[2022] UKFTT 00137 (TC)

TC 08468/V

Corporation tax – loan relationships – Appellant sued bank for damages for mis-sold interest rate hedging product – litigation settled on basis that £3.5 million of existing debt to the bank was "released and discharged" by way of settlement of the damages claim – whether this amounted to a "related transaction" – yes – whether the £3.5 million potentially represented a "profit" for loan relationship purposes – yes – whether it arose to the Appellant from its loan relationships or related transactions – held no, it arose from the settlement of the underlying damages claim – therefore taxable under general principles rather than loan relationship regime – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2019/06130

BETWEEN

HEXAGON PROPERTIES LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE KEVIN POOLE

The hearing took place on 22 November 2021, followed by written submissions from the parties. The form of the hearing was V (video), using the Tribunal's video hearing system. All the participants attended remotely. A face to face hearing was not held because of the difficulty of organising a hearing which would ensure the safety of all participants, none of whom objected to a remote hearing. The documents to which I was referred comprised a bundle of documents consisting of 159 pages and an authorities bundle of 286 pages (with an additional authority of 22 pages admitted at the hearing).

Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

Andrew Wood of counsel, instructed by Elysium Law Limited, for the Appellant

Charles Bradley of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. This appeal concerns the appropriate tax treatment of what was expressed to be a release of debt of some £3.5 million previously owed by the Appellant to its bank; the release was not however a simple or standalone release but took place as part of a settlement of a claim brought by the Appellant against that bank in respect of the mis-selling to the Appellant of an interest rate hedging product.

2. In broad terms, HMRC claim the amount so released to be taxable as income under the loan relationship rules on the straightforward basis that a "release" (or possibly an exchange or redemption) had taken place, whatever the wider context; the Appellant claims the amount so released to represent a payment to it by the bank in settlement of its action for damages against the bank and accordingly to represent wholly or in part a receipt of capital outside the scope of any charge to corporation tax under the loan relationship rules. The Appellant then claims to be entitled to the benefit of extra-statutory concession D33 in respect of the capital element, but the parties are agreed the applicability of that concession lies outside the scope of the Tribunal's jurisdiction.

3. It was agreed that if I considered the disputed amount was not taxable in its entirety under the loan relationship rules, there would need to be further negotiation (and, if necessary, a final hearing) to determine how it should be allocated as between income and capital. In effect, therefore, the hearing was the hearing of a preliminary issue, namely whether the disputed amount was taxable in its entirety under the loan relationship rules.

THE FACTS

4. A small bundle of documents was submitted to the Tribunal. There were no written witness statements or oral evidence before me. The factual evidence was therefore rather less clear and comprehensive than might have been expected in such a high value case. In particular, there was no evidence as to the course of the negotiation with the Appellant's bank that had led to the settlement, or the detailed basis upon which either the Appellant had calculated its original claim against the bank or the final settlement figure had been calculated and agreed.

5. I find the following facts, many of which are derived from the Appellant's December 2016 particulars of claim in its proceedings against its bank. Those particulars are of course couched in fairly general terms and do not include any detailed figures in respect of its various heads of claim.

6. At all material times the Appellant carried on business as an owner and developer of residential and commercial properties including for retention and rental by it.

7. In 2007, the Appellant wished to procure new banking services and loan facilities as follows:

(1) in the sum of £1.9 million in relation to the refinancing of existing loan facilities until then provided by Yorkshire Bank plc;

(2) in the sum of £2.3 million as development loans for phase 1 of a pair of developments; and

(3) in the sum of £800,000 as development loans for phase 2 of the developments.

8. The Appellant's new bank issued offer letters for the three loan facilities on 16 May 2007 and these were accepted on 23 May 2007.

9. Around the same time, the bank introduced the Appellant to a member of its Treasury Department with a view to selling it an interest rate hedging product ("IRHP"). As a result, in July 2007 the Appellant entered into a "Base Rate Extendable Swap" on a notional amount of £1 million for a period of five years (extendable, according to the particulars of claim, at the option of the bank) and a fixed rate of 5.95%. At that time, base rate stood at 5.5%. The terms of the swap are not clear (and no copy of any documentation creating it was included in the bundle), but I infer that the effect was to lock the Appellant into artificially high effective interest rates in the event of base rates falling (as they did, significantly), having been "sold" to the Appellant on the basis that it represented a way for the Appellant to protect itself against the risk of interest rates rising (without mentioning the risk of significant costs arising if interest rates fell).

10. Up to 30 April 2012 the Appellant paid £194,574 into the IRHP; in order to terminate the IRHP early, it would have had to pay much larger amounts (possibly more than £260,000 as at 26 October 2010). Its credit rating (and therefore its ability to obtain further loan finance elsewhere) was directly affected by the existence of the IRHP and the payments it was required to make under it, preventing it from completing and realising the developments. The bank appointed LPA receivers on 1 March 2012 over numerous properties owned by the Appellant, sold some (apparently at less than market value) and retained income from others. This further damaged the Appellant's business. The IRHP was finally terminated on 18 May 2012 following a declaration of default two days earlier and the cost of termination was said to be £260,575.

11. By that time, the Financial Conduct Authority had become aware of numerous complaints around mis-selling of IRHPs and established, by agreement with a number of banks (including the Appellant's bank) a scheme under which redress could potentially be given by the banks for such mis-selling. Pursuant to that scheme, the bank offered to refund the premiums paid for the IRHP plus interest at 8% (apparently totalling £245,501.49 as at either March or November 2014) and "waived the alleged liability of £275,139.72 as the costs said to be incurred in respect of payments due following 2nd March 2012". In correspondence with HMRC dated 11 April 2019, the Appellant's accountants stated that "a redress payment was made by [the bank] in the tax year ending 2015. It was disclosed in the accounts and does not form part of the claimed amount brought in the civil action referred to as set out in the Particulars of Claim…". There was no clear evidence before me as to the amount of the redress payment made, but I infer that any such payment that was made was by way of refund of the premiums paid under the IRHP plus interest. The bank apparently refused to pay the Appellant anything more than £601 by way of redress for its consequential loss.

12. The Appellant, having failed to obtain what it considered to be adequate redress, commenced proceedings against its bank for damages on 13 April 2016. In its Particulars of Claim dated 8 December 2016, the Appellant provided the following "Particulars of Loss and Damage":

> 80. But for the Acts and omissions particularised herein Hexagon would not have entered into the IRHP contract or any IRHP contract.
>
> 81. Entry into the IRHP was followed by a fall in interest rates from September 2008 with the following consequences:
>
> (1) Hexagon was required to pay the fixed interest on the IRHP at 5.95% together with all other costs and payments due under the loan. The sum of £194,574 was paid into the IRHP to 30th April 2012
>
> (2) Hexagon was not able to take advantage of the fall in interest rates from 2008 to date.

(3) Hexagon was not able to utilise the money paid into the IRHP within its business and in particular to utilise it to complete the developments at Enholmes Farm as planned. In particular the restriction or diminution of income prevented the completion of Phases 2 and 3 at Enholmes Farm

(4) Further, Hexagon was unable to complete the partially completed development at West Farm Holmpton.

(5) The creation of the IRHP adversely affected Hexagon's credit rating and ability to borrow further. The IRHP created a Credit Equivalent Exposure ("CEE") which reduced the available security that could be provided to any lending bank as security for further borrowing. On attempting to borrow money to complete the developments Hexagon was refused. It will be said that the IRHP was the cause of refusal by other lending institutions. Hexagon will say that the break costs to terminate the IRHP exceeded £260,000 which could not be paid from capital or from further borrowing because of a funding and borrowing crisis created by the IRHP.

(6) The IRHP costs affected Hexagon's cash flow and capital funding by reducing the available capital and income.

(7) Hexagon was unable to rebut the claim by the bank that it had failed to service the interest or other financial covenants contained in the loan agreements as they fell due. Hexagon will rely upon a financial reconstruction of its assets and available cash flow to be provided in an experts report to demonstrate that but for the IRHP it would have been able to service and discharge all financial liabilities to HSBC arising under the loan terms and conditions.

(8) The prevention of the completion of Phases 2 and 3 at Enholmes Farm and at Holmpton deprived Hexagon of the capacity to sell completed properties and to apply the funds to discharge debts to the bank that would otherwise have been discharged.

(9) The bank appointed Law of Property Act receivers GVA Grimley on 15th March 2012 over properties charged to the bank as listed as 1-11 in the Schedule to the letter of appointment. The relevant properties are particularised in the attached Schedule of Properties marked Schedule 1 to the Particulars of Claim. The bank relied upon breaches of terms conditions and covenants that would not have been breached or would not have been capable of supporting an allegation of breach but for the deprivation of income caused by the IRHP. Hexagon will refer to the default events as claimed in a letter dated 16th May 2012 said to be a Declaration of an Event of Default and to the alleged breaches under s.5 of the terms of the ISDA Master Agreement 1992 relied upon.

(10) Hexagon was unable to complete and sell the listed properties at full market value, creating further deprivation of cash flow and capital and so precluding further repayment to the bank at market levels.

(11) Hexagon was unable to apply the balances following sale to the completion of further outstanding developments.

(12) Following the appointment of receivers the credit rating of the company dropped to a level that had the commercial consequence of preventing or seriously hindering further borrowing. Hexagon was unable to obtain commercial supplies and credit facilities previously available which limited or precluded the ongoing completion of the developments.

(13) The receivers disposed of properties that Hexagon would otherwise have retained as set out in the Schedule attached marked Schedule 2 to the Particulars of Claim. Hexagon will claim loss and damage measured by the valuations of properties disposed of that would otherwise have been retained to be evaluated by an expert at trial.

(14) Hexagon was deprived of rental income that would otherwise have been obtained from the properties sold or retained under the control of the receivers. Hexagon will claim loss and damage measured by the lost rental income from all properties that would have been retained to be evaluated by an expert at trial. The properties from which rental income would have been obtained are set out in the Schedule marked Schedule 3 to the Particulars of Claim.

(15) The rental income would have been applied to service the loans as required. Hexagon will adduce expert evidence of the level of income capable of being generated by the properties at trial in order to show that the loan interest was otherwise capable of being serviced.

(16) The value of the properties retained declined by reason of the appointment of the receivers. Hexagon will adduce evidence from an expert at trial to show the current and proper open market valuations on a free-sale basis of all properties devalued by reason of the appointment of the receivers.

13. The proceedings were settled by a settlement agreement dated some time in February 2017 or shortly afterwards. This settlement appears to have been reached by the means of the acceptance by the bank (subject to contract) on 20 December 2016 of a "without prejudice" offer of settlement made by the Appellant dated 8 December 2016, however no copies of the letters containing that offer or the bank's acceptance were in evidence before me, nor was there any other information about the substance of the negotiations which was capable of providing sufficient evidence for the Tribunal to carry out an exercise of analysing the settlement amongst the different heads of claim advanced by the Appellant.

14. The settlement agreement (to which the Appellant, its two directors, the bank and the receivers were parties) contained the following provisions:

2. Definitions and Interpretation

In this Agreement, the following terms shall have the following meaning *[sic]*:

Accrued interest means the aggregate amount of interest arising from the amounts outstanding in connection with the Loan Accounts, accrued and calculated up to and including the date on which the Loan Accounts are closed.

…

Claim means any claim, potential claim, counterclaim, potential counterclaim, right of set-off, indemnity, cause of action, right or interest of any kind or nature whatsoever, whether known or unknown, suspected or unsuspected, present or future, which:

(a) the Customer, the Directors and/or their Associated Persons have or may have against the Bank, its Associated Persons and/or the Joint Receivers and/or their Associated Persons, including, but not limited to, any and all claims arising out of or in relation to the Swap, the claims made by the Customer in the FCA Review, the claims made in the Proceedings, the conduct of the Joint Receivers and/or their Associated Persons, any outgoings or liabilities relating to or in connection with the Properties

and/or the Stockton Proceedings, any and all claims for consequential loss and any and all claims in relation to legal and other costs, or

(b) the Bank has or may have against the Customer arising out of, or in any way connected to, the Outstanding Indebtedness and/or the Loan Accounts, or

(c) the Joint Receivers have or may have against the Customer and/or the Directors.

Debenture means the debenture entered into between the Bank and the Customer on or around 12 June 2007.

…..

Loan Accounts means the following accounts with the Bank: *[six accounts were identified by sort code and account number]*.

Loan Agreements means the loan agreements entered into between the Bank and the Customer respectively dated 16 May 2007, 16 October 2007 and 22 September 2009, as amended from time to time.

Middlesborough Insurance Claim means the insurance claim made by the Joint Receivers with AXA in relation to the Middlesborough Property (*[a policy reference and claim number were recited]*).

….

Outstanding Indebtedness means all sums owing and outstanding by the Customer to the Bank pursuant to the Loan Agreements, such sums being the equivalent to the balances of the Loan Accounts plus the Accrued Interest.

Payment Due Date means 5pm (Greenwich Mean Time) on 16 February 2017.

Proceedings means the proceedings issued on 13 April 2016 by the Customer against the Bank in the High Court of Justice, Queen's Bench Division, York District Registry (claim number: C90YO007).

Properties means the properties listed in Appendix 1 to this Agreement over which the Joint Receivers have been appointed.

Settlement Sum means the sum of £1,490,000 payable by the Customer to the Bank in accordance with clause 6 of this Agreement.

….

Swap means the base rate extendable swap with a notional amount of £1,000,000 entered into between the Customer and the Bank on or around 4 July 2007 (current reference numbers *[two references given]*) and terminated on 18 May 2012.

3. Full and Final Settlement

3.1 In full and final settlement of all Claims:

(a) the Customer agrees to:

(i) no later than the Payment Due Date, pay the Settlement Sum to the Bank in accordance with clause 6 below; and

(ii) within 2 business days of the day on which the Settlement Sum is paid and in any event no later than the Payment Due Date, discontinue the Proceedings;

(b) the Joint Receivers agree to:

(i) on the day on which confirmation is received from the Bank that the Bank has received the Settlement Sum, notify the Bank of the resignation of their appointment as Joint Receivers over the Properties;

(ii) within 2 business days of the day on which confirmation is received from the Bank that the Bank has received the Settlement Sum, pay the Apportioned Rental Income to Lupton Fawcett LLP's client account;

(iii within 5 business days of the day on which confirmation is received from the Bank that the Bank has received the Settlement Sum, procure to assign to the Customer all the Joint Receivers' rights, title, interest and benefit under the Middlesborough Insurance Claim (the *Middlesborough Insurance Assignment*); and

(iv) within 3 business days of the day on which the Middlesborough Insurance Assignment is effected, deliver to Lupton Fawcett LLP all documents in the Joint Receivers' possession relating to the Middlesborough Insurance Claim; and

(c) subject to clause 8 below, the Bank agrees to:

(i) within 2 business days of the date on which the Settlement Sum is received, deliver to Lupton Fawcett LLP the signed version of a form DS1 for each of the Properties, substantially in the form agreed between the Bank and the Customer and attached as Appendix 2 to this Agreement;

(ii) on the day on which the Bank receives the Joint Receivers' notification of their resignation, accept the resignation of the Joint Receivers; and

(iii) within 5 business days of the day on which the proceedings are discontinued:

(A) close the Loan Accounts; and

(B) issue a letter addressed to the Customer confirming that the Customer's obligation to pay the Outstanding Indebtedness is released and discharged.

3.2 The Bank agrees that, upon receipt by the Bank of the Settlement Sum, any and all of the Customer's duties, obligations and liabilities pursuant to and arising from the Debenture are released and discharged.

3.3 The Customer agrees that, on the date of this Agreement, any and all of the Bank's duties, obligations and liabilities pursuant to and arising from each and all of the Loan Agreements are released and discharged.

3.4 Save in relation to obligations arising under this Agreement, the Customer and the Directors and their Associated Persons agree that the Bank, its Associated Persons and the Joint Receivers are hereby released and forever discharged from all Claims.

….

6 Payment of the Settlement Sum

6.1 The Customer undertakes to pay to Freshfields Bruckhaus Deringer LLP's client account the Settlement Sum no later than the Payment Due Date.

6.2 Details of Freshfields Bruckhaus Deringer LLP's client account are:

[Details provided]

15. The Appellant's pre-existing indebtedness to the bank under the loan accounts was, I was given to understand, in the region of £5 million. By agreeing to accept a payment of £1.49 million and a waiver of all claims in settlement of that £5 million debt, the bank was therefore effectively paying approximately £3.5 million by way of damages to settle the Appellant's claims.

16. In its accounts for the period ended 25 April 2017, which showed an overall pre-tax profit for the year of £1,921,456, the Appellant recognised a credit of £3,552,596 in its profit and loss account in respect of the settlement, itemised separately as "IRHP compensation". In a note to its accounts, it said this about this entry:

> During the year the company reached legal settlement with one of its bankers regards a mis-sold Interest Rate Hedging Product. Under the settlement the company received compensation totalling £3,552,596, which was used to pay off certain bank loan and overdraft liabilities.

17. In its tax computation for the year, it adjusted its reported net profit for the year by deducting the sum of £3,552,596. The combined effect of this and other adjustments was to reduce its accounting profit from £1,921,456 to a taxable trading loss of £1,153,562, with a chargeable gain of £36,912, resulting in an overall nil corporation tax liability for the year.

18. HMRC opened an enquiry into the Appellant's corporation tax return by letter dated 31 August 2018. Correspondence was exchanged, and by an amendment to the Appellant's self-assessment return made pursuant to a closure notice issued on 9 November 2018, HMRC added back £3,552,596 to the Appellant's taxable trading profits, resulting (after various other adjustments) in a corporation tax liability for the year of £265,581.55. The Appellant appealed to HMRC, who confirmed their decision in a statutory review letter dated 15 August 2019, following which the appeal was notified to the Tribunal on 9 September 2019.

THE LEGISLATION

19. Relevant extracts from Part 5 Corporation Tax Act 2009 ("CTA09") are set out in the Appendix to this decision. References in this decision to sections are to sections in that Act.

ARGUMENTS OF THE PARTIES

20. The only real issue between the parties for the purposes of this hearing was whether the loan relationship rules should be treated as overriding for tax purposes any suggestion that any part of the credit received by the Appellant was capital in nature.

21. Mr Bradley's argument, in summary, was that the pre-existing debts to the bank were loan relationships of the Appellant; the release of those debts effected under the settlement fell squarely within the meaning of the phrase "related transaction" in the loan relationships code; the Appellant had recognised a credit of £3,552,596 in its accounts in respect of that release; there was no suggestion that this recognition was in conflict with generally accepted accounting practice; and accordingly the Appellant was required to bring that amount into account as a trading receipt under the loan relationship rules (by definition, therefore, as income rather than capital).

22. Mr Wood effectively argued that Mr Bradley's approach was an oversimplification. He argued that, as a general proposition, when a taxpayer carrying on a business received a payment by way of damages, it was necessary to establish the character of the payment, i.e. whether it was income or capital in nature. This would depend on what the damages payment was for. To the extent the payment was income in nature, then it was appropriate that it be included in the income profits of the business, and taxable as such; to the extent it was capital

in nature then this was not the correct approach. He referred to the well known stream of authority commencing with *Glenboig Union Fireclay Limited v CIR* (1930) 12 TC 427 and including *Burmah Steam Ship Co. v CIR* [1931] S.C. 156 and *London & Thames Haven Oil Wharves Limited v Attwooll (Inspector of Taxes)* [1967] Ch. 772.

23. What had actually happened in this case, he submitted, was that an arm's length settlement had been negotiated of a perfectly bona fide cause of action, comprising amounts which were (he asserted) substantially capital in nature.

24. The fact that the agreed mechanics of settlement meant that the settlement amounts had been netted off against pre-existing indebtedness should not be allowed to distort the correct tax treatment. In this situation, it was inappropriate to regard the Appellant's debt to the bank as having been "released"; what had actually happened was that it had been satisfied by netting off against the Appellant's claim for damages; in essence, the debt had been satisfied rather than released. To treat it otherwise would reflect a triumph of form over substance.

25. In this, he sought to rely on the following statement by Nourse LJ in *Collins v Addies* [1992] STC 746 at 749 g-h (a case considering whether a novation of a loan made by a company to a participator amounted to a "release" of that loan so far as the participator was concerned for the purposes of the "loans to participators" provisions):

> The Crown's basic proposition, with which I agree, is that "release" does not include any transaction which either consists of or amounts to a repayment of the loan, even if the transaction, when viewed in isolation, might be said to have the effect of releasing the debtor from his obligation to repay the loan.

26. In arguing that the settlement with the bank reflected the satisfaction of the Appellant's debt rather than its release, Mr Wood also cited *In re Harmony and Montague Tin and Copper Mining Company (Spargo's Case)* (1872-73) L.R. 8 Ch App. 407. In that case, Mr Spargo had agreed to sell a lease of a mine to a company for a particular price. He also subscribed for shares in the company. The subscription price for the shares was greater than the price of the property. It was agreed that the company would credit him with the amount of the purchase price of the property against the subscription price of his shares. He paid the balance of the subscription price in cash. When the company subsequently went into liquidation, its liquidator sought to claim payment in cash from him for the shares which he had acquired by payment "in kind" by his sale of the mine to the company. It was held that he could not do so, because the shares in question were to be regarded as having already been paid up in cash. Mellish LJ (agreeing with James LJ) said this:

> Nothing is clearer than that if parties account with each other, and sums are stated to be due on one side, and sums to an equal amount due on the other side of that account, and those accounts are settled by both parties, it is exactly the same thing as if the sums due on both sides had been paid. Indeed, it is a general rule of law, that in every case where a transaction resolves itself into paying money by A to B, and then handing it back again by B to A, if the parties meet together and agree to set one demand against the other, they need not go through the form and ceremony of handing the money backwards and forwards.

27. Mr Bradley's response was that, strictly by reference to the definition of "related transaction" in s.304 CTA09, the liabilities of the Appellant under its loan relationships with the bank had clearly been "extinguished", whether by "release" (which was his primary contention), "exchange" or "redemption" (if one took the view that the Appellant had effectively paid off its debt by setting off its damages claim). He also argued that *Collins v Addies* did not assist the Appellant, because it was common ground in that case that the ordinary meaning of "release" would include a release for full value; the only issue was whether the

particular statutory context required that "release" be given a more narrow meaning, so as not to apply to a release of the liability of the original debtor which necessarily took place when his liability under the debt was novated to another person who undertook an equivalent liability to the lender.

28. If it were accepted that the release of the Appellant's indebtedness to its bank was a "related transaction" within the meaning of s.304, it followed that the Appellant was required under s.306A to bring into account the "profits" that arose to the Appellant from that release. The amount to be brought into account, under s.307, was the credit recognised in the Appellant's accounts in respect of it. In Mr Bradley's submission, there being no dispute that the accounts were GAAP-compliant, the amount of the credit shown in the accounts must therefore be recognised as a credit for loan relationship purposes. Relying on the Court of Appeal's analysis of "the loss issue" in relation to the parallel derivatives provisions in *Union Castle Mail Steamship Co Ltd v HMRC* [2020] EWCA Civ 547 at [35] to [38], he submitted that no further enquiry was needed on this point – the accounts recognised a credit in respect of the relevant related transaction, the amount of which therefore constituted a profit to be brought into account under the loan relationship rules.

29. Following the hearing, further representations from the parties were sought on the question of whether, even if the £3.5 million recognised in the Appellant's accounts could appropriately be regarded as a "profit", it should properly be regarded as "a profit of the company that arises from its loan relationships and related transactions." For the Appellant, Mr Wood argued that the £3.5 million was "in substance, a payment for the Appellant giving up its right of action against the bank. As such, this was not an item of profit that arose from its loan relationships." Mr Bradley characterised this as a "non-sequitur", on the basis that "the fact the profit could be described as arising from [the Appellant's] claim against the bank does not preclude it also arising from the release. To say that the profit arises from the claim is simply to explain the reason the release took place." He likened the analysis to a situation in which the owner of a company decides to release a large debt owed to her by the company, where he submitted that any resulting credit in the company's accounts would be chargeable under the loan relationship regime as a profit arising from the release, and would not fall outside that regime on the basis that it really "arose from" the bounty of the shareholder in releasing the debt.

30. In the circumstances, the authorities around the characterisation of damages payments as income or capital in nature were not explored in any detail during the hearing. It was agreed that if the decision of the Tribunal on the preliminary issue went in favour of the Appellant, then further evidence and argument would be required in order to address that issue.

DISCUSSION AND DECISION

31. It is quite clear that the Appellant was party to one or more loan relationships with its bank until the completion of the settlement of its litigation with the bank. At that point, it paid off approximately £1.5 million of its debt, and its liability to pay the remaining amount of approximately £3.5 million was "released and discharged" by virtue of the settlement agreement. It is equally clear that this was done as part of the overall full and final settlement of all "Claims", the most material of which was the Appellant's claim against its bank for damages in respect of the alleged mis-selling of the IRHP to it.

32. I consider that the "release and discharge" of £3.5 million of the Appellant's debt to the bank can properly be described as the "extinguishment", *pro tanto*, of its liabilities under the pre-existing debtor relationship, and that such extinguishment was either by way of "exchange" (on the basis that, viewed properly, the Appellant had exchanged its right of action for damages against the bank for the extinguishment of the £3.5 million of debt), by way of "redemption"

(on the basis that the £3.5 million of debt was redeemed by the operation of the same transaction) or by way of "release" (on the basis that whatever the cause, the £3.5 million debt was as a matter of fact released).

33. As such, I consider the transaction to fall within the definition of "related transaction" for the purposes of s. 304 CTA09. The fact that it might fairly be described in economic terms (whether by reference to *Collins v Addies*, *Spargo's case* or otherwise) as the settlement by the bank of its liability in damages to the Appellant is not, in my judgment, relevant to this question. I agree with Mr Bradley that once the transaction has been shown to fall within the definition of "related transaction" in relation to the Appellant's pre-existing debtor loan relationship, it does not matter whether it could also be viewed in some other way.

34. It follows that any profit arising to the Appellant arising from the related transaction in question must be brought into account as a loan relationship credit under s. 306A CTA09.

35. Incidentally, I reject Mr Wood's argument that any credit arising from the transactions did not "fairly represent" a profit arising from a related transaction and accordingly should not be recognised as such for loan relationship purposes – as Mr Bradley says, the "fairly represents" requirement (previously appearing in s. 307(3)) had been abolished (pursuant to Finance (No.2) Act 2015) for all companies in respect of their accounting periods commencing on or after 1 January 2016, so does not apply in relation to the transactions the subject of this appeal.

36. The next question that must therefore be decided is whether the credit item in the Appellant's accounts constituted "profits… that arise to [the Appellant] from its loan relationships and related transactions" for the purposes of s.306A.

37. As *Union Castle* makes clear, this "arise from" issue is central. The wording of the relevant legislation in that case was different, but not in any material respect so far as this issue is concerned. The legislation in that case brought into account "all profits and losses of the company which… arise to the company from its derivative contracts and related transactions…" In the present case, s. 306A brings into account "profits and losses of the company that arise to it from its loan relationships and related transactions…"

38. In *Union Castle*, an accounting debit arose in the taxpayer company when 95% of the value of the relevant derivative assets owned by it (some "in the money" put options) was derecognised as a result of an issue of A shares which effectively transferred that benefit (in the form of a right to a dividend attached to those shares) to the company's parent company. One of the key questions that arose in the case (apart from the "loss issue" referred to above) was what was referred to as the "arise issue" – the question of whether, if there was a "loss", it did "arise from" the derivative contracts in question. The Court of Appeal held, agreeing with the Upper Tribunal, that the derecognition which gave rise to the loss and the issue of the A shares were "inseparable", and it was the issue of the A shares which "had the effect, by reason of the derecognition mandated by IAS 39, of reducing the carrying value of the derivative contracts by 95%." It was therefore "not tenable to say that the derecognition arises from the derivative contract, as opposed to the issue of the A shares."

39. Mr Bradley argued that the Court of Appeal in *Union Castle* had (at [68] and [76]) endorsed the Upper Tribunal's view that the phrase "arise from"… "implies a direct causal connection" between the relevant losses (or profits) and the derivative contracts in question in that case. Mapping that across to the present facts, that would require a direct causal connection between the related transaction (the exchange, redemption or release of its debtor relationship with the bank) and the profit of the Appellant. In his submission, that direct causal connection was "self-evidently present", because if the bank had not released the debt, there would have

been no credit in the accounts. It was irrelevant, in his submission, that the profit might also be regarded as "arising from" the Appellant's claim against its bank.

40. Whilst accepting that a "direct causal connection" is required, I reject this latter submission. Any objective consideration of what the £3.5 million arose from in this case would conclude that it arose "from" the Appellant's claim in damages against its bank and not "from" any related transaction of its loan relationships. This is reinforced by the fact that the very clear entry and note in the (undisputedly GAAP-compliant accounts) specifically identifies its nature not as a profit arising from a loan relationship or related transaction, but as receipt of compensation for the mis-sold IRHP.

41. In contrast, with regard to Mr Bradley's example of the bounteous shareholder at [29] above, I see no difficulty in accepting that whilst the underlying cause of the profit might be that bounty, on any objective view the company's "profit" would undoubtedly "arise from" the related transaction and not from the bounty of the shareholder; and any entry in the accounts as to the reason for the credit (the shareholder's bounty) would not affect this.

42. It follows that the appeal is ALLOWED and no enquiry is required into the amount of any credit pursuant to s. 307.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

43. 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.

KEVIN POOLE
TRIBUNAL JUDGE

Release date: 14 APRIL 2022

APPENDIX

EXTRACTS FROM CORPORATION TAX ACT 2009

292 Overview of Part

(1) This Part sets out how profits and deficits arising to a company from its loan relationships are brought into account for corporation tax purposes.

293 Construction of references to profits or losses from loan relationships

(1) In this Part references to profits or losses from loan relationships include references to profits or losses from related transactions.

(2) For the meaning of *'related transaction'* see section 304.

(3) Except where the context indicates otherwise, in this Part references to profits or losses from loan relationships include references to profits or losses of a capital nature.

…

295 General rule: profits arising from loan relationships chargeable as income

(1) The general rule for corporation tax purposes is that all profits arising to a company from its loan relationships are chargeable to tax as income in accordance with this Part.

(2) But see section 465 (exclusion of distributions except in tax avoidance cases).

296 Profits and deficits to be calculated using credits and debits given by this Part

Profits and deficits arising to a company from its loan relationships are to be calculated using the credits and debits given by this Part.

297 Trading credits and debits to be brought into account under Part 3

(1) This section applies so far as in any accounting period a company is a party to a loan relationship for the purposes of a trade it carries on.

(2) The credits in respect of the relationship for the period are treated as receipts of the trade which are to be brought into account in calculating its profits for that period.

(3) The debits in respect of the relationship for the period are treated as expenses of the trade which are deductible in calculating those profits.

(4) So far as subsection (3) provides for any amount to be deductible, it has effect despite anything in—

(a) section 53 (capital expenditure),

(b) section 54 (expenses not wholly and exclusively for trade and unconnected losses), or

(c) section 59 (patent royalties).

(5) This section is subject to—

(a) section 330 (debits in respect of pre-trading expenditure),

(b) section 482(1) (under which credits or debits to be brought into account under Chapter 2 of Part 6 (relevant non-lending relationships) are treated as non-trading credits or debits), and

(c) sections 286(5) and 287(5) of CTA 2010 (under which some credits and debits affecting ring-fence profits from petroleum extraction activities are treated as non-trading credits and debits).

302 "Loan relationship", "creditor relationship", "debtor relationship"

(1) For the purposes of the Corporation Tax Acts a company has a loan relationship if—

(a) the company stands in the position of a creditor or debtor as respects any money debt (whether by reference to a security or otherwise), and

(b) the debt arises from a transaction for the lending of money.

(2) References to a loan relationship and to a company being a party to a loan relationship are to be read accordingly.

…

(5) In this Part "creditor relationship", in relation to a company, means any loan relationship of the company where it stands in the position of a creditor as respects the debt in question.

(6) In this Part "debtor relationship", in relation to a company, means any loan relationship of the company where it stands in the position of a debtor as respects the debt in question.

…

304 "Related transaction"

(1) In this Part "related transaction", in relation to a loan relationship, means any disposal or acquisition (in whole or in part) of rights or liabilities under the relationship.

(2) For this purpose the cases where there is taken to be such a disposal and acquisition include those where rights or liabilities under the loan relationship are transferred or extinguished by any sale, gift, exchange, surrender, redemption or release.

…

306A Matters in respect of which amounts to be brought into account

(1) The matters in respect of which amounts are to be brought into account for the purposes of this Part in respect of a company's loan relationships are—

(a) profits and losses of the company that arise to it from its loan relationships and related transactions (excluding interest or expenses),

(b) interest under those relationships, and

(c) expenses incurred by the company under or for the purposes of those relationships and transactions.

(2) Expenses are only treated as incurred as mentioned in subsection (1)(c) if they are incurred directly—

(a) in bringing any of the loan relationships into existence,

(b) in entering into or giving effect to any of the related transactions,

(c) in making payments under any of those relationships or as a result of any of those transactions, or

(d) in taking steps to ensure the receipt of payments under any of those relationships or in accordance with any of those transactions.

(3) For the treatment of pre-loan relationship and abortive expenses, see section 329.

307 General principles about the bringing into account of credits and debits

(1) This Part operates by reference to the accounts of companies and amounts recognised for accounting purposes.

(2) The general rule is that the amounts to be brought into account by a company as credits and debits for any period for the purposes of this Part in respect of the matters mentioned in section 306A(1) are those

that are recognised in determining the company's profit or loss for the period in accordance with generally accepted accounting practice.

308 Amounts recognised in determining a company's profit or loss

(1) References in this Part to an amount recognised in determining a company's profit or loss for a period are references to an amount that is recognised in the company's accounts for the period as an item of profit or loss.

(1A) The reference in subsection (1) to an amount recognised in the company's accounts for the period as an item of profit or loss includes a reference to an amount that—

(a) was previously recognised as an item of other comprehensive income, and

(b) is transferred to become an item of profit or loss in determining the company's profit or loss for the period.

(1B) In subsections (1) and (1A) "item of profit or loss" and "item of other comprehensive income" each has the meaning that it has for accounting purposes.

…

464 Priority of this Part for corporation tax purposes

(1) The amounts which are brought into account in accordance with this Part in respect of any matter are the only amounts which may be brought into account for corporation tax purposes in respect of it.

(2) Subsection (1) is subject to any express provision to the contrary.