TAX AND THE CITY

The FTT in *Keighley* agrees with HMRC on its interpretation of 'control' in the loan relationships connected parties' rule but, on the facts, determines the parties were not connected although the deduction for the debit on the write-off of a loan was still denied, albeit by the unallowable purpose rule. The Spring Budget confirms that a new type of investment fund, the Reserved Investor Fund, will be legislated for in the Spring Finance Bill, with details of the new regime to be provided in secondary legislation. The taxpayers in *Clipperton* lose their appeal for the third time with the Court of Appeal concluding the tribunals had correctly applied the *Ramsay* approach to conclude the taxpayers had received a distribution in respect of their shares upon which tax was due. HMRC publishes a call for evidence on powers, penalties and safeguards, with some quite wide-ranging proposals as part of establishing a trusted and modern tax administration system.

Keighley: control in the connected parties test and unallowable purpose

The decision of the First-tier Tribunal (FTT) in *James Keighley and Primeur Ltd v HMRC* [2024] UKFTT 30 TC included some interesting points on the loan relationship rules. The FTT had to determine (amongst many other issues) whether a corporation tax loss on the write-off of a loan between two companies should be denied either on the basis that the borrower and lender were connected companies or, failing that, under the unallowable purpose rule.

James Keighley (JK) owned shares in a company (Primeur) and he, as well as Barry Minal (BM), another Primeur shareholder, owned shares in a second company (VDP). Under the VDP shareholders' agreement, consent of a third individual shareholder was required for a number of actions. Primeur and its shareholders made loans to VDP. Primeur's loan was secured over a property owned by VDP. After the sale of the property, there were insufficient funds for VDP to pay its debts in full and instead of Primeur being paid in priority, as was its entitlement as the secured lender, Primeur wrote off part of its loan so that JK and BM could be repaid in full.

Control

The connected parties issue raises some points relating to control which are relevant not just to loan relationships but also in other contexts such as determining whether there are disqualifying arrangements under the group relief / consortium relief rules. As the arguments were run mostly on how the law applied to the facts, rather than what the law in various cases actually was, we will have to wait to see if it is appealed in order to get some legal analysis and a binding decision on control.

The test for connection in CTA 2009 s466(2)(c) is whether the companies are 'controlled by the same person'. You might argue this requires a person who is a common controller of both companies but HMRC have long maintained in guidance CFM35120 that the Interpretation Act 1978 allows you to read 'controlled by the same person' in s466(2)(c) as including 'controlled by the same persons'. According to HMRC's guidance:

'Following section 6(c) of the Interpretation Act 1978 we accept that the word 'person' can include 'persons'. But such persons will only meet the requirements of the legislation if together they can secure that the company's affairs are controlled in accordance with their wishes. Whether this exists will be a question of fact in all cases. For example, there could be an oral or written agreement always to vote together, or the intention could be implied by the relationship between the parties.'

We are not wholly convinced by the Interpretation Act argument. How does this fit in with CTA 2010 s450(5) (which specifically treats two or more persons who together satisfy the relevant conditions in s450 as having control)? If 'person' is to be read as 'persons' anyway because of the Interpretation Act why is s450(5) required? Doesn't the absence of an equivalent provision in s466 point towards an intention not to extend 'person' to 'persons'? And it is unclear what difference the 'oral or written agreement always to vote together' could make if it is not a 'document regulating the company' for the purposes of CTA 2009, s472(2)(b).

In this case the lender and borrower companies did not consider themselves connected. They were each owned by a different group of individual shareholders, although JK and BM held a majority shareholding in each. The taxpayers argued that where two people are alleged to control a company, they must 'act as one' but the FTT did not agree. According to the FTT, you simply look at whether the rights attaching to the shares, the articles or the shareholders' agreement give the two people the power to secure that the affairs of the company are conducted in accordance with their wishes. On the facts of this case, however, because consent of a third shareholder was required for various actions under the VDP shareholders' agreement, the FTT concluded that the two companies were not connected.

Interestingly, the FTT did not share the same uncertainty as some, post *Farnborough* [2019] EWCA Civ 118, as to whether the shareholders' agreement should be treated as a document regulating the company or not. The FTT merely qualified the reference to the shareholders' agreement with '(which in our view falls within the ambit of another document regulating the company)' without providing any analysis. It will be interesting to see if there is any analysis of this point if the case is appealed.

Unallowable purpose

On the unallowable purpose point, this case is a useful reminder that the unallowable purpose rule is not (just) a tax avoidance rule. The FTT found that the partial write-off of the loan had an unallowable purpose, not because the company writing off the loan did so to secure a tax benefit for anyone, but because it did so to ensure JK and BM could be repaid fully to reward them for work done securing a good deal on the sale of the property by VDP. This purpose was not amongst Primeur's commercial or business purposes.

Budget: Reserved Investor Fund

There was very little in the Budget of interest to financial services. It was, however, announced that the Spring Finance Bill will include legislation to define the Reserved Investor Fund (Contractual Scheme) (RIF) (known earlier in the consultation process as the Professional Investor Fund or PIF) and provide a regulation-making power.

The RIF is in response to industry demand for a UK-based unauthorised contractual scheme with lower costs and more flexibility than the existing authorised contractual scheme. It is expected to be particularly attractive for investment in commercial real estate. The RIF has emerged as part of the wider review of the UK funds regime launched in 2020 to identify options to make the UK more attractive to the setting up, administration and management of funds. The RIF has been the subject of consultation since April 2023 and the consultation outcome was also published at the Spring Budget.

The details of the regime will be provided in secondary legislation which will be discussed with stakeholders in due course. The government's objectives for the RIF tax regime are tax neutrality, certainty and protection against risks to the Exchequer (particularly ensuring there can be no loss of tax from non-UK resident investors on disposals of UK property).

The RIF will be structured as an unauthorised co-ownership contractual scheme and will be open to professional and institutional investors. The RIF rules are expected to replicate the tax rules which apply to co-ownership authorised contractual schemes (CoACS) including the CGT treatment so that the investors would be taxed on gains realised on the disposal of their units in the fund (not on a share of gains realised on the disposal by the fund of underlying assets) although they would be taxable on income as it arises.

One of the government's key concerns is ensuring compatibility of the RIF regime with the purpose and operation of the non-resident capital gains rules. There will be three types of RIF in order to simplify the regime and protect against risks to the Exchequer: a UK property rich RIF which has 75% or more of the value of its total assets derived from UK property; an exempt investor RIF which is open only to investors who are exempt from UK tax on gains (other than by reason of residence), for example certain pension funds; and a non-UK property RIF which is restricted from investing in UK property with the possible exception of minor interests in UK property rich collective investment vehicles. The requirements for each RIF will be included in the eligibility criteria and if the restrictions are breached, RIF status will be lost unless mitigating provisions apply. It has been decided not to go ahead with an unrestricted RIF (one without restrictions on investors or assets) which would have required more complex provisions to prevent loss of tax on gains from disposals of UK property by non-UK resident investors.

Clipperton; purposive construction of 'distribution…in respect of shares'

The Court of Appeal described *Clipperton & Anor v Commissioners for His Majesty's Revenue and Customs* [2024] EWCA Civ 180 as seeming to be a 'paradigm case for the application of the *Ramsay* principle'. The case concerned a marketed tax avoidance scheme designed to enable shareholders to obtain tax-free returns on their investment instead of receiving taxable dividends. The scheme worked in its simplest form as follows. The amount that would otherwise have been paid out by way of a dividend by a company (A) was put into a newly incorporated subsidiary (B) by way of a share subscription. The shares in B were put into a settlement, then a dividend was paid out by B on B's shares into the settlement. The shareholders of A (the taxpayers) were beneficiaries of the settlement and entitled to the majority of the income under the settlement.

The success of the scheme relied on ITTOIA 2005, Chapter 5 of Part 5, (referred to as the settlements code) which provides that income arising under a settlement is, in certain circumstances, treated as income of the settlor. As A had a small interest in the settlement, it was argued that the income paid out of the settlement to the shareholders of A could be treated as income of A (meaning the taxpayers would not need to pay tax on the amounts they received under the settlement).

The FTT decided that the scheme failed and the Upper Tribunal (UT) agreed it was the correct decision. Applying the *Ramsay* approach, on a purposive construction of ITTOIA ss383-385 and CTA 2010 s1000 and on a realistic view of the facts, the FTT concluded that A made a distribution to the taxpayers in respect of their shares in A by providing funds to B (by way of share subscription) with the sole purpose of enabling B to pay the dividend into the trust for the intended benefit of the taxpayers, solely in their capacity as shareholders of A.

Before the Court of Appeal, the taxpayers tried to rely on *Khan v HMRC* [2021] EWCA Civ 624, to argue that the steps should be looked at separately and that there had not been a distribution from A to the taxpayers in respect of their shares in A. In *Khan*, purposive construction of the relevant charging provision (ITTOIA s 385(1)) required looking at the transaction under which the taxable distribution arose and was not 'concerned with the overall economic outcome of a series of commercially interlinked transactions'. The taxpayer in *Khan* tried to rely on *Ramsay* to argue that the sale and buy-back transaction should be looked at as a composite whole but the Court of Appeal held that the statutory provisions require the focus to be on the transaction under which the taxable distribution arose, not on the connected transactions as a whole.

But the Court of Appeal concluded that the statutory question in *Khan* was a different question to that in *Clipperton*. In *Khan* it was agreed that there was a distribution and there was no dispute as to what the distribution was (the payment for the share buyback). The issue was whether Mr Khan was 'entitled to' or 'received' the distribution. By way of contrast, in *Clipperton* the question was whether there was a 'distribution …in respect of shares' so *Khan* does not constrain the Court of Appeal to look at the steps separately. The Court of Appeal agreed with the FTT that 'distribution …in respect of shares' in CTA 2010, s1000, as further explained in s 1113, is, on a purposive construction, wide enough to include a distribution by a company which reaches the company's shareholders directly or indirectly as a result of more circuitous route involving a series of steps.

The Court of Appeal concluded that there was a distribution in respect of A's shares in favour of the taxpayers. Accordingly, the Court of Appeal dismissed the appeal holding that the FTT's decision was correct and the UT was right to uphold it. The Court of Appeal also affirmed the decision of the FTT and UT that the settlements code did not apply to the sum paid to the taxpayers.

This case is further illustration of that fact that sometimes transactions need to be viewed independently (for example in the 'cautionary tale' of *Mr Khan*) whereas other times purposive construction of the statutory provision requires looking at transactions as a whole (as in *Clipperton*). It all depends on looking at the statutory provision in light of its purpose and applying the provision so construed to the facts, viewed realistically.

The Tax Administration Framework Review: powers, penalties, safeguards

HMRC have published a call for evidence which is open until 9 May 2024 on how HMRC's enquiry and assessment powers, penalties and safeguards could be reformed as part of establishing a trusted and modern tax administration system.

The call for evidence is extensive and includes proposals to align the direct and non-direct appeals processes going with which one works best in practice and the possible reform of the discovery powers. Examples of what other countries do are provided in Annex B to illustrate alternative approaches the UK could explore.

What to look out for:

- On 12 or 13 march, the Court of Appeal is scheduled to hear the appeal in *Hargreaves Property Holdings Ltd v HMRC* about UK withholding tax on interest paid by a UK resident borrower on recurring loans.
- The closing date for the consultation on simplification for alternative finance is 9 April. This consultation seeks to address the difference in tax treatment between 'conventional' finance arrangements and 'alternative' finance where property is used as collateral.
- On 10 April, the Court of Appeal is scheduled to hear the appeal in H*otel La Tour Ltd v HMRC* on the recoverability of input vat in respect of advisers' fees in relation to a share sale for the purpose of raising funds for a holding company's taxable general activity.
- There will be a further set of tax administration and maintenance announcements on 18 April 2024.

This article was first published in the 15 March edition of Tax Journal.

CONTACT

Mike Lane
PARTNER
T: +44 (0)20 7090 5358
E: mike.lane@slaughterandmay.com

Zoe Andrews
PSL COUNSEL & HEAD OF TAX KNOWLEDGE
T: +44 (0)20 7090 5017
E: zoe.andrews@slaughterandmay.com

London
T +44 (0)20 7600 1200
F +44 (0)20 7090 5000

Brussels
T +32 (0)2 737 94 00
F +32 (0)2 737 94 01

Hong Kong
T +852 2521 0551
F +852 2845 2125

Beijing
T +86 10 5965 0600
F +86 10 5965 0650