[2015] UKFTT 582 (TC)

TC04728

Appeal numbers: TC/2012/05214 (1)
TC/2012/05218 (2)

Corporation tax – tax avoidance scheme – use of total return swap over shares in subsidiary company to create a deemed creditor loan relationship – value of shares depressed by novating liability for large loans to subsidiary – creating large fair value loan relationship debit in parent company – whether loan relationship had unallowable purpose – subsidiary incurred interest charges on novated loans – whether interest charges also disallowed as loan relationship debits having unallowable purposes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

TRAVEL DOCUMENT SERVICE (1) **Appellants**
LADBROKE GROUP INTERNATIONAL (2)

-and-

THE COMMISSIONERS FOR HER MAJESTY'S **Respondents**
REVENUE AND CUSTOMS

TRIBUNAL: JUDGE KEVIN POOLE
JULIAN SIMS FCA CTA

Sitting in public at the Royal Courts of Justice, Strand, London on 16 & 17 December 2014

Nicola Shaw QC and Michael Firth of counsel, instructed by Deloitte LLP, for the Appellants

Julian Ghosh QC and Elizabeth Wilson of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

Introduction

1. These appeals relate to an acknowledged tax avoidance scheme, notified as such under Part 7 Finance Act 2004. The essence of the scheme was to exploit a perceived loophole in the code for taxation of loan relationships contained in Finance Act 1996 ("FA96").

2. At its heart, the scheme involved bringing a holding of a subsidiary's shares within the loan relationship rules by entering into a form of derivative contract known as a "total return swap" in relation to them, then depressing the value of the shares by novating a large loan liability into the subsidiary from another group company. The intended effect of these arrangements was to accrue a large loan relationship debit in the shareholding company by reference to the reduction in the fair value of the shares in its subsidiary. In consequence of the novation, the subsidiary company also accrued conventional loan relationship debits as a result of its liability to interest on the loans novated to it.

3. In addition to disallowing the large debit in the shareholding company, HMRC have disallowed the smaller debits in the subsidiary. Their stated basis for doing this was the "unallowable purpose" rule contained in paragraph 13 of Schedule 9 FA96 and in considering the appeals, we have essentially explored aspects of that rule.

The facts

4. The facts were largely agreed. We received a bundle of documents (essentially comprising background information about the Ladbrokes group of companies, the documentation used to effect the scheme and the subsequent correspondence with HMRC) and a short witness statement from Philip Turner, Head of Group Tax and Strategic Planning of the Ladbrokes plc group of companies and also a director of the first appellant ("TDS"). Mr Turner was cross-examined on his witness statement by Mr Ghosh. There was also a short statement of agreed facts, which included the following explanation of the transactions involved in the scheme (for consistency, we use the defined terms in this statement in the rest of this decision):

> "**The Appellants**
>
> 1. The First Appellant, Travel Document Service, was incorporated and registered with Companies House on 14 June 1934 with company number 00289158. The First Appellant was previously known as Leadenhall Investments and Finance Ltd until 14 January 1992 and then Travel Document Service Limited until 16 March 2006. The First Appellant is a United Kingdom tax resident company.
>
> 2. The Second Appellant, Ladbroke Group International, was incorporated and registered with Companies House on 12 August 1965 with company number 00856636. The Second Appellant was

previously known as Ladbroke (Uxbridge) Limited until 31 December 1977 and then Ladbroke Group International Limited until 16 March 2006. The Second Appellant is a United Kingdom tax resident company.

5 3. Both the First Appellant and Second Appellant are members of the Ladbroke Group of Companies, the ultimate owner of which is Ladbrokes plc, company number 00566221. At all material times the Second Appellant was a subsidiary of the First Appellant, and has continued to be a subsidiary since 2008 to date.

10 4. Ladbrokes Betting and Gaming Ltd ("**LB&G**") is the principal operating company of the Ladbrokes group.

5. Jack Brown (Bookmaker) Ltd ("**JBB**") and Ladbrokes Call Centre Ltd (formerly Vernons Pools Ltd) were subsidiary companies of the Second Appellant.

15 **Background**

6. On 26 February 2008 Sponsio Ltd ("**Sponsio**"), a subsidiary of the First Appellant, applied for 28 ordinary shares of £1.00 each in the unissued share capital of the Second Appellant. Sponsio offered to pay a subscription price of £37,015.71 per share.

20 7. On 26 February 2008 the Finance Committee of the Second Appellant approved the issue of the shares in the terms set out therein.

8. The funds for the above subscription of shares by Sponsio (£1,036,439.88) were borrowed from another Ladbrokes Group member, LB&G.

25 9. On 28 February 2008, Sponsio borrowed £143,600,000 from Ladbroke Group Finance plc ("**LGF**"). LGF is the principal financing company for the Ladbrokes Group.

10. On 28 February 2008 Sponsio used £23,600,000 of the funds borrowed from LGF to acquire Ladbrokes (Northern Ireland)
30 (Holdings) Limited ("**L(NI)(H)"**) from LB&G.

11. On 28 February 2008 Sponsio made an intercompany loan of £120,000,000 to L(NI)(H). On 28 February 2008 L(NI)(H) made a second intercompany loan of £120,000,000 to another group member, North Western Bookmakers Ltd ("**NWB**").

35 12. On 29 February 2008, the First Appellant entered into a total return swap with LB&G over the shares it held in the Second Appellant. This total return swap had a maximum term of 5 years but was subject to early termination on any payment date.

13. On 6 March 2008, at a meeting of the Finance Committee of LB&G it was decided that an interim dividend of £110,000,000 would be paid to the ordinary shareholders.

14. On 6 March 2008 Sponsio Borrowed £110,000,000 from LGF, which it then on-lent to LB&G.

15. On 11 March 2008, the First Appellant subscribed for 1901 shares in Sponsio at a subscription price of £1,036,440. Sponsio repaid LB&G the amount of £1,036,440 on 11 March 2008.

16. On 11 March 2008, Sponsio novated its right and obligations under the loans of £143,600,000 and £110,000,000 (plus accrued interest) to the Second Appellant for nominal consideration.

17. On 23 May 2008, the JBB business was sold to LB&G.

18. On 30 May 2008, the total return swap of the shares in the Second Appellant was terminated. A termination payment of £648,555 was made by the First Appellant to LB&G."

5. The statement of agreed facts then went on to record that:

(1) TDS claimed a non-trading loan relationship debit of £253,939,631 under section 91B FA96 for its accounting period ended 31 December 2008 (in respect of the reduction in fair value of its investment in the Second Appellant ("LGI") as a result of the novation by Sponsio to LGI of the borrowings mentioned in paragraph 16 of the statement of facts ("the Novations"));

(2) LGI claimed non-trading loan relationship debits of £9,953,748 and £2,181,479 in respect of interest payable on the novated loans for the accounting periods ended 31 December 2008 and 2009 respectively;

(3) HMRC disallowed all the above debits and such disallowance was ultimately appealed (after a statutory review) to the Tribunal.

6. A much simplified diagram depicting the key transactions set out above in outline is appended to this decision to assist the reader.

7. The total return swap referred to in paragraph 12 of the statement of agreed facts ("the Swap") requires a little more explanation. It comprised a standard form ISDA Master Agreement and a Total Return Swap Confirmation, both dated 29 February 2008. We were not taken through them in detail, but we were informed that in broad terms under the Swap as it applied in practice, LB&G was required to pay interest to TDS at a rate of 0.125% below 3 month LIBOR on a notional equity amount of £280,973,959 (agreed as the fair value of the LGI shares at 29 February 2008) and TDS was required to pay to LB&G an amount equal to the increase in the fair value of the LGI shares, both with effect from 11 March 2008. Adjustments were to be made in respect of non-arms length transactions, and this applied in relation to the Novations and the subsequent interest on the novated loans.

8. We were provided with a calculation showing how the termination payment of £648,555 made to LB&G was arrived at. It showed that the fair value of the shares in LGI had decreased to £28,750,868 by 30 May 2008; after adjustments of £253,600,000 (in respect of the novated loans) and £3,204,136 (in respect of the associated interest) had been added back, this brought the notional fair value of the shares at 30 May 2008 up to £285,555,004. This represented an increase of £4,581,045 over the 29 February 2008 value, which was therefore the amount TDS was required to pay under the Swap on 30 May 2008. To set against that, LB&G was required to pay TDS notional interest totalling £3,932,490, so after netting off the two liabilities, TDS ended up having to pay a net amount of £648,555 to LB&G on 30 May 2008.

9. It appears that the "fair value" for these purposes was simply based on the consolidated net asset value of LGI and its subsidiaries, both when the Swap was entered into and when it was terminated. The increase in "fair value" (after adjusting for the Novations) was therefore equivalent to the net profit of LGI and its subsidiaries over the lifetime of the Swap. HMRC did not seek to argue this was incorrect.

10. The stated purpose of Mr Turner's witness statement was "to explain the commercial purpose of TDS holding the shares of LGI" as well as to "set out the background" to the various transactions entered into by TDS and LGI.

11. He informed us that the business of the Ladbrokes group of companies is currently focused on betting and gaming, through retail outlets in the UK, Eire, Spain and Belgium and online (based in Gibraltar). Over the last ten years or so it has divested itself of a number of other significant businesses, including the Hilton Hotels business (outside the USA), Vernons Football Pools, Texas Homecare DIY stores, various property investment and development activities and UK casinos.

12. Following the Hilton sale in 2006 (for £3.7 billion), the group concentrated on expanding the retail spread of its betting and gaming business. As part of that process, it acquired two companies in Northern Ireland, NWB and Eastwoods Limited (which between them operated 70 shops in Northern Ireland). This acquisition was effected using a Northern Ireland holding company L(NI)(H), a subsidiary of LB&G. It was done in this way in order to avoid regulatory issues in Northern Ireland, which required that any company seeking to hold a bookmaker's licence there had to be incorporated in Northern Ireland. L(NI)(H) was apparently incorporated as a Northern Irish intermediate holding company as a further precaution in the light of this restriction.

13. Amongst the stated main aims of the Ladbrokes group corporate policy were (a) to reduce the number of active UK subsidiaries and merge the operating business into LB&G and (b) to shorten the ownership chains of the group and reduce the number of active subsidiaries.

14. In pursuance of these aims, Mr Turner said that the group's intention was to "streamline its activities by making LB&G the main operating company for its UK

betting and gaming business”. As such, it was the intention “where practicable and for administrative simplicity” to keep LB&G as “a pure operating company rather than a holding company”. He said it was “with this in mind” that LB&G transferred away its shares in L(NI)(H) as part of the transactions with which this appeal is concerned. No reason was given as to why Sponsio was chosen to be the new holding company of L(NI)(H), but we infer the answer is to be found in Mr Turner’s response to a question about why Sponsio made the loan referred to at paragraph 11 of the agreed statement of facts, when he said it was “quite natural to be funding [L(NI)(H) and, though it, NWB] through the parent”; that is to say, in the absence of any other reason being given, it appears likely that Sponsio was chosen to acquire the L(NI)(H) shares because it would then be more logical for Sponsio also to borrow and on-lend the further £120 million referred to at paragraph 11 of the agreed statement of facts, providing £120 million of indebtedness in Sponsio which could then be novated to TDS (along with the £23.6 million it borrowed in order to buy the L(NI)(H) shares and the £110 million incurred in respect of the loan referred to at paragraph 14 of the agreed statement of facts).

15. We note that by the time these decisions were being taken (in late January and February 2008), Mr Turner had “been approached by Deloitte with a proposal for a tax planning opportunity involving a total return swap… and a novation of loans to extract reserves”. From that point on, his thinking was clearly influenced by the aim of taking advantage of that opportunity if possible.

16. The Swap was referred to by Mr Turner as the chosen means to achieve a “synthetic transfer” of the JBB business to LB&G. He acknowledged briefly in his witness statement (and more comprehensively in cross examination) that as the Swap related to the shares in LGI, it encompassed all that company’s activities and not just the JBB business. LGI apparently carried on no business of its own, it simply held the shares of another company called Ladbroke Group, which in turn held the shares of JBB and Ladbrokes Call Centre Limited (“LCC”) (formerly a Vernon Pools company, which provided call centre services within the group and was profitable in a small way, though its profitability depended entirely on the rest of the group and it was in the process of being run down with a view to probable closure). Mr Turner accepted that the “synthetic transfer” effected by the Swap related to the combined business and activities of all these entities, but maintained that this was appropriate.

17. The reason for effecting a synthetic rather than an actual transfer of the JBB business to LB&G was, he said, due to problems over the 150 leasehold properties from which JBB operated. There were clauses in a great many of the leases which prevented free assignment and whilst there were other potential solutions to that difficulty (and indeed a solution which had been identified as potentially available in January 2008 was later put into effect when the Swap was unwound in May 2008), it was perceived that putting the Swap in place was the most desirable, both to “buy time” to address the lease issue and specifically in the light of the tax advantages that might be available at a later stage as a result of entering into the Novations if suitably reassuring advice was obtained on the effects of doing so. Even in the absence of those tax advantages it was, Mr Turner said, simpler to implement the Swap on a “once and for all” basis rather than to carry out a regular quarterly dividend strip of

the JBB profits until the JBB business could be properly transferred into LB&G. Thus he maintained that whilst the prospective tax advantage was admittedly a main purpose of putting the Swap into place, there were also significant non-tax purposes which would have meant the transaction was worthwhile even in the absence of the tax advantage.

18. So far as the Novations were concerned, Mr Turner acknowledged that it would have been perfectly possible to extract the reserves from LGI by means of dividends – what he referred to as "our normal way of doing this". He openly acknowledged that the only reason to carry out the extraction of reserves by means of the Novations was in order to achieve the expected tax advantage. This did not affect the fact that there was also a subsisting main purpose (which was not a tax avoidance purpose) of stripping out the reserves. Clearly the effect of the Novations was that the reserves were moved to Sponsio rather than to TDS, but this difference had no material significance for the group as a whole.

19. The balance sheet of LGI as at 31 December 2008 showed an accumulated deficit of £493,239 on profit and loss account, compared to a figure as at 31 December 2007 of an accumulated surplus of some £272 million; on any view, therefore, the extraction of its reserves as a result of the Novations was more or less total.

The law

20. The key legislative provisions involved in this appeal (which substantially relates back to events in the period leading up to Budget Day on 12 March 2008) were as follows. The various provisions have since been amended and re-written in the Corporation Tax Act 2009.

21. Section 91B FA96 made provision for shares to be treated as rights under a creditor relationship in certain situations, with the result that the debits and credits to be brought into account in respect of them were determined on the basis of fair value accounting. So far as relevant, section 91B provided as follows:

> "**91B Non-qualifying shares**
>
> (1) This section applies for the purposes of corporation tax in relation to the times in a company's accounting period during which –
>
> > (a) the company ("the investing company") holds a share in another company ("the issuing company"),
> >
> > (b) …, and
> >
> > (c) the share is a non-qualifying share (see subsection (6))
>
> …
>
> (2) This Chapter shall have effect for that accounting period in accordance with subsection (3) below as if during those times –

(a) the share were rights under a creditor relationship[1] of the investing company, and

(b) any distribution in respect of the share were not a distribution falling within section 209(2)(a) or (b) of the Taxes Act 1988.

(3) The debits and credits to be brought into account by the investing company for the purposes of this Chapter as respects the share must be determined on the basis of fair value accounting.

…

(5) In any case where Condition 3 in section 91E below is satisfied –

(a) debits and credits shall be brought into account for the purposes of Schedule 26 to the Finance Act 2002 (derivative contracts) by the investing company in respect of any associated transaction falling within section 91E below as if it were, or were a transaction in respect of, a derivative contract (if that is not in fact the case), and

(b) those debits and credits shall be determined on the basis of fair value accounting.

(6) A share is a non-qualifying share for the purposes of this section if –

(a) it is not one where section 95 of the Taxes Act 1988 (dealers etc) applies in relation to distributions in respect of the share, and

(b) one or more of the Conditions in sections 91C to 91E below is satisfied.

(7) Subsection (10) of section 91A above (company treated as holding a share) also applies for the purposes of this section."[2]

22. So far as relevant, section 91E FA96 provided as follows:

"**Condition 3 for section 91B(6)(b)**

(1) Condition 3 is that there is a scheme or arrangement under which the share and one or more associated transactions are together designed

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[1] Section 103(1) FA96 provided as follows: "'*creditor relationship*', in relation to a company, means any loan relationship of that company in the case of which it stands in the position of a creditor as respects the debt in question"

[2] Subsection 91A(10) provided as follows: "For the purposes of this section a company shall be treated as continuing to hold a share notwithstanding that the share has been transferred to another person – (a) under a repo or stock lending agreement, or (b) under a transaction which is treated by section 26 of the Taxation of Chargeable Gains Act 1992 as not involving any disposal."

to produce a return which equates, in substance, to the return on an investment of money at a commercial rate of interest.

…

(3) In this section, '*associated transaction*' includes entering into, or acquiring rights or liabilities under, any of the following –

(a) a derivative contract…

(4) This section is to be construed as one with section 91B above."

23. So far as relevant, paragraph 13 of schedule 9 FA96 provided as follows:

"(1) Where in any accounting period a loan relationship of a company has an unallowable purpose,

(a) the debits, and

(b) the credits in respect of exchange gains,

which, for that period fall, in the case of that company, to be brought into account for the purposes of this Chapter shall not include so much of the debits or credits (as the case may be) as respects that relationship as, on a just and reasonable apportionment, is attributable to the unallowable purpose.

(1A) Amounts which, by virtue of this paragraph, are not brought into account for the purposes of this Chapter as respects any matter are in consequence also amounts which, in accordance with section 80(5) of this Act, are not to be brought into account for the purposes of corporation tax as respects that matter apart from this Chapter.

(2) For the purposes of this paragraph a loan relationship of a company shall be taken to have an unallowable purpose in an accounting period where the purposes for which, at times during that period, the company –

(a) is a party to the relationship, or

(b) enters into transactions which are related transactions by reference to that relationship,

include a purpose ("the unallowable purpose") which is not amongst the business or other commercial purposes of the company.

(3) For the purposes of this paragraph the business and other commercial purposes of a company do not include the purposes of any part of its activities in respect of which it is not within the charge to corporation tax.

(4) For the purposes of this paragraph, where 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 any loan relationship of the company,

is a tax avoidance purpose, that purpose shall be taken to be a business or other commercial purpose of the company only where it is not the main purpose, or one of the main purposes, for which the company is a party to the loan relationship at that time or, as the case may be, for which the company enters into that transaction.

(5) The reference in sub-paragraph (4) above to a tax avoidance purpose is a reference to any purpose that consists in securing a tax advantage (whether for the company or any other person).

(6) In this paragraph '*tax advantage*' has the meaning given by section 840ZA of the Taxes Act 1988."

The issues and arguments – TDS

24. The parties were agreed that:

(1) the shares in LGI held by TDS became "non-qualifying shares" for the purposes of section 91B FA96 when it entered into the Swap because they satisfied "condition 3" contained in section 91E FA96;

(2) it followed that the debits and credits to be brought into account by TDS under the loan relationship rules as respects the shares in LGI, when the Novations were effected, had to be determined "on the basis of fair value accounting" in accordance with section 91B(3) FA96, subject to the application of paragraph 13 of Schedule 9 FA96; and

(3) if paragraph 13 of Schedule 9 did not apply, then the debits claimed by TDS were appropriate and its appeal must be allowed.

25. Clearly, therefore, it was on the application of paragraph 13 of Schedule 9 that the parties did not agree.

26. There were two parts to this disagreement:

(1) First, Ms Shaw on behalf of TDS argued that paragraph 13 simply did not apply in the present situation because, as she put it, paragraph 13 "cannot apply in the case of a deemed loan relationship" ("issue 1");

(2) Second, she argued that even if paragraph 13 were capable of applying, TDS did not have an unallowable purpose in holding the shares in LGI ("issue 2").

Issue 1 – can paragraph 13 apply to a deemed loan relationship?

27. Ms Shaw argued that paragraph 13 required an examination of the purposes for which the relevant company is a party to the loan relationship. It was well-established (and Mr Ghosh did not disagree with this) that the test of "purpose" was a subjective one.

28. A subjective purpose, she argued, could only exist in relation to real things. By the very nature of "purpose", it could not exist in relation to a deemed loan relationship. To put it another way (as she did in her skeleton argument), "a person cannot have a subjective purpose for being party to a legal fiction", and "if a taxpayer is only treated *[i.e. by a deeming provision]* as having entered into a loan relationship then it is a nonsense to ask what its purposes were".

29. She referred to *Marshall v Kerr* [1994] STC 638, in which Lord Browne-Wilkinson approved what had been said in the Court of Appeal by Peter Gibson J about "the correct approach to deeming provisions":

> "For my part I take the correct approach in construing a deeming provision to be to give the words used their ordinary and natural meaning, consistent so far as possible with the policy of the Act and the purposes of the provisions so far as such policy and purposes can be ascertained; but if such construction would lead to injustice or absurdity, the application of the statutory fiction should be limited to the extent needed to avoid such injustice or absurdity, unless such application would clearly be within the purposes of the fiction. I further bear in mind that because one must treat as real that which is only deemed to be so, one must treat as real the consequences and incidents inevitably flowing from or accompanying that deemed state of affairs, unless prohibited from doing so."

30. In her submission, the "statutory fiction" of section 91B FA96 was "limited to deeming the shares to be rights under a creditor relationship of the investing company". This was sufficient to require debits and credits to be brought into account. No other features of a real loan relationship were imported by the statutory fiction. Thus it would be an "illegitimate extrapolation" (or even judicial legislation) to treat TDS's purposes in holding the shares "as if" they were its purposes in being party to a deemed loan relationship. If Parliament had intended this result, it would have said so.

31. She highlighted what she described as the "absurdity" of HMRC's position by reference to section 91A(10) FA96 (applied to section 91B by virtue of section 91B(7)). Under that provision, if a company parted with shares under a repo or stock lending agreement, it was to be treated as continuing to hold the shares for the purposes of section 91B. In that situation, she submitted, HMRC's reasoning would say that the company's purpose in transferring the shares and ceasing to own them would become the deemed purpose of the deemed loan relationship – in effect the purpose of transferring the shares would, on HMRC's argument, become the purpose of being deemed to continue to own them – an obvious logical nonsense.

32. In short, it was not possible, as a matter of common sense or logic, to take TDS's purpose for actually holding the shares in LGI as being its purpose for the deemed loan relationship that arose when the Swap was put into place.

33. Mr Ghosh, on the other hand, argued that there was "less than meets the eye" to sections 91B and 91E. Where section 91E applied (and the parties agreed that to be the case here), it was because of the existence of the scheme under which the shares and the Swap were together designed to produce "a return which equates, in substance, to the return on an investment of money at a commercial rate of interest"; what triggered the treatment under section 91B was therefore the combination of the shares with the Swap pursuant to the scheme. What section 91B then did was to recharacterise the shares as creditor rights under a loan relationship. It did not deem TDS to have entered into a transaction for the lending of money, it simply looked at the actual shares and applied the provisions of the whole of Chapter II (including Schedule 9, and in particular paragraph 13) as if the shares were rights under a creditor relationship. TDS still held the shares, and there was nothing illogical about enquiring into the purpose which it had for doing so. There was no suggestion that TDS's "real-world rights" should be ignored or nullified in doing this, one was simply recognising that those rights had now become clothed with loan relationship attributes for certain tax purposes.

34. So far as section 91B(7) and 91A(10) were concerned, a company which transferred shares under a repo agreement still had real world rights and liabilities and the effect of those provisions was to treat those real world rights and liabilities as amounting to a creditor relationship, on the basis of the specific deeming provision in section 91A(10) which deemed the company to be continuing to hold the shares. Those provisions did not therefore take matters any further so far as Ms Shaw's argument was concerned.

Issue 2 – Does Paragraph 13 disallow the debits claimed by TDS as being attributable to an unallowable purpose?

35. Both parties were agreed that the purpose we are here concerned with is the purpose of TDS in holding the shares in LGI. Where they disagreed was as to the relevance of the Swap and the Novations.

36. Ms Shaw submitted that if it applied at all, Paragraph 13 of Schedule 9 FA96 required an examination solely of TDS's purpose in holding the shares in LGI. It was clear, in her submission, that its purpose in holding those shares had throughout been entirely "unequivocally commercial". Up to the creation of the Swap, and after it was terminated, this appeared uncontroversial. In her submission, the evidence showed that this was also the case during the life of the Swap. She submitted that the only test to be applied was the purpose for holding the deemed loan relationship (i.e., the shares in LGI) and whilst TDS had an admittedly tax-avoidance purpose in entering into the Swap, that was irrelevant. It was not correct to "conflate" the two purposes as the legislation was quite clear.

37. As a secondary point, she also argued that if one was assessing whether TDS's tax-avoidance purpose (if that purpose could be attributed to the holding of the shares in LGI) was a "main purpose" for the purposes of paragraph 13, one had to carry out an assessment of the respective weights of all TDS's purposes in holding the shares. When viewed in that way, a purpose of obtaining a tax advantage worth some £71 million "pales in comparison" to the £280 million value of the shares themselves (that being the value placed on them for the purposes of the Swap).

38. Mr Ghosh submitted that the enquiry to be carried out was as follows. First, in relation to the accounting period for which the debit was claimed, one must ascertain whether the creditor company had among its purposes in being a party to the relevant loan relationship a purpose of securing a "tax advantage", whether for that company or any other person – see paragraph 13(5) of Schedule 9 FA96. The significance of the tax advantage to that company must be considered as a matter of subjective intention, which necessarily involved a careful analysis of all the reasons the company had for entering into the transaction. Here, he referred to *Versteegh v HMRC* [2013] UKFTT 642 (TC) at [159]:

> "The threshold requirement that the tax avoidance purpose should be one of the main purposes of the taxpayer company in entering into the transaction is one that, on authority, can only be met by reference to a full factual enquiry as to the intentions of the taxpayer, and the significance to the taxpayer of any tax avoidance purpose identified."

39. Where, as here, a share held by a company is deemed to be "rights under a creditor relationship" for so long as certain conditions were satisfied (in this case, the existence of the Swap), in his submission "the taxpayer's reasons for causing those conditions to be satisfied… will inform (indeed comprise) his purpose in holding the share for the period of the deeming".

40. He also submitted that "decisions taken by a taxpayer about how he intends to use or exploit a share for a period tells us his purpose in holding that share for that period". Here he referred to *Fidex Limited v Revenue and Customs Commissioners* [2014] UKUT 454 (TCC), in particular at [110] and [112]:

> "110. It seems to us that what you do with an asset may be evidence of your purpose in holding it, but it need not be determinative of that purpose. The benefits you hope to derive as a result of holding an asset may also evidence your purpose in holding it. A finding that such a hope exists may, depending on the circumstances, be sufficient for a finding that a purpose of holding the assets was the obtaining of that benefit…
>
> 112. … There was evidence that Fidex hoped to obtain a large debit and that it would obtain that debit only if it held the bonds to the end of 2004/beginning of 2005. That was sufficient for the FTT to conclude that Fidex became possessed of a purpose, or an additional purpose, for the holding of the bonds, and that that was a main tax avoidance purpose, and therefore an unallowable purpose. The facts that Fidex may have retained other purposes and that it did nothing different with

> the bonds cannot, in the light of evidence of hope of the debit which would come with the holding of the bonds, make that finding unreasonable, perverse or otherwise impermissible. `

41. By way of illustration, Mr Ghosh invited us to consider a hypothetical scenario in which he had owned a gun for years as a purely decorative item, then formed the intention to use it to shoot someone. If he did so, but then returned it to its former use as a decorative item, this illustrated graphically how one's purpose in owning something might change over time, informed (in that case) by a new additional purpose of using the gun for lethal rather than decorative purposes.

42. Having (in his submission) established that there was a tax avoidance purpose in holding the shares, it was then necessary to ascertain whether that tax avoidance purpose was a main purpose ("main" meaning simply "important"). This required a careful analysis of all the relevant facts and circumstances and a proper balancing of all the components of decisions made by the taxpayer in entering into the transaction. The fact that there might also have been an additional main commercial purpose was irrelevant – the existence of such a purpose did not "trump" any tax avoidance main purpose.

43. In his submission, it was clear that TDS had a main purpose of securing a tax advantage in entering into its deemed loan relationship, and it was also clear that the whole of the debits claimed by TDS were properly attributable to its unallowable purpose. It followed, in his submission, that the debits should be disallowed.

44. So far as the burden of proof was concerned, he asked the Tribunal to note that HMRC's position was that the burden lay on the taxpayer to establish facts sufficient to displace the amendments made by the closure notices and it does not lie on HMRC to establish facts sufficient to apply paragraph 13. This was contrary to the position which had apparently been taken by HMRC in *Fidex* (at [115], where HMRC had seemingly accepted that the burden lay on them to establish facts sufficient to justify the operation of paragraph 13). In the circumstances of this case, however, he considered the burden of proof to be irrelevant as the necessary facts were, in his submission, quite clear. This point applied equally to the appeal of LGI as to that of TDS.

The issues and arguments – LGI

45. LGI being party to an actual loan relationship in respect of which it was claiming debits, "Issue 1" above does not arise.

46. In Ms Shaw's submission, the Novations were effected as a way of achieving the commercial objective of extracting LGI's reserves with a view to making it dormant. That objective could admittedly have been achieved by other means (most obviously, by declaring a dividend) but that was not relevant.

47. Even if this was incorrect and LGI was found to have an unallowable purpose in being party to the loan relationships which arose for it as a result of the Novations, she argued that no part of the debits claimed ought to be disallowed on a "just and

reasonable" basis, given that equal and opposite loan relationship credits arose in LGF as a result of the interest payments; even if it were assumed that LGI became party to the loan relationships for the purpose of the tax advantage intended to be achieved by TDS, it could not be said that any part of the debits were attributable to that unallowable purpose. Here she referred to the conclusion reached by the First-tier Tribunal in *Iliffe News & Media Limited and others v HMRC* [2012] UKFTT 696 (TC) at [327], arguing that the same reasoning applied in the present case and thus attributing all the debits to the second appellant's business or commercial purpose of extracting its reserves in preparation for dormancy. Alternatively, she submitted that even if there were an unallowable purpose (in the form of the large debits in TDS), that purpose crystallised in March 2008 when the Novations took place; therefore by the time LGI's debits started to accrue, the unallowable purpose had already been achieved and accordingly it was not appropriate to attribute any part of LGI's debits to that purpose. In effect, those debits should be viewed as being comparable to the debits that would have arisen if LGI had simply borrowed in order to fund the extraction of its reserves by a straightforward dividend – a situation which HMRC would find entirely inoffensive.

48. Mr Ghosh argued that the acceptance of the Novations by LGI (with the consequential creation of the debits in LGI) could not be regarded as being amongst LGI's "business or other commercial purposes". LGI was simply being a "good corporate citizen" within the group by doing what it was told; it was not doing anything that could be seen as advancing its own business or commercial interests as it was already on its way to dormancy. Even if this point were not accepted, he argued, LGI's acceptance of the Novations was clearly tainted by the known purpose of TDS (from which it had to get approval to the Novations) to achieve a tax deduction. The debits arising to LGI as a result of the Novation thus clearly had an unallowable purpose, namely the purpose of facilitating TDS's tax avoidance scheme.

Discussion and decision

The debits claimed by TDS

Issue 1

49. It is quite clear that it was TDS's intention, by entering into the Swap, to trigger the provisions of section 91B FA96. It knew (indeed it intended) that, as a result of doing so, the loan relationship provisions in FA96 would "have effect… as if the shares *[in LGI]* were rights under a creditor relationship…".

50. It was clearly therefore the intention of TDS that it should be treated for the purposes of FA96 as having "rights under a creditor relationship".

51. In view of the way in which "creditor relationship" is defined (see the first footnote to paragraph [21] above), it seems to us that the deemed existence[3] of a

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[3] We use this phrase as shorthand, whilst acknowledging it refers to a state of affairs in which the various provisions are to "have effect" on the postulated basis.

"creditor relationship in relation to" a company necessarily implies the deemed existence of a "loan relationship of" that company to which paragraph 13 of Schedule 9 is at least capable of applying. To put it another way, if any particular statutory provisions are stated to have effect "as if" a company's shares in another company were rights under a creditor relationship, they must also have effect "as if" there were an underlying loan relationship of the first company from which those rights derive.

52. In the nature of deeming provisions such as section 91B, there is no actual underlying loan relationship, only a combination of circumstances which, as a result of the statutory deeming provision, give rise to stated consequences.

53. It is therefore inappropriate to seek to identify precisely what actual asset (or bundle of assets) constitutes the underlying loan relationship in order to test whether it has an unallowable purpose (i.e., as the parties agree, whether the company has an unallowable purpose in relation to it).

54. Thus far, we are in agreement with Ms Shaw. However, when the wording of paragraph 13 is examined closely, it seems to us that this apparent difficulty misses the point, for the following reasons.

55. If section 91B is triggered, there is a statutory fiction: the shares are no longer treated as shares, they are instead to be treated as rights under a creditor relationship.

56. Because a creditor relationship is, by definition, a loan relationship (see [51] above), the investing company is therefore to be treated as being party to a loan relationship.

57. By definition, it has only become (and remains) so treated by reason of the satisfaction (and continued satisfaction) of the conditions in section 91B(1).

58. On any rational analysis, therefore, its purpose or purposes in causing the satisfaction (and continued satisfaction) of those conditions must be treated as being its purpose or purposes for being (and remaining) party to the deemed loan relationship which arises and continues for so long as the conditions remain satisfied.

59. It follows logically from this that it is the company's purposes in bringing about and maintaining the satisfaction of the conditions in section 91B(1) which are the relevant purposes to be tested against paragraph 13(2).

60. Having reached this conclusion on the ordinary and natural meaning of the wording of the statute, we consider it appropriate also to stand back and consider the scheme and policy of the legislation in the round (as referred to in *Marshall v Kerr*). It would seem to us to be more in tune with the general scheme and policy of the legislation that an anti-avoidance provision which has been carefully phrased in quite broad and general terms should apply to what might be called "deemed" loan relationships just the same as it does to real ones, indeed the provisions appear to us to have been structured in a way designed to achieve that result. The opposite view would lead inexorably to the conclusion that Parliament did not intend there to be any anti-avoidance provisions applying to matters which it specifically designated to be

treated as loan relationships (whether that treatment arises under section 91B or otherwise).

61. It follows that we find against TDS on "Issue 1" and specifically that paragraph 13 of Schedule 9 FA96 applies to a deemed loan relationship.

5 Issue 2

62. Given our analysis of Issue 1 above, Issue 2 becomes more straightforward.

63. Both parties argued that we should be examining TDS's purposes in holding the LGI shares when applying the "unallowable purpose" test. Ms Shaw broadly sought to persuade us that TDS had, throughout, a clear business or commercial 10 purpose (independent of any tax avoidance purpose) in holding them. Mr Ghosh broadly sought to persuade us that TDS's purposes in holding the LGI shares became tainted by a tax avoidance purpose as a result of the transactions it and LGI undertook.

64. We take the view, however, that the legislation requires us to examine TDS's 15 purposes not in holding the LGI shares themselves but in being party to the deemed loan relationship which had come into existence. In doing so, we consider that we are required to address TDS's purposes in bringing the deemed loan relationship into (and maintaining it in) existence (see [59] above).

65. The event that triggered section 91B and brought the deemed loan relationship 20 into existence was the entry into of the Swap whilst continuing to hold the LGI shares.

66. Mr Turner quite fairly admitted in his witness statement that "I accept that the potential tax advantage was one of the main purposes of entering into the TRS *[i.e. the Swap]* and novating the loans". It is equally clear that a main purpose of entering into the Swap on its own on 29 February 2008 (i.e. 11 days before the Slaughter & 25 May advice was received which gave the group the comfort it wanted before entering into the Novations) was to position TDS to be able to achieve that tax advantage by LGI later entering into the Novations if the relevant assurances were obtained from its solicitors. As Mr Turner himself put it in cross-examination:

> "…we have accepted that the tax advantage was a main purpose of the 30 TRS. I am only making the point that there was a commercial purpose as well, and in fact we did go ahead with the TRS in advance of any tax opinion, and that would have stood, regardless of any potential tax advantage.".

67. We therefore have no difficulty in finding that one of TDS's main purposes in 35 entering into the Swap whilst holding the shares in LGI was a tax avoidance purpose, and that continued to be the case until the Swap was finally terminated. As such, for the reasons given above, we consider that TDS had an unallowable purpose throughout that period for the creditor relationship it was deemed to have by reason of section 91B(2) FA96.

68. It follows that paragraph 13(1) applies, to disallow "so much of the debits… as, on a just and reasonable basis, is attributable to the unallowable purpose".

69. If we are wrong in the view expressed at [64] above, however, and the appropriate purposes to be examined are (as both Ms Shaw and Mr Ghosh submitted) those of TDS in holding the LGI shares, then we agree with Mr Ghosh. It is quite clear that a company's purposes for the existence of a particular state of affairs can change over time – paragraph 13 expressly contemplates this by referring to "the purposes for which, at times during that period, the company… is a party to the relationship". Mr Ghosh's example of changing purposes for owning a gun is apposite. The fact that TDS may have had a perfectly sound business and commercial purpose in holding the LGI shares throughout the whole period in question does not alter the fact that its hoped-for use of those shares for the purposes of obtaining the debits meant that it also had another main tax avoidance purpose in holding those shares from the time when the Swap was entered into until the time when the Novations were effected; this conclusion is inescapable, given Mr Turner's perfectly fair and understandable (indeed, one might say inevitable) admission that there was a main tax avoidance purpose for entering into the Swap. We discount entirely Ms Shaw's submission that a purpose of saving some £70 million of tax could not be counted as a "main" purpose when set in the context of a company worth some £280 million. Clearly it could and, in our view, did.

70. Therefore we would still hold that paragraph 13(1) applies as above, even if our view expressed at [64] above is wrong.

71. Finally, on whichever basis it is decided that paragraph 13(1) applies, we consider that the whole of the debits claimed by TDS are, on a just and reasonable apportionment, attributable the unallowable purpose. The debits accrued as a result of the completion of the Novations, following the establishment of the deemed loan relationship by virtue of the Swap. So far as TDS was concerned there was no significant business or commercial purpose to the Novation that we can discern – all that happened was that the net assets of its subsidiary LGI were depressed by £253 million, with a corresponding increase in the net assets of Sponsio, another of its subsidiaries. Mr Turner did not seek to assert otherwise. The furthest he could go in his evidence was to say that the Novations represented a more tax-efficient way (for the group) of extracting the reserves of LGI as a precursor to making it dormant. In the context of a scheme specifically devised to create these debits, once an unallowable purpose is found to exist for the (deemed) loan relationships giving rise to them as a result of, effectively, that scheme, we have no doubt that the debits should be attributed entirely to that unallowable purpose.

72. We therefore hold that all the debits in TDS are excluded by operation of paragraph 13(1).

The debits claimed by LGI

73. The debits in question for LGI arise out of actual (rather than deemed) loan relationships, so "Issue 1" does not arise on LGI's appeal.

74. The question to be determined in relation to the LGI debits is whether LGI's (debtor) loan relationships which arose as a result of the Novations had an unallowable purpose for the purposes of paragraph 13(1).

75. This in turn depends on an examination of the purposes for which LGI was a party to those loan relationships, and in particular whether those purposes included a purpose which was not amongst the business or other commercial purposes of LGI (see paragraph 13(2) of Schedule 9). In considering that issue, if LGI is found to have had a "tax avoidance purpose" for being party to the loan relationships, the debits must be disallowed unless that purpose is found not to be "the main purpose, or one of the main purposes" for which LGI was party to the relationships at the relevant time.

76. Crucially, by virtue of paragraph 13(5), "tax avoidance purpose" here refers to "any purpose that consists in securing a tax advantage (whether for the company or any other person)". Thus if LGI was party to the loan relationships for the purpose of securing a tax advantage for TDS, that would be a relevant tax advantage for the purposes of paragraph 13(4), and so if that purpose was one of the main purposes of LGI in being party to the loan relationships, the debits would fall within paragraph 13(1) and would therefore be disallowed (to the extent attributable to that purpose on a just and reasonable apportionment).

77. Mr Turner's evidence was that LGI became party to the loan relationships only following and as a result of receiving Slaughter and May's advice to the effect that the deduction in TDS should be available as a result of the Novations; without that comfort, LGI would have distributed its reserves by a more "straightforward" dividend route. This seems to us to provide unequivocal confirmation that at the very least one of LGI's main purposes in becoming a party to the relevant loan relationships was to secure a tax advantage for TDS. As such, we consider the loan relationships in question to have had an unallowable purpose for the purposes of paragraph 13(1).

78. The question then arises as to the extent to which the debits are attributable to that unallowable purpose, on a just and reasonable apportionment.

79. Ms Shaw argued that, given there were equal and opposite loan relationship credits arising in LGF, there was no tax advantage arising in respect of the debits claimed by LGI and therefore a just and reasonable apportionment would attribute none of the debits to LGI's unallowable purpose. Whilst superficially attractive, this argument seems to us to address the wrong question. It is effectively little more than a plea for fairness in the light of the wider picture. The legislation does not require a view of the wider picture, however. It is anti-avoidance legislation. Whilst "symmetry" may be a feature of the loan relationship regime generally – Ms Shaw referred us to the judgment of the Supreme Court in *Commissioners for Her Majesty's Revenue and Customs v DCC Holdings (UK) Limited* [2010] UKSC 58, in particular Lord Walker's statement at [26] that "the need for a symmetrical solution lies at the heart of this appeal" – we do not consider it to be a necessary feature of an anti-avoidance provision, still less one which is invoked in relation to a tax avoidance scheme intended to play on a lack of symmetry inherent in one part of the regime.

80. The more important question, in our view, is the extent of the available evidence upon which to base any attribution of the debits to the unallowable purpose. This was the crucial missing element in *Iliffe*.

81. It seems to us that where Company A adopts one particular method of achieving what is said to be a commercial purpose by entering into a loan relationship with the specific pre-planned and avowed intention, by adopting that method, of generating a tax advantage in Company B where Company A is found to have an unallowable purpose for the loan relationship in question, it is very hard, on a just and reasonable apportionment, to attribute Company A's resulting loan relationship debits to anything other than that unallowable purpose. We do not consider it relevant that Company A could have incurred undoubtedly allowable loan relationship debits of exactly the same amount by entering into loan relationships designed to achieve substantially the same end result for Company A (but without achieving the tax advantage for Company B). If LGI as Company A elects, in the face of that choice, to enter into loan relationships which are found to have an unallowable purpose then we consider it just and reasonable to attribute the full amount of those loan relationships to that unallowable purpose.

82. It follows that we hold the debits in LGI must be disallowed in full.

Summary and conclusion

83. We consider that either:

(1) the deemed loan relationship arising from the combination of TDS's ownership of the LGI shares and TDS entering into the Swap, or

(2) the shares in LGI

amounted to (or is required to be treated as) a loan relationship of TDS for which, in either case, there was an unallowable purpose – see [68] and [70] above.

84. The entire amount of those debits should, on a just and reasonable apportionment, be attributed to the unallowable purpose, and therefore disallowed – see [72].

85. We consider that the loan relationship to which LGI became a party on execution of the Novations had an unallowable purpose – see [77].

86. The entire amount of the debits arising on that loan relationship should, in our view, on a just and reasonable apportionment, be attributed to the unallowable purpose and therefore disallowed – see [82].

87. The appeals are therefore dismissed.

88. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax

Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

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KEVIN POOLE
TRIBUNAL JUDGE

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RELEASE DATE: 19 NOVEMBER 2015

Simplified Group Structure Outlining Main Transactions