Neutral Citation Number: [2024] EWCA Civ 434

Case No: CA-2023-000429

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
UPPER TRIBUNAL JUDGE SWAMI RAGHAVAN AND UPPER TRIBUNAL JUDGE RUPERT JONES
[2022] UKUT 00314 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 03/05/2024

Before:

LADY JUSTICE ANDREWS
LADY JUSTICE FALK
and
SIR LAUNCELOT HENDERSON

- -

Between:

(1) KWIK-FIT GROUP LIMITED **(2) STAPLETON'S (TYRE SERVICES) LIMITED** **(3) KWIK-FIT FINANCE LIMITED** **(4) KWIK-FIT (GB) LIMITED** **(5) KWIK-FIT EURO LIMITED**	**Appellants**
- and –	
THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS	**Respondents**

- -
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Julian Ghosh KC, Quinlan Windle and Laura Ruxandu (instructed by **Baker & McKenzie LLP**) for the **Appellants**
Elizabeth Wilson KC and Ronan Magee (instructed by **HMRC Solicitor's Office and Legal Services**) for the **Respondents**

Hearing dates: 17 and 18 April 2024

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Approved Judgment

This judgment was handed down remotely at 10.00am on 3 May 2024 by circulation to the parties or their representatives by e-mail and by release to the National Archives.

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Lady Justice Falk:

Introduction

1. The Appellants are all members of the Kwik-Fit group of companies (the "Kwik-Fit group"). The appeal concerns a reorganisation of intra-group debt in which they participated in 2013, following the group's acquisition in 2011 by a Japanese company, Itochu Corporation. Under the reorganisation a number of intra-group receivables owed by the Appellants were assigned to an intermediate holding company within the Kwik-Fit group, Speedy 1 Limited ("Speedy 1"), and certain additional receivables were created in Speedy 1's favour. The interest rates on the amounts owed to Speedy 1 were also increased.

2. Speedy 1 had existing tax reliefs of around £48m, in the form of non-trading loan relationship deficits ("non-trading deficits") carried forward from earlier periods. The Kwik-Fit group anticipated that the non-trading deficits would offset Speedy 1's interest income, while the Appellants would generate tax relief in respect of their interest liabilities which could either be used by them or surrendered by way of group relief to reduce the taxable profits of other members of the group. As the First-tier Tribunal ("FTT") found, the effect was to use up the non-trading deficits in under three years rather than the group tax manager's previous estimate of around 25 years.

3. HMRC formed the view that the reorganisation engaged the unallowable purpose rule in s.441 Corporation Tax Act 2009 ("CTA 2009"). They largely disallowed the Appellants' claims to tax relief on the interest in respect of the accounting periods ended 31 March 2014, 2015 and 2016, capping the disallowance at the amount of Speedy 1's non-trading deficits.

4. The Appellants appealed to the FTT. The FTT (Judge Jeanette Zaman and John Woodman) agreed with HMRC about the existence of an unallowable purpose but allowed the appeal in part by permitting the deduction of interest on pre-existing loans to the extent that it corresponded to the rate at which interest was charged before the reorganisation ([2021] UKFTT 0283 (TC): the "FTT Decision"). The Upper Tribunal ("UT") (Judges Swami Raghavan and Rupert Jones) agreed with the FTT, dismissing appeals by both the Appellants and HMRC ([2022] UKUT 00314 (TCC): the "UT Decision"). The Appellants now appeal to this Court.

5. We are grateful for the submissions of Mr Ghosh KC, leading Quinlan Windle and Laura Ruxandu, for the Appellants and Elizabeth Wilson KC, leading Ronan Magee, for HMRC.

Relevant legislation

6. As explained in the recent decision in *BlackRock Holdco 5, LLC v HMRC* [2024] EWCA Civ 330 ("*BlackRock*"), the unallowable purpose rule in s.441 CTA 2009 forms part of Part 5 of that Act, which contains the provisions governing the treatment of "loan relationships" for corporation tax purposes. There is no dispute that the receivables with which we are concerned in this case are loan relationships.

7. In very broad terms, Part 5 provides for credits and debits from loan relationships to be determined in accordance with generally accepted accounting practice. For a non-trader

like Speedy 1, a net loss from loan relationships (being an excess of debits over credits) is a non-trading deficit (s.301 CTA 2009). For the periods with which we are concerned, a non-trading deficit that could not be used against other profits or surrendered by way of group relief in the year that it arose was automatically carried forward to offset future non-trading profits of the company in question pursuant to s.457 CTA 2009. Importantly, before the rules changed with effect from 1 April 2017 there was no scope for a carried forward non-trading deficit to be surrendered to other members of the group. Instead it was "trapped" in the company in which it arose and could be used only against its own non-trading profits.

8. Speedy 1's brought forward non-trading deficits were often referred to in submissions and the decisions below as Speedy 1's losses. That is a convenient shorthand that I will also adopt where appropriate.

9. Sections 441 and 442 CTA 2009 relevantly provide:

> "**441 Loan relationships for unallowable purposes**
> (1) This section applies if in any accounting period a loan relationship of a company has an unallowable purpose.
> …
> (3) The company may not bring into account for that period for the purposes of this Part so much of any debit in respect of that relationship as on a just and reasonable apportionment is attributable to the unallowable purpose.
> …
> (6) For the meaning of "has an unallowable purpose" and "the unallowable purpose" in this section, see section 442.
>
> **442 Meaning of 'unallowable purpose'**
> (1) For the purposes of section 441 a loan relationship of a company has an unallowable purpose in an accounting period if, at times during that period, the purposes for which the company—
> (a) is a party to the relationship, or
> (b) enters into transactions which are related transactions by reference to it,
> include a purpose ("the unallowable purpose") which is not amongst the business or other commercial purposes of the company.
> …
> (3) Subsection (4) applies if a tax avoidance purpose is one of the purposes for which a company —
> (a) is a party to a loan relationship at any time, or
> (b) enters into a transaction which is a related transaction by reference to a loan relationship of the company.
> (4) For the purposes of subsection (1) the tax avoidance purpose is only regarded as a business or other commercial purpose of the company if it is not—
> (a) the main purpose for which the company is a party to the loan relationship or, as the case may be, enters into the related transaction, or
> (b) one of the main purposes for which it is or does so.

> (5) The references in subsections (3) and (4) to a tax avoidance purpose are references to any purpose which consists of securing a tax advantage for the company or any other person."

("Related transaction" is defined in s.304 CTA 2009 as any disposal or acquisition of rights or liabilities under a loan relationship. So it would include, for example, an assignment.)

10. "Tax advantage" is defined in s.1139 Corporation Tax Act 2010 ("CTA 2010") in the following terms:

> "**1139 "Tax advantage"**
> (1) This section has effect for the purposes of the provisions of the Corporation Tax Acts which apply this section.
> (2) "Tax advantage" means—
> (a) a relief from tax or increased relief from tax,
> (b) a repayment of tax or increased repayment of tax,
> (c) the avoidance or reduction of a charge to tax or an assessment to tax,
> (d) the avoidance of a possible assessment to tax…
> (3) For the purposes of subsection (2)(c) and (d) it does not matter whether the avoidance or reduction is effected—
> (a) by receipts accruing in such a way that the recipient does not pay or bear tax on them, or
> (b) by a deduction in calculating profits or gains."

(Section 1139 CTA 2010 is applied to the loan relationships code by s.476(1) CTA 2009.)

11. In summary, loan relationships debits may not be brought into account to the extent that they are attributable, on a just and reasonable apportionment, to an unallowable purpose. Unallowable purposes are purposes which are "not amongst the business or other commercial purposes of the company". Where the main purpose, or one of the main purposes, for which a company is a party to a loan relationship consists of securing a tax advantage for it or another person, that is treated as not being a business or other commercial purpose of the company, and is therefore an unallowable purpose.

12. It will also be necessary to refer to the transfer pricing rules in Part 4 of the Taxation (International and Other Provisions) Act 2010 ("TIOPA").

13. Section 147 TIOPA relevantly provides:

> "**147 Tax calculations to be based on arm's length, not actual, provision**
> (1) For the purposes of this section "the basic pre-condition" is that—
> (a) provision ("the actual provision") has been made or imposed as between any two persons ("the affected persons") by means of a transaction or series of transactions,
> (b) the participation condition is met (see section 148),
> (c) …, and
> (d) the actual provision differs from the provision ("the arm's length provision") which would have been made as between independent enterprises.

(2) Subsection (3) applies if—
(a) the basic pre-condition is met, and
(b) the actual provision confers a potential advantage in relation to United Kingdom taxation on one of the affected persons.
(3) The profits and losses of the potentially advantaged person are to be calculated for tax purposes as if the arm's length provision had been made or imposed instead of the actual provision.
…"

14. Section 148, read with ss.157 to 163, has the effect that the "participation condition" is met if, among other things, one of the persons controls the other or the persons are under common control. The concept of "potential advantage" is defined in s.155 and includes both a reduction in profits and the creation or increase in losses for tax purposes.

15. Section 152 TIOPA deals specifically with debt financing between corporate entities. It requires s.147(1)(d) to be read as requiring account to be taken of all factors, including whether the loan would have been made at all at arm's length, in what amount the loan would have been made and what the interest rate and other terms of the loan would have been.

16. Section 174 TIOPA relevantly provides:

"**174 Claim by the affected person who is not potentially advantaged**
(1) Subsection (2) applies if—
(a) only one of the affected persons (in this Chapter called "the advantaged person") is a person on whom a potential advantage in relation to United Kingdom taxation is conferred by the actual provision, and
(b) the other affected person (in this Chapter called "the disadvantaged person") is within the charge to income tax or corporation tax in respect of profits arising from the relevant activities (see section 216).
(2) On the making of a claim by the disadvantaged person—
(a) the profits and losses of the disadvantaged person are to be calculated for tax purposes as if the arm's length provision had been made or imposed instead of the actual provision, and
(b) despite any limit in the Tax Acts on the time within which any adjustment may be made, all such adjustments are to be made in the disadvantaged person's case as may be required to give effect to the assumption that the arm's length provision was made or imposed instead of the actual provision.
…"

17. The relationship between the transfer pricing rules and the loan relationships code is addressed in s.446 CTA 2009, which provides:

"**446 Bringing into account adjustments made under Part 4 of TIOPA 2010**
(1) This section deals with the credits and debits which are to be brought into account for the purposes of this Part as a result of Part 4 of TIOPA

> 2010 (provision not at arm's length) applying in relation to a company's loan relationships or related transactions.
> (2) Subsection (3) applies if under Part 4 of TIOPA 2010 an amount ("the imputed amount") is treated as an amount of profits or losses arising to a company from any of its loan relationships or related transactions.
> (3) Credits or debits relating to the imputed amount are to be brought into account for the purposes of this Part to the same extent as they would be in the case of an actual amount of such profits or losses.
> (4) Subsection (5) applies if under Part 4 of TIOPA 2010 an amount is treated as interest payable under any of a company's loan relationships.
> (5) Credits or debits relating to that amount are to be brought into account for the purposes of this Part to the same extent as they would be in the case of an actual amount of such interest.
> …"

18. As can be seen, the effect of s.446 is that amounts imputed under the transfer pricing rules in respect of non-arm's length loan relationships are taxed and relieved under Part 5 CTA 2009, in the same way as if they were actual profits, losses or interest.

19. Neither the transfer pricing rules nor s.446 have any direct application in this case because the relevant loan relationships were found to be on arm's length terms, but the Appellants rely on them in their submissions as part of the relevant statutory framework.

The FTT's findings of fact and conclusions

20. The FTT had the advantage of a detailed statement of agreed facts, which is set out in Appendix 1 to the FTT Decision. It also heard evidence from Mr Kazushi Ogura, a director of each of the Appellants and their common parent European Tyre Enterprise Ltd ("ETEL") during the relevant period, and Mr Glenn Andrews, the Kwik-Fit group's tax manager, both of whom were found to be reliable witnesses. As the UT observed, the FTT's findings were detailed and comprehensive. The fact that I do not refer to the same level of detail in this judgment should not be taken to detract from the very helpful nature of the FTT's comprehensive and clear findings, which provide the key to determining the issues in this case.

21. Unless otherwise indicated, references below to paragraph numbers are to paragraphs of the FTT Decision.

22. By the time that Itochu acquired it, the Kwik-Fit group was highly leveraged as a result of funding structures put in place by previous owners. Speedy 1's non-trading deficits were related to that. They were attributable both to external borrowings and to shareholder and intra-group loans (para. 16). The Itochu acquisition increased the total accumulated deficit still further, to £48m by the end of Speedy 1's 2012 accounting period, because it triggered a requirement to prepay the external debt (para. 17). The Kwik-Fit group had also accumulated a large number of undocumented intra-group borrowings attributable to group charges and re-charges and to debt re-financings (para. 18).

23. Mr Andrews sought advice as to how the intra-group debt might be restructured so as to simplify it and allow Speedy 1's non-trading deficits to be utilised more quickly than his 25 year estimate. The advice was sought initially from Ernst & Young and then from PwC. PwC produced a slide pack and advice and also a shorter document which was sent to HMRC (paras. 20 and 21).

24. In March 2013 there was a meeting between Mr Dominic Bartley of HMRC (the Kwik-Fit group's Customer Relationship Manager), Mr Andrews and PwC to discuss the proposals, for which Mr Bartley's meeting note was available (para. 22). The meeting was followed by correspondence in June 2013 in which Mr Bartley was informed about the proposed rate of interest, LIBOR plus 5%, following which Mr Bartley indicated that he was happy for the reorganisation to proceed and was content with the interest rate (paras. 25 and 26). The context for the approach to HMRC was Itochu's "risk averse" approach to the group's tax position. The FTT found that if Mr Bartley had given an adverse response then "the Kwik-Fit Group (including the Appellants) would not have undertaken the reorganisation in the form in which it in fact took place" (paras. 97 and 98).

25. The proposals were then developed further in a way that included the creation of new debts that had not been envisaged in the earlier proposals, and were implemented in September and October 2013 (paras. 27 and 28).

26. There are two relevant categories of debts that were owed by the Appellants prior to the reorganisation, as follows (para. 60):

    (1) The First Appellant, Kwik-Fit Group Limited ("KFG"), already owed Speedy 1 £160,226,000. The interest rate on this debt was increased from 0.74% to LIBOR plus 5% (the "KFG Loan").

    (2) KFG and the other Appellants owed other group entities various amounts that were assigned to Speedy 1 (the "Assigned Loans"). The existing interest rates on these debts were either nil, 0.74%, or in two cases 0.7-0.9% and 1.89% respectively. Each rate was increased to LIBOR plus 5% (para. 60 and para. 4.4 of Appendix 1). In each case the relevant Appellant acknowledged and accepted the assignment and the increase in rate (para. 63(4)).

    The FTT referred to these two categories together as "Pre-existing Loans": para. 81.

27. In addition, three new loans came into existence during the reorganisation, as follows (para. 61):

    a) The Fourth Appellant, Kwik-Fit (GB) Limited ("KF GB") made a distribution to its immediate parent which was partially satisfied by the issue of a loan note of around £40m which was then distributed up the corporate chain to Speedy 1.

    b) The Third Appellant, Kwik-Fit Finance Limited ("KF Finance"), made a distribution to its immediate parent KFG which was partially satisfied by the issue of a loan note of £16m. The loan note was then distributed by KFG to its parent Speedy 1. Speedy 1 retained the loan note but at a later step made a distribution of £16m to its immediate parent ETEL. It satisfied that distribution

by the release of £16m of a £35m debt due from ETEL to Speedy 1 which had itself been transferred to Speedy 1 by earlier steps in the reorganisation.

c) The Second Appellant, Stapleton's (Tyre Services) Limited ("Stapleton's"), made a distribution to its immediate parent ETEL which was partially satisfied by the issue of a loan note of £19.5m. This loan note was then used by ETEL to settle the balance of the £35m debt due to Speedy 1 plus £0.5m of an amount owed to KF GB.

28. KF GB initially challenged HMRC's disallowance of interest on the £40m debt owed by KF GB but did not pursue that challenge before the FTT. We are therefore concerned with the £16m loan note issued by KF Finance and the £19m of the loan note issued by Stapleton's which was used to satisfy the balance of the £35m debt owed by ETEL to Speedy 1 (together, the "New Loans"). However, HMRC also relied on the creation and treatment of the £40m debt as part of the relevant factual context.

29. As the FTT explained at para. 62, the effect of the steps referred to at [27.] b) and c) above was that £35m of debt that had previously been owed by ETEL was "pushed down" such that KF Finance owed £16m to Speedy 1 and Stapleton's owed £19m to Speedy 1. Overall intra-group indebtedness was not increased but the borrowers as well as the creditor changed.

30. The FTT found as follows about interest rates:

> "29. As recorded in Appendix 1, following these steps, the interest rates on receivables held by Speedy 1 [were] either set at or increased to LIBOR + 5%. This included both receivables assigned to Speedy 1 and … the receivable which had already been owed by KFG to Speedy 1.
>
> 30. The interest rate on intra-group loans that were not involved in the reorganisation was not increased. Such loans included loans between other companies within the Kwik-Fit Group where Speedy 1 was not the creditor, and a loan of £57.6m owed by Speedy 1 to Detailagent (a subsidiary of [Kwik-Fit Euro Limited, the Fifth Appellant]) (the "Detailagent Loan")."

31. Leaving the impact of the transfer pricing rules to one side, it is obvious that the higher the interest rate charged by Speedy 1 (and the lower the rate charged on any debts owed by Speedy 1), the faster the non-trading deficits would be used up. As the FTT noted at para. 142 in the context of Mr Bartley's understanding of the position, "the interest rate set by the group as well as the quantum of loans assigned to Speedy 1 would be key drivers of the rate of use of those losses".

32. In the absence of challenge by HMRC, the FTT also found as a fact that LIBOR plus 5% was an arm's length rate of interest (para. 49). However, later in its decision it rejected the Appellants' explanation of the increase in the interest rate on the loans owed to Speedy 1 by reference to the mandatory requirements of the transfer pricing legislation in Part 4 of TIOPA, saying this:

> "115. We do not consider that the existence of the transfer pricing legislation, its application to the Pre-existing Loans (or the New Loans), the decision not to charge this higher rate of interest on other loans in the

Kwik-Fit Group that were not involved in the reorganisation, or HMRC's failure to challenge that rate assist with the Appellants' argument:

(1) Section 147 TIOPA 2010 requires that the profits and losses of a potentially advantaged person (in this case Speedy 1) are to be calculated for tax purposes as if the arm's length provision had been imposed instead of the actual provision. This therefore requires that tax is calculated as if an arm's length rate of interest is received; it does not require that such a rate of interest is actually imposed.

(2) It is only if tax is calculated on the basis of an arm's length provision rather than the actual provision that another affected party (in this case the Appellants) may make a claim so that their taxable profits are calculated as if the arm's length provision had been made.

(3) Following the reorganisation, the higher interest rate of LIBOR + 5% was charged on the Pre-existing Loans, ie the loans within the Kwik-Fit Group that were repayable to Speedy 1. This higher rate of interest was not charged on the Detailagent Loan (which was owed by Speedy 1) or on loans owing between other members of the Kwik-Fit Group. The group was taking decisions to manage the amount of net interest income in Speedy 1 – if Speedy 1 had paid out the higher rate of interest on the Detailagent Loan then this would have had the effect of slowing down the rate of utilisation of the [non-trading deficits].

(4) Having referred to the fact that the higher rate of interest was not applied to all loans within the group, Mr Andrews stated that had they applied transfer pricing, those loans would become tax neutral anyway. One difficulty with this argument is that we are not satisfied that the Kwik-Fit Group applied the transfer pricing legislation to those other loans when calculating the profits and losses of the creditors and accordingly no claim was made, or was able to be made, by the debtors for a corresponding adjustment.

(5) The selective approach adopted within the group relates therefore not just to the decision as to the actual provision to impose (ie whether the debtors should pay the higher rate of LIBOR + 5%) but also as to whether to apply the (mandatory) transfer pricing legislation."

33. As to the purpose of the reorganisation, the FTT recorded at para. 48 that it was accepted by the Appellants that a purpose of the reorganisation was to accelerate the use of Speedy 1's non-trading deficits. It further found at para. 100 that the Appellants' directors had received and understood a memorandum prepared in June 2013 (the "June 2013 Memorandum"). The memorandum is summarised at para. 99. It referred to a "long-term aim" of simplifying the group structure by eliminating surplus entities and described the first step as simplifying the intra-group funding structure. It stated that a "significant advantage" of doing so would be permit the use of Speedy 1's non-trading deficits "and thus reduce the group's total tax liability". As to "Tax impact" it said:

> "The effect of the proposed transaction is that the interest-paying entities below Speedy 1 would obtain tax relief on their payments and thereby reduce their respective tax liabilities, whilst the interest income arising in Speedy 1 would be offset against the brought forward [non-trading deficits] without incurring any tax liability."

I will return at [93.] below to the point that there is no express reference here or elsewhere in the FTT's decision to group relief.

34. The FTT also found that the directors had received a detailed steps and advice paper produced by PwC in August 2013 and "understood the consequences of the transactions set out in that paper" (para. 100).

35. The FTT then made the following findings:

> "101. We find, based on the evidence of Mr Ogura, that:
>
> (1) the decision to implement the reorganisation was made as a whole group; the Appellants were part of that group so they understood and cooperated in that decision;
>
> (2) the June 2013 Memorandum sets out what the directors of each company wanted to achieve, both for themselves and for the other members of the Kwik-Fit Group. That group purpose (as set out in that memorandum) was to create net receivables within Speedy 1, to enable utilisation of the losses in Speedy 1, and tax deductions for the interest expense of each debtor. That outcome was considered to be good for the whole group;
>
> (3) an additional group purpose of the reorganisation was to simplify the intercompany balances within the Kwik-Fit Group;
>
> (4) each of the Appellants knew the full details of the reorganisation which was being implemented, the steps they were required to take to implement that reorganisation, whether for themselves or as shareholder of another company involved in the reorganisation and understood as a matter of fact that the reorganisation had the effect of assigning the receivables under the Pre-existing Loans to Speedy 1. They understood that this was "for the benefit of the whole group"; and
>
> (5) each of the Appellants had a choice as to whether or not to participate in the reorganisation, and if they had decided not to do so then the Pre-existing Loans to which they were party would have been left out of the reorganisation. The only potential reason for not participating given by Mr Ogura was if they had not wanted to pay the increased interest rate on those loans.
>
> 102. It was agreed that the Appellants had incurred the debts under the Pre-existing Loans for commercial purposes. We also find that:
>
> (1) this commercial purpose for being party to those loans remained throughout the accounting periods in issue;
>
> (2) the Appellants had little capacity to repay the sums due, and still required debt-funding for their ongoing commercial activities;
>
> (3) all of the Pre-existing Loans were repayable on demand, and there had been no "threat" by the existing creditors to call for repayment of those loans;
>
> (4) it was an integral part of the reorganisation that the interest rate on the Pre-existing Loans would be increased to LIBOR + 5%. If the relevant debtor had not agreed to participate in the reorganisation and take the steps required of it then the relevant Pre-existing Loans would not have been assigned to Speedy 1 (other than the KFG Loan under

which Speedy 1 was already the creditor) and the interest rate would not have been increased; and

(5) the Appellants agreed to pay a higher interest rate on the amounts they owed as part of the reorganisation. This was on the understanding that such higher rate did not exceed the rate at which they could otherwise borrow from third parties. The Appellants were aware that paying this higher rate of interest on the Pre-existing Loans (which would ultimately be payable to Speedy 1) directly fed into the tax benefit for the group.

103. The £35m of debt of ETEL (which was pushed down to KF Finance and Stapleton's in the reorganisation and resulted in them incurring the New Loans) had been incurred for ETEL's commercial purposes. The £16m incurred by KF Finance and the £19m incurred by Stapleton's as part of the reorganisation did not increase the amount of debt owed within the group. Mr Ogura accepted that these two debts, the New Loans, were incurred in order to assist in the reorganisation. On the basis of that evidence, we find that KF Finance and Stapleton's did not have their own commercial purpose (eg, needing to borrow the funds for their commercial activities) in being party to the New Loans other than the group purpose of facilitating the reorganisation.

104. There were some companies within the group that were almost dormant [giving two examples]… We accept that a long-term aim of the group was to reduce the number of dormant companies, and note that these two companies were subsidiaries (direct and indirect) of Stapleton's and have since been struck off. However, we find that this wider aim, whilst having been referred to in the June 2013 Memorandum, was part of the background to the reorganisation proposals but are not satisfied that it was a purpose of the Appellants in approving the reorganisation or agreeing to undertake the transactions required to implement the reorganisation. It was merely part of the background noise..."

36. The FTT also found as follows at para. 113 about the increase in interest rate:

"… the increase in interest rate was a significant additional cost which the Appellants agreed to incur in respect of their existing borrowings. The consequence of this was that the Appellants benefitted from greater interest debits and Speedy 1 was able to use its NTDs over a shorter period of time. We have concluded that the only reason the Appellants agreed to incur [the higher rate of interest on the Pre-existing Loans] was to secure the intended tax advantages for themselves and for Speedy 1. If they had not consented to this increased interest expense, they would have continued to borrow at the cheaper rate from the original creditor (albeit that Speedy 1 was also the original creditor under the KFG Loan). It is the decision to incur this additional cost, rather than agreeing to the assignments of the debt and thus the change in creditor, which we regard as being of greatest significance."

37. At para. 116 the FTT concluded that the decisions to increase the rate of interest on the Pre-Existing Loans provided strong evidence that the Appellants had acquired a new

purpose for being party to them, in addition to their existing commercial purpose. This was a tax avoidance purpose, and was important as it was integral to the steps taken. It was a main purpose. As to the New Loans, ETEL had incurred the original £35m debt for commercial purposes but KF Finance and Stapleton's did not have their own commercial purpose (see above), and the intended tax advantages were not only a main purpose but the main purpose for which KF Finance and Stapleton's were party to them (para. 117).

38. The FTT then went on to consider apportionment. Based on its conclusion that KF Finance and Stapleton's did not have their own commercial purpose in entering into the New Loans and that tax avoidance was the main purpose, it attributed all the debits on those loans to the unallowable purpose (para. 133). For the Pre-existing Loans, it agreed with HMRC's approach on the KFG Loan (in respect of which there had been no change of creditor), namely that debits should be disallowed in respect of the increase in rate, concluding that the decision to increase the rate was "solely attributable to the tax avoidance purpose of KFG" (para. 135). For the Assigned Loans, the interest on which had been disallowed by HMRC in full, the FTT decided that this did not reflect the Appellants' (continued) commercial purpose and instead adopted the same approach as for the KFG Loan, disallowing the interest corresponding to the increased rate. It was on that basis that it allowed the appeal in part. The FTT also agreed at para. 138 with HMRC's approach of capping the disallowance at the amount of Speedy 1's non-trading deficits.

The UT Decision

39. The Appellants appealed to the UT on the grounds that the FTT made an error of law in deciding that there was an unallowable purpose in respect of Speedy 1's use of its non-trading deficits, and that as far as the Appellants' own tax positions were concerned the FTT had confused knowledge with purpose, there being no evidence that they had the requisite purpose of increasing their own deductions. In the alternative, the Appellants maintained that the FTT erred in its approach to apportionment. HMRC appealed on the ground that the FTT erred in allowing interest at the pre-increase rate on the Assigned Loans.

40. The UT held that the interest debits claimed by the Appellants were tax advantages. It also held that Speedy 1's use of its non-trading deficits was a tax advantage (paras. 42 to 46 of the UT Decision). It made no difference that losses were used up as a result (para. 47). The UT also rejected arguments based on the *Sema* and *Kleinwort Benson* cases discussed below, the transfer pricing legislation and the fact that there were no findings about specific tax savings (paras. 52 to 81).

41. The UT went on to decide that the FTT had been entitled to reach the conclusions that it had about main purpose. The Appellants' attempt to contrast their accepted purpose of using Speedy 1's non-trading deficits with their disavowal of any purpose in seeking deductions for themselves flew in the face of the rationale for the reorganisation, which was "to achieve a group tax benefit". That required not only an increase in Speedy 1's income but the debit generated in the entity paying interest to Speedy 1 to "be capable of being put to use, by being set off against income, either in the paying entity or elsewhere in the group" (para. 105 of the UT Decision). There was no unfairness in failing to put squarely to the witnesses that the Appellants had a purpose of securing deductions, which the witnesses had in fact confirmed was a key feature of the

reorganisation (paras. 108 to 110). The interlinking between Speedy 1's non-trading deficits and deductions for the Appellants also explained the logic of HMRC's approach of capping the disallowance at the amount of the non-trading deficits (para. 111). Further, there was no error in the inferences drawn by the FTT about the selective approach to interest rate increases (para. 115), and no evidence to indicate that the FTT should have found that compliance with the transfer pricing rules featured in the Appellants' subjective purposes (para. 117).

42. The UT also upheld the FTT's decisions about apportionment, again rejecting the Appellants' arguments about the impact of the transfer pricing legislation and concluding on HMRC's appeal that it was open to the FTT not to disallow interest at the pre-increase rate under the Assigned Loans (paras. 133 to 146). Finally, the UT rejected an argument based on the "double-hit" to the Kwik-Fit group of using up Speedy 1's non-trading deficits and being denied deductions under the unallowable purpose rule (paras. 147 and 148).

The grounds of appeal

43. The issues raised by the grounds of appeal to this Court can be outlined as follows:

Issue 1: The FTT and the UT erred in holding the Appellants each had an unallowable purpose in becoming or remaining parties to the relevant loan relationships. Specifically:

Issue 1a: The FTT and UT erred in concluding that the accelerated utilisation of Speedy 1's valid and unrelated non-trading deficits was a tax advantage for Speedy 1, and therefore that the Appellants thus had a main purpose of conferring a tax advantage on Speedy 1.

Issue 1b: The FTT and UT also erred in concluding that the Appellants' purpose was to obtain a tax advantage for themselves, namely deductible debits, in circumstances where there was no finding of a reduction in tax charges in the Appellants and it was not put to the witnesses that securing a tax advantage for themselves or another person was a purpose. The Appellants' subjective intention was confined to accelerating the use of Speedy 1's non-trading deficits, and that could not be conflated with knowledge that the Appellants would obtain deductible debits.

Issue 2: In the alternative, the FTT and the UT erred in their application of the just and reasonable attribution provision. The UT misunderstood this issue and also erred in rejecting the Appellants' argument about the impact of the transfer pricing legislation.

Respondent's Notice

44. HMRC has filed a Respondent's Notice which maintains that, in addition to the reasons given by the UT, the UT should have found that the Appellants' witnesses did give evidence that the Appellants' purpose was to secure deductions.

Submissions for the Appellants

45. Mr Ghosh's key submissions can be outlined as follows.

46. It was accepted that the reorganisation had a purpose of using Speedy 1's brought forward losses. However, that was not a tax advantage because Speedy 1 was not better off as against HMRC as a result: *IRC v Sema Group Pension Scheme Trustees* [2002] EWCA Civ 1857, [2003] STC 95 ("*Sema*").

47. It was also accepted, and the FTT found, that the Appellants knew that paying increased interest would result in deductible debits, further that they wanted such debits, expected them to arise and would not have engaged in the reorganisation if they had been told that deductions would not be available. However, knowledge and expectation did not amount to a (main) purpose: cf. *IRC v Kleinwort Benson* [1969] 2 Ch 221 ("*Kleinwort Benson*"), cited in *Sema*.

48. There was no evidence that obtaining the increased deductible debits was a purpose of the Appellants, rather than simply being within their knowledge. Such a purpose was not put to the Appellants' witnesses in cross-examination. It would be unfair to infer purpose from knowledge without that being put straightforwardly to the witnesses. Rather (and until prompted by this Court to adopt a different approach during argument), HMRC's case had always been put on the basis that the main purpose was to secure a tax advantage for Speedy 1, being the use of its losses. The concepts of "group tax benefit" and the "interlinkage" of "twin elements" of obtaining deductions and using losses were wrongly introduced by the UT. It had not been put to the witnesses that the use of Speedy 1's losses was no more than a means to an end of generating tax relief for the group in the form of deductible debits.

49. This case is important. HMRC were seeking to apply the unallowable purpose rule to commercial loans on which interest was charged at an arm's length rate. The fact that the effect of the transfer pricing rules was mandatory, requiring interest to be charged at an arm's length rate on the debt, was relevant statutory context. Speedy 1 had used existing, genuine, losses against its interest income. What the group had done was precisely what the statutory code envisaged.

50. In the alternative, the FTT and UT erred in respect of apportionment. It was wrong to treat interest on a commercial loan, charged at an arm's length rate in compliance with the requirements of the transfer pricing rules, as infected by a main tax avoidance purpose. The fact that HMRC were prepared to "cap" the disallowance at the amount of Speedy 1's non-trading deficits was highly relevant. The Appellants' position, and desire for deductions, did not alter once the deficits were used up. The "capping" showed that this case was all about Speedy 1's losses.

51. If it was correct that the Appellants had main purposes comprising both the use of Speedy 1's non-trading deficits and the creation of debits then, because the former did not give rise to a tax advantage and so could not be an unallowable purpose, the tribunals' approach to apportionment was wrong on that basis. Alternatively, if there was a single purpose involving the interlinking suggested by the UT and the use of losses as a means to an end of generating tax relief then that had not been raised with Counsel or put to the witnesses. It would require the decision to be remade and would be unfair.

The test for unallowable purpose

52. *BlackRock* is obviously a very recent decision of this Court that considers the concept of unallowable purpose in some detail. As in that case, there was no dispute that in interpreting ss.441 and 442 CTA 2009 it is appropriate to apply the summary by Newey LJ (with whom the other members of the court agreed) in *Travel Document Service v HMRC* [2018] EWCA Civ 549, [2018] STC 723 at [41], in relation to the predecessor legislation in para. 13 of Schedule 9 to the Finance Act 1996. That summary is as follows:

> "i) A company had an "unallowable purpose" if its purposes included one that was "not amongst the business or other commercial purposes of the company" (see paragraph 13(2) of schedule 9 to FA 1996);
>
> ii) A tax avoidance purpose was not necessarily fatal. It was to be taken to be a "business or other commercial purpose" unless it was "the main purpose, or one of the main purposes, for which the company is a party to the relationship" (see paragraph 13(4));
>
> iii) It was the company's subjective purposes that mattered. Authority for that can be found in the decision of the House of Lords in *Inland Revenue Commissioners v Brebner* [1967] 2 AC 18 , which concerned a comparable issue, viz. whether transactions had as "their main object, or one of their main objects, to enable tax advantages to be obtained". Lord Pearce concluded (at 27) that "[t]he 'object' which has to be considered is a subjective matter of intention", and Lord Upjohn (with whom Lord Reid agreed) said (at 30) that "the question whether one of the main objects is to obtain a tax advantage is subjective, that is, a matter of the intention of the parties"…"

53. Further, and again as in *BlackRock*, it is uncontroversial that what matters is the company's subjective purpose or purposes in being a party to the loan relationship in question, and that for a corporate entity it is necessary to consider the subjective purpose of the relevant decision makers, generally the board of directors (*BlackRock* at [106]-[108]).

54. It is also worth reproducing the summary in *BlackRock* at [124] of key points relevant to ascertaining purpose:

> "a) Save in "obvious" cases, ascertaining the object or purpose of something involves an inquiry into the subjective intentions of the relevant actor.
> b) Object or purpose must be distinguished from effect. Effects or consequences, even if inevitable, are not necessarily the same as objects or purposes.
> c) Subjective intentions are not limited to conscious motives.
> d) Further, motives are not necessarily the same as objects or purposes.
> e) "Some" results or consequences are "so inevitably and inextricably involved" in an activity that, unless they are merely incidental, they must be a purpose for it.

> f) It is for the fact finding tribunal to determine the object or purpose sought to be achieved, and that question is not answered simply by asking the decision maker."

Sema and *Kleinwort Benson*

55. *Sema* concerned a claim by the trustees of a pension scheme for the payment of tax credits arising on buy-backs of shares by Powergen plc. The Inland Revenue sought to counteract the perceived tax advantage under the transactions in securities rules then contained in Chapter 1 of Part XVII Income and Corporation Taxes Act 1988 ("ICTA 1988").

56. The trustees' appeal against the refusal of the tax credits was allowed by the Special Commissioners but their decision was reversed by Lightman J. This Court allowed the trustees' appeal on the basis that they had not received an "abnormal amount by way of dividend" and so did not fall within the legislation on that basis. However, relevantly for our purposes Jonathan Parker LJ, with whom Aldous LJ and Aikens J agreed, went on to consider the concept of "tax advantage", which was defined in s.709(1) ICTA 1988 in a virtually identical way to the definition in s.1139 CTA 2010. As is clear from Jonathan Parker LJ's judgment at [106] his comments on that issue are therefore obiter, but nonetheless they should be afforded considerable respect. Ms Wilson also did not submit that we should not adopt them because they were wrong, rather that they were made in the context of the facts of *Sema* and that s.1139 is a provision that is applied in various parts of the corporation tax code, so that it should not be inappropriately cut down.

57. While I understand Ms Wilson's points, for my part I would endorse Jonathan Parker LJ's comments on the meaning of tax advantage and apply them to s.1139 CTA 2010. I do not consider that they should be confined by reference to the facts of *Sema*.

58. The issue arose in *Sema* because Mr Gardiner QC, for the trustees, had argued that the entitlement to a tax credit which arose by virtue of the pension scheme's exemption from tax was not an advantage that fell within the concept of a "relief" for the purposes of s.709(1). He had also submitted that it was not a "repayment" because that presupposed a prior payment of tax, such as where tax is deducted at source.

59. Jonathan Parker LJ responded as follows:

> "108. In the first place, I reject Mr Gardiner's submissions based on the conceptual difference between exemption and relief. Such submissions seem to me to involve a degree of sophistication which runs entirely counter to the general approach to be adopted to the construction of the relevant statutory provisions, as finally laid down by the House of Lords in *IRC v Joiner* [1975] STC 657, [1975] 1 WLR 1701...
>
> 109. In my judgment, what the draftsman was manifestly trying to do when defining '*tax advantage*' in s 709(1) was to cover every situation in which the position of the taxpayer vis-à-vis the Revenue is improved in consequence of the particular transaction or transactions. As I read s 709(1) the distinction between '*relief*' and '*repayment*' is not based on any conceptual difference between the two; the true interpretation of s 709(1) is

> in my judgment much simpler than that. In my judgment, '*relief*' in s 709(1) is intended to cover situations where the taxpayer's liability is reduced, leaving a smaller sum to be paid, and '*repayment*' is intended to cover situations in which a payment is due from the Revenue. In the same way, the references to '*increased relief*' and '*increased repayment*' are directed at situations in which the taxpayer is otherwise entitled to a relief or repayment, with which the '*relief*' or '*repayment*' referred to in s 709(1) must be aggregated.
>
> 110. It follows that I respectfully agree with the observation of Aldous J in *Sheppard and anor (Trustees of the Woodland Trust) v IRC (No 2)* [1993] STC 240 that the words '*tax advantage*' in the relevant statutory provision (Aldous J was concerned with s 466(1) of the 1970 Act: the forerunner of s 709(1)) presuppose that a better position has been achieved. However, I respectfully differ from him when he goes on to answer the question 'An advantage over whom or what?' by saying: 'Advantage over persons of a similar class' (see [1993] STC 240 at 253). In my judgment, the simple answer to that question is that a better position has been achieved vis-à-vis the Revenue.
>
> 111. On this issue, therefore, I would uphold the conclusions of the Special Commissioners and of the judge, holding that in consequence of the buy-backs the trustees obtained a '*tax advantage*' within the meaning of the definition of that expression in s 709(1)."

60. Mr Ghosh also relies on further obiter comments by Jonathan Parker LJ on the question of whether the trustees had a main object of obtaining a tax advantage. Mr Gardiner had submitted that the conclusions reached below contradicted the rationale of what Cross J had said in *Kleinwort Benson* and were wrong given that a decision had previously been made to sell the Powergen shares for investment reasons, and the buy-backs simply provided a golden opportunity to implement that decision.

61. Jonathan Parker LJ referred at [113] and [114] to Lord Upjohn's speech in *IRC v Brebner* [1967] 2 AC 18, 30, where Lord Upjohn had explained that the test was a subjective one to be decided on all the evidence and the proper inferences to be drawn from that evidence. He concluded that the Special Commissioners had been entitled to decide that a main object of the sales by the trustees was to obtain tax advantages. The sales were made *when* they were only because it was known that the tax credits were available: the tax credits were crucial because otherwise there would have been a loss. As to *Kleinwort Benson*, at [119] Jonathan Parker LJ agreed with the comments of Lightman J in his judgment in the High Court ([2002] STC 276) at [53], adding that:

> "Cross J's observations must be read in the context of the particular transaction which was in issue in that case. So read, they do not in my judgment raise any doubts as to the application of the *Brebner* principle."

62. In *Kleinwort Benson* the taxpayer bank bought debenture stock at a price which reflected significant arrears of interest. The outstanding interest was then paid to the bank but under the tax rules then in force it did not have to bring that receipt into its tax computation. The effect was to create a loss on the subsequent sale of the stock, which the Revenue sought to counteract under the transactions in securities rules. As in *Sema*,

Cross J decided that the transaction did not fall within those rules so his comments on main object are obiter. The observations made by Cross J to which Jonathan Parker LJ's judgment refers are set out in Lightman J's decision in *Sema* at [52], and read as follows:

> "Here there was only a single indivisible transaction and it was an ordinary commercial transaction, a simple purchase of debenture stock. As the purchaser was a dealer he was entitled to keep the interest element out of his tax return and so was able to pay a higher price than an ordinary taxpayer would have been able to pay. Similarly, a charity, because it would have been able to reclaim the tax, would have been able to pay an equally large price and still make a profit. But it is to my mind an abuse of language to say that the object of a dealer or a charity in entering into such a transaction is to obtain a tax advantage.
>
> When a trader buys goods for £20 and sells them for £30, he intends to bring in the £20 as a deduction in computing his gross receipts for tax purposes. If one chooses to describe his right to deduct the £20 (very tendentiously be it said) as a "tax advantage" one may say that he intended from the first to secure this tax advantage. But it would be ridiculous to say that his object in entering into the transaction was to obtain this tax advantage. In the same way I do not think that one can fairly say that the object of a charity or a dealer in shares who buys a security with arrears of interest accruing on it, is to obtain a tax advantage, simply because the charity or the dealer in calculating the price which they are prepared to pay proceed on the footing that they will have the right which the law gives them either to recover the tax or to exclude the interest as the case may be."

63. Lightman J's comments on this which were approved by the Court of Appeal were as follows:

> "53. The observations of Cross J call attention to the need when determining whether the obtaining of a tax advantage was a main object of an ordinary commercial transaction, to consider with care the significance to the taxpayer of the tax advantage. The tax advantage may not be a relevant factor in the decision to purchase or sell or in the decision to purchase or sell at a particular price. Obviously if the tax advantage is mere 'icing on the cake' it will not constitute a main object. Nor will it necessarily do so merely because it is a feature of the transaction or a relevant factor in the decision to buy or sell. The statutory criterion is that the tax advantage shall be more than relevant or indeed an object; it must be a main object. The question whether it is so is a question of fact for the commissioners in every case. Unless the commissioners misdirect themselves in law as to the test to be applied (as Cross J plainly thought was the case in *Kleinwort*) their decision cannot be challenged. It is plain that the commissioners correctly directed themselves in law in this case and that their decision was one which they could reasonably reach. I therefore do not think that invocation of the judgment of Cross J in *Kleinwort* assists the trustees."

Discussion: Issue 1

64. Mr Ghosh's submissions were skilfully and forcefully put, but I cannot accept that the FTT was wrong to decide that the unallowable purpose rule applied to restrict the availability of relief on the Pre-existing Loans and New Loans, or that the UT was wrong not to disturb the FTT's conclusion.

Purpose of using losses vs generating deductions: Issue 1a and 1b

65. The fundamental premise of Mr Ghosh's submissions is a distinction that he seeks to draw between the (admitted) purpose of utilising Speedy 1's losses and the Appellants' knowledge that deductible debits would be generated in the Appellants. In reality no such distinction can be drawn.

66. The relevant decision-makers in this case were the directors of the Appellants. The FTT had the benefit of clear evidence from one of their number, Mr Ogura, and from Mr Andrews, whose advice (and that of the firms he involved) the directors both understood and followed.

67. The FTT rightly focused on the Appellants' decisions to participate in the reorganisation, and their purposes in doing so. Commercial decision-makers such as Mr Ogura would have no real interest in using up Speedy 1's losses as an end in itself. It would achieve nothing of benefit to the group, for the very reason that Mr Ghosh relies on in submitting that the use of existing losses is not a tax advantage. Compared to a scenario where no reorganisation is implemented, neither Speedy 1 nor any other entity in the Kwik-Fit group would be better off vis-à-vis HMRC solely as a result of using those losses. Indeed, in the longer term the group could be worse off because the losses would no longer be available to shelter other income.

68. It is obvious that the decision-makers, and both tribunals, understood that the real benefit, being the one that would make the group better off as against HMRC, was not the receipt of interest income in Speedy 1 as such but the concomitant generation of interest deductions in the Appellants. It was these deductions that provided the tax saving to the group, because they were available for use either by the Appellants or by other members of the group via group relief surrenders, without needing to be used to offset any tax on the corresponding income in Speedy 1. The arrangements had the economic effect of releasing the non-trading deficits trapped in Speedy 1 for use by the group as a whole. Those losses could not be accessed directly under the rules at the time, so it was necessary to do so indirectly by creating deductions elsewhere and using Speedy 1's losses to absorb the resulting income. It was the creation of what were, in effect, "net" deductions, being deductions where the corresponding income did not create a tax charge, that would produce a real saving for the group. This was what the reorganisation was intended to achieve, and was the reason why the Appellants took part in it.

69. That Mr Ogura and the other directors understood this is an obvious inference. The FTT did not need to spell the point out in quite the same way as I have done because the case was not put in that way before it. But it is, and was, obvious. It is reflected in the first paragraph of the June 2013 Memorandum, which as the FTT recorded referred to the "significant advantage" of permitting use of Speedy 1's non-trading deficits "and thus

reduc[ing] the group's total tax liability". The "Tax impact" paragraph set out at [33.] above explains in terms how that reduction was to be achieved.

70. The point is also neatly illustrated by an email sent by Mr Andrews to Mr Ogura on 11 June 2013, shortly before the June 2013 Memorandum was finalised. The email referred to a reorganisation "so as to utilise the brought forward losses in Speedy 1", attached a draft of the paper setting out the proposed steps and discussed professional fees, comparing them with the fact that "as a minimum we would save cash tax of £1.3m per annum for a period of 5-8 years" based on an interest rate of 1.5%, with the savings being greater if the rate was higher. This saving could only be derived from the use of the deductions available to the Appellants, in circumstances where the group did not have to concern itself with covering a tax charge on the corresponding income.

71. The FTT's findings of fact reflect this. Paragraph 101(2) bears repeating, with emphasis added:

> "(2) the June 2013 Memorandum sets out what the directors of each company wanted to achieve, both for themselves and for the other members of the Kwik-Fit Group. That group purpose (as set out in that memorandum) was to create net receivables within Speedy 1, to enable utilisation of the losses in Speedy 1, and tax deductions for the interest expense of each debtor. That outcome was considered to be good for the whole group;"

The benefit to the group came from the availability of tax deductions without a charge to tax on the corresponding income.

72. At least until prompted by this Court to consider an alternative approach, HMRC has throughout sought to maintain that the reorganisation generated two separate tax advantages which the Appellants had a main purpose in securing, one for Speedy 1 (being the use of its losses) and one being the generation of relief in the Appellants. With respect, I think that has been the cause of unnecessary difficulties in this case. It has both over-complicated the analysis and left it open to the Appellants to run the case that they have before us.

73. I see significant force in Mr Ghosh's submission that, on the facts of this case, the reorganisation did not create a tax advantage for Speedy 1. Speedy 1 had existing losses which arose in an unobjectionable way. HMRC say that it is the setting of those losses against income which is the relevant tax advantage, because that avoids or reduces a charge (or possible charge) to tax within s.1139(2)(c) or (d) CTA 2010. But without the reorganisation Speedy 1 would not have a charge to tax that could be reduced, because it would not have the relevant income. In order to identify a tax advantage it is necessary to postulate the existence of income, the tax charge on which is then sought to be sheltered. Echoing Jonathan Parker LJ's comments in *Sema* it is only in that sense that Speedy 1 is better off as against the Revenue.

74. The distinction is important because what we are considering is whether the Appellants agreed to participate in the reorganisation with a main purpose of securing a tax advantage. In the context of Speedy 1 that most naturally requires a comparison of its tax position with and without the reorganisation, not (as HMRC's approach involves)

assuming that the reorganisation has occurred but comparing the position with or without the availability of Speedy 1's unobjectionable losses.

75. The tax advantage sought to be secured by the reorganisation was the generation of cash tax savings through the creation of deductible interest expense in circumstances where there was no need to worry about a tax charge on the income. The relevance of Speedy 1's losses is just that: it makes the deductions of real value to the group because the corresponding income is sheltered by reliefs that could not otherwise be used. That is why it was entirely appropriate for HMRC to have "capped" the disallowance at the amount of Speedy 1's brought forward losses. Once they are used up the value of the deductions to the group is offset by the need to cover the tax charge on the income.

76. It is right that much of the evidence, and cross-examination, in the FTT focuses on using Speedy 1's brought forward losses. But as already discussed that was clearly with a view to the savings that would be available from the use of the deductions arising in the Appellants. It follows that, with respect, the distinction drawn by Mr Ghosh between a purpose of using Speedy 1's losses and knowledge that a tax deduction would be available is an unreal one on the facts of this case. In effect, referring to using Speedy 1's losses was a convenient, and understood, shorthand for a description of arrangements which had the effect of creating a real tax saving for the group.

77. The FTT found that there was a purpose as described at para. 101(2). In my view, and bearing in mind that the Appellants' case was not put to the FTT in the way in which it was put to us, that paragraph and the FTT's other findings amply demonstrate that it concluded that the generation of deductions, without tax on the corresponding income, was found to be a main purpose of the reorganisation.

78. It is true that the FTT also stated at paras. 109 and 110 that a main purpose of the Appellants was to secure a tax advantage for Speedy 1, being the accelerated use of its losses. But it clearly understood this in the context of the corresponding deduction in the Appellants, for example referring at para. 113 to the consequence of the increased rate being "that the Appellants benefitted from greater interest debits and Speedy 1 was able to use its NTDs over a shorter period of time" and concluding that "the only reason" for agreeing to the increase was "to secure the intended tax advantages for themselves and for Speedy 1", and at para. 117 to the main purpose for which KF Finance and Stapleton's were party to the New Loans being "to secure the intended tax advantages for Speedy 1 and themselves".

79. The FTT was not asked to distinguish between the two asserted tax advantages and rightly considered the tax impact of them in combination. Put another way, it found a single unallowable purpose, which in shorthand terms was the "accelerated" use of Speedy 1's losses, but in longhand comprises the generation of the deductions for the benefit of the Appellants or other group members in circumstances where the corresponding income was sheltered from tax by Speedy 1's brought forward non-trading deficits, so in effect freeing those trapped reliefs for use by the Appellants or other members of the group.

80. I would prefer not to describe the use of Speedy 1's non-trading deficits as (by itself) a tax advantage intended to be secured by the reorganisation. I consider that that introduces a complexity into the description of the Appellants' purpose which is both unnecessary and apt to confuse. It involves the application of a technical tax analysis

that reflects the detailed mechanics of how the legislation works rather than how decisions are taken and expressed in the real world. However, in my view that is a detail rather than a material flaw in the FTT's approach.

Is there unfairness?

81. It largely follows from what I have already said that I do not consider that there was any unfairness in the UT reaching conclusions based on the "group tax benefit", or in this Court not basing its analysis on that part of HMRC's case that relates to an aim of securing a tax advantage in Speedy 1. The FTT referred in terms to the benefit to the group at paras. 101(4) and 102(5), set out above. The UT rightly agreed. Further, it was obviously understood by both witnesses that it was, and could only be, the combination of the deduction in the Appellants and the sheltering of income by losses in Speedy 1 that would allow the group benefit to be obtained.

82. Moreover, it is clear even from the passages of the transcript on which Mr Ghosh relied that Ms Wilson put the relevant points to Kwik-Fit's witnesses in cross-examination. It is true that there are plenty of references to utilising or accelerating the use of trapped losses, but this was in the context of the benefit to the group, which as already discussed could only be derived from the generation of interest deductions in the Appellants. For example, after agreeing that the purpose of the reorganisation was to "utilise these trapped losses in Speedy 1" Mr Ogura also confirmed that he understood that "one part of that process was that the debtor would pay more interest and it would get a corporation tax deduction for the interest that it was paying". Even more clearly, Mr Ogura agreed with the following (emphasis supplied):

> "In a sense it's obvious because the point of the reorganisation is to put net interest income in Speedy 1's hands because if it has more net interest income, it can use the trapped losses against that and then, of course, the debtor company that's paying the increased interest, it gets the tax deduction. <u>And that's the idea, isn't it; that's the sense in which you're accessing the losses</u>?"

Mr Andrews also agreed that the Appellants "would benefit from the PwC idea because they would get the CT deduction and Speedy 1, the group, would be utilising the trapped losses and so the benefit accrued to the whole group".

83. As in *BlackRock*, it also bears emphasising that, while ascertaining the object or purpose of something involves an inquiry into the subjective intentions of the relevant actor, it is for the fact finding tribunal to determine the object or purpose sought to be achieved, and that question is not answered simply by asking the decision maker (*BlackRock* at [124f)]). It was for the FTT to reach its own decision on whether there was an unallowable purpose based on all the evidence before it. The case did not depend on obtaining a concession in particular terms in cross-examination, or indeed on framing a question to a witness in a particular way.

The statutory context: commercial loans at arm's length rates

84. Mr Ghosh was right to emphasise that the Pre-existing Loans had a commercial purpose, which the FTT accepted at paras. 102(1) and 112 subsisted throughout. Further, the FTT found that interest was charged at an arm's length rate. Combined

with the features that deductions for interest at an arm's length rate are specifically contemplated by the loan relationships code, that Speedy 1's non-trading deficits arose in unobjectionable circumstances and that the legislation specifically provides for their offset against loan relationship profits, the conclusion that the unallowable purpose rules restricted the deductions might on a superficial analysis be considered to be a surprising one.

85. I would agree with Mr Ghosh that in most circumstances of that kind there would be no question of the unallowable purpose rule applying. As I explained in *BlackRock* at [150], it cannot have been Parliament's intention that the unallowable purpose rule will be engaged as an inevitable consequence of taking out (or, I would add, maintaining) a loan, or indeed charging interest on it at a commercial rate, subject only to consideration of whether the value of the tax benefits are sufficient to make it a "main" purpose. The mere fact that a group organises its affairs in a manner that makes use of brought forward non-trading deficits and that it expects to obtain relief for interest and other expenses of loan relationships, in each case as the legislation contemplates, cannot be enough to engage the unallowable purpose rule.

86. The comments of Cross J in *Kleinwort Benson*, set out at [62.] above, reflect a similar point in a different context. The tax consequences he was describing for a dealer (or charity in his other example) were specifically contemplated by the legislation.

87. However, as this Court recognised in *Sema*, Cross J's comments in *Kleinwort Benson* must be understood in the light of the facts of that case. Lightman J rightly emphasised at [53] of his decision in *Sema* (the paragraph approved by the Court of Appeal in that case) that the significance of the tax advantage to the taxpayer must be considered with care. I would add that it should also be considered in the context of the relevant legislative code. As Lightman J also explained, there is a range of possibilities. The possibilities include that the tax advantage may be a "feature" or a "relevant factor" without being a main object. (I would take the opportunity to clarify that Lightman J was not saying in the preceding sentence that anything that is more than "icing on the cake" will be a main object, rather that if it is no more than that then the answer is obvious that it will not be.) But the important point is that whether a purpose is a main purpose is a question of fact for the fact-finding tribunal, which cannot be interfered with in the absence of an error of law.

88. In this case, the FTT's conclusions were based on very particular factual features:

a) The "group purpose" of the reorganisation, which the Appellants willingly adopted, was to achieve the tax benefits that I have already described: para. 101 of the FTT Decision, set out set out at [35.] above.

b) There was an additional group purpose of simplifying intercompany balances (para. 101(3)), but that was clearly not considered by the FTT to be material. Further, the long-term aim of reducing the number of dormant companies was "merely part of the background noise": para. 104 ([35.] above).

c) The Appellants had a choice as to whether or not to participate in the reorganisation, the only reason given for not doing so being if they had not wanted to pay the increased rate of interest (para. 101(5)).

d) The Pre-existing Loans were repayable on demand and the Appellants had little capacity to repay them, but there was no threat to call for their repayment. Instead, the Appellants understood that the increased interest rate "directly fed into the tax benefit for the group". (See para. 102, set out above; the points are reiterated at para. 112.) In other words, the Appellants willingly agreed to take on the obligation to pay significant additional interest without any non-tax reason to do so. In contrast, if payment of interest at a commercial rate on a loan is the alternative to being required to repay it in circumstances where funds are still required, then that may well provide a commercial explanation for the borrower's agreement to the revised rate.

e) The increase in rate also had nothing to do with any recognition on the part of the Kwik-Fit group that it needed to make the change to avoid falling foul of the transfer pricing rules. There was no such recognition. The interest rate on the relevant loans was not set at LIBOR plus 5% because of a concern that the transfer pricing rules would otherwise be applied to adjust the rate upwards. Rather, the rate was set at LIBOR plus 5% to maximise the savings available while aiming to ensure that it was not objected to by HMRC as being excessive because it was above an arm's length rate. Setting the rate at a level that sought to ensure that it did not exceed what would be charged at arm's length i) meant that it could be accepted by the borrowers and ii) reduced the risk that the rate would be adjusted downwards for tax purposes, which would reduce the benefits available. The assumption was that the transfer pricing rules would not otherwise be applied to increase the interest rate.

f) Mr Ghosh frankly acknowledged that the transfer pricing rules did not motivate the increase in rate, but the point is also made very starkly by the FTT's findings that the Appellants could have chosen not to participate and that the interest rate would not have been increased on the Pre-existing Loans if they had not done so (paras. 101(5) and 102(4)), and by the group's decision not to increase the rate of interest on other intra-group debt, including the Detailagent Loan (paras. 30 and 115; see [30.] and [32.] above).

g) The result was that, although the commercial purpose for the Pre-existing Loans remained, the only reason for incurring the additional interest cost on the Pre-existing Loans was to secure tax advantages: para. 113 ([36.] above). The new rate was "integral" to the steps taken: para. 116 ([37.] above).

h) As to the New Loans, the FTT found at paras. 103 and 117 that KF Finance and Stapleton's did not have their own commercial purpose in taking them on and that the intended tax advantages were the main purpose for which KF Finance and Stapleton's were party to them ([35.] and [37.] above).

89. The FTT's analysis at para. 115 of the transfer pricing position ([32.] above) can also not be faulted. Mr Andrews' suggestion that loans not involved in the reorganisation were not transfer priced because it would be "tax neutral" rather makes the point for HMRC. The interest rates on loans owed to Speedy 1 was increased because a cash tax saving could be achieved – and indeed the higher that rate, the faster the saving – but a similar benefit could not be obtained in respect of other loans. Indeed, increasing the rate on the Detailagent Loan would slow the rate at which the benefit would be achieved, as the FTT explained.

90. It is apparent from this that the Kwik-Fit group chose not to comply with the strict requirements of the transfer pricing rules, which would have required it to adjust the rate on, among other things, the Detailagent Loan to an arm's length rate. Against that background, its submissions based on the requirements of the transfer pricing rules ring somewhat hollow. This is not a case where, for example, the group had reviewed its transfer pricing position on intra-group debt and decided that it should adjust interest rates generally to ensure compliance. The only reason that LIBOR plus 5% was selectively applied to debts owed to Speedy 1 was to achieve the anticipated tax benefits.

91. The Appellants are of course correct to say that the transfer pricing rules are mandatory. If Speedy 1 had charged less than an arm's length interest rate on the relevant loans, it should, as a "potentially advantaged person", nonetheless have filed its tax returns as if it had. That would have enabled each of the Appellants, as "the disadvantaged person", to claim relief under s.174 TIOPA in the form of correspondingly increased deductions. Section 446 CTA would have ensured that the amounts in question were taxed and relieved under the loan relationships regime, as if they had actually accrued. But none of that occurred, and further that approach was not applied to other loans, including the Detailagent Loan.

92. More importantly, what we are concerned with under the unallowable purpose rule is the Appellants' subjective purposes. Except insofar as the group sought to ensure that the rate would not be challenged as being excessive, it is clear that the transfer pricing rules played no part in the decision making process. Those rules therefore cannot assist in determining the Appellants' purposes. I see no statutory justification for interpreting ss.441 and 442 in a way that requires the transfer pricing rules to be taken into account when they were actually disregarded.

Failure to identify reduction in tax charge

93. One aspect of Issue 1b was that HMRC had at no stage identified any tax saving achieved by the generation of the deductions in the Appellants. The Appellants say that three of the Appellants were in fact loss-making. The possibility of other members of the Kwik-Fit group making using of the deductions by way of group relief did not feature before the FTT at all, and the FTT confined its conclusions to the securing of tax advantages for the Appellants themselves and Speedy 1 (see for example para. 113, set out at [36.] above).

94. This was obviously not an issue raised before the FTT, and I do not consider that HMRC was either obliged to raise it or the FTT to deal with it if it was not put in issue. But in any event I accept the submissions of Ms Wilson that there is no requirement to identify either a specific quantum of tax saving or the precise identity of the beneficiaries of that saving before concluding that an unallowable purpose exists.

95. First, identifying purpose requires a consideration of subjective intentions. That is necessarily a forward-looking exercise: broadly, what is sought to be achieved, not what is ultimately achieved. It is perfectly obvious that the group sought and expected to make material tax savings.

96. Secondly, s.442(5) provides that references to a tax avoidance purpose "are references to any purpose which consists of securing a tax advantage for the company or any other

person". This needs to be read in the context of the legislation of which it forms part. That includes the fact that, because profits and losses from loan relationships are determined in accordance with generally accepted accounting practice (and further, for a trading company, generally form part of its trading computation: s.297 CTA 2009), it may well be unclear until after the end of the relevant accounting period whether any debits will be absorbed by income in the company or whether they will generate excess reliefs available for surrender to other group companies or for carry forward. Further, the group relief position may well not be settled until well after the end of the period. This is illustrated by provisions which allow group relief claims to be made and adjusted well after the filing date for group members' tax returns: see para. 74 Schedule 18 Finance Act 1998.

97. It would frustrate the obvious aim of the unallowable purpose rule if it were confined to identified amounts saved by a specified person. Rather, as Ms Wilson submitted, and bearing in mind that under s.6 Interpretation Act 1978 the singular will include the plural unless a contrary intention appears, s.442(5) should properly be read as referring to the company in question and/or any other person or persons. In this case the FTT found at para. 101 that the aim was to benefit the "whole group". I consider that that was a sufficient identification of persons for the purposes of s.442(5). The persons in question were the Appellants and other members of the Kwik-Fit group.

Discussion: Issue 2

98. Issue 2 is that the FTT and the UT erred in their application of the just and reasonable attribution provision.

99. The correct approach to just and reasonable apportionment pursuant to s.441(3) CTA 2009 was considered in *BlackRock* at [179] and [180]. In summary, it is an objective exercise which requires apportionment by reference to the relevant purposes. The exercise is a fact specific one. The facts in *BlackRock* did not permit any element to be apportioned to the commercial purpose ([182]). The same result was reached if a "but for" approach was adopted, as the parties had suggested ([185]).

100. I can see no legal error in the FTT's approach to apportionment in this case. Mr Ghosh's submissions proceeded on the basis that apportionment should be by reference to the relevant "main" purposes rather than any ancillary one (which in this case might include simplifying group balances: see [88.b)] above). He also proposed a "but for" approach. As the FTT noted at para. 136, this is essentially the approach that it adopted.

101. KF Finance and Stapleton's were found to have had no commercial purpose in entering into the New Loans. That entitled the FTT to attribute all the debits on those loans to the unallowable purpose. Given its findings of fact, the FTT was also fully entitled to attribute all the debits arising from the increase in rates on the Pre-existing Loans to the unallowable purpose. For the reasons already discussed the transfer pricing rules do not assist the Appellants.

102. However, HMRC correctly accepted that once Speedy 1's losses were used up, it would no longer be just and reasonable to deny relief for the debits. This reflects the nature of the tax advantage sought to be secured, as already described (see [79.] above).

Conclusion

103. In conclusion, the FTT was entitled to reach the conclusions that it did and the UT was right not to disturb them. I would dismiss the appeals.

Sir Launcelot Henderson:

104. I agree.

Lady Justice Andrews:

105. I also agree.