (which mirrors the example as Section 455D(1)(b), this scheme gives rise to a result which mirrors the example at Section 455D(1)(g) as it is designed to ensure that the group continuity rules apply such that no company in the group is required to bring into account a credit in respect of the income arising from the ZC Notes.

D.13.2(f) Does the LR have an unallowable purpose?

The Court of Appeal's judgement does not discuss whether the issuers of the ZC Notes had a commercial need for the funding that those notes provided. However, on the basis that HMRC did not challenge the deductibility of the unwinding of the discount, it seems reasonable to assume that the borrowers had a commercial requirement for the funding provided.

D 13.3 Summary of conclusions

D.13.3(a) GAAR

In addition to this scheme being a marketed avoidance scheme, it is clearly designed to manipulate the group continuity rules. As such, HMRC are likely to have sought to use the GAAR to counteract it.

D.13.3(b) LR TAAR

Given that this scheme so closely mirrors the example shown a Section 455D(1)(g), it is likely that HMRC would seek to apply the LR TAAR in this case.

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