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TAX AND THE CITY

CLIENT BRIEFING

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The FTT's decision in the *Lloyds Asset Leasing* case on the purpose test in the now-repealed legislation on cross-border loss relief through intra-group surrenders is a key read for anyone involved in any tax enquiries/tax litigation. The Supreme Court decides in *Royal Bank of Canada* that the UK does not have taxing rights over oil-related payments made to the Canadian bank under rights assigned to it upon receivership of a debtor. In a welcome U-turn, HMRC/HMT accept that an arrangement which results in a genuine contribution (including top-up arrangements) to an LLP, intended to be enduring and giving rise to real risk, will not trigger the TAAR in the salaried member rules and the guidance in the Partnership Manual will be revised accordingly.

Lloyds Asset Leasing: purpose test

In *Lloyds Asset Leasing v HMRC* [2025] UKFTT 57 (TC) the First-tier Tribunal (FTT) agreed with HMRC that cross-border group relief was excluded by the anti-avoidance provision designed to deny group relief where arrangements have been made creating a cross-border loss or creating the conditions where a cross-border loss can be claimed. The cross-border group relief legislation was the UK's response to the *Marks & Spencer* case in which the ECJ, as it then was, held that under EU law the UK was required to permit cross-border group relief in certain, (very) limited circumstances. Unsurprisingly, after Brexit the UK was quick to repeal the cross-border group relief legislation but because the regime applied so narrowly it is unlikely to be missed by taxpayers. Indeed, the Tax Information and Impact Note on the repeal of the relief estimated the impact would be a tax saving of just £5m a year.

Although the substantive issues in the case were whether the conditions for cross-border group relief were met and, if they were, whether relief would be denied by the anti-avoidance provision in CTA 2010 s 127, there are some very important lessons for witness selection and evidence that we wish to draw attention to here.

Section 127 provided that an amount cannot be surrendered if it results from arrangements whose 'main purpose, or one of their main purposes, is to secure that the amount (or part) may be surrendered for the purposes of group relief'. As the burden of proof was on the taxpayer to establish that s 127 did not apply, considerable amounts of evidence of the purpose of the arrangements were adduced. The FTT was not impressed that the parties had been unable to agree a chronology and an agreed statement of facts and so the first two-thirds of the lengthy judgment sets out the facts!

In brief, an Irish subsidiary, BOSI, of the Lloyds Banking Group (LBG) was loss-making and was a drain on LBG's capital resources and so options were explored to address this. The initial plan was not to exit the Irish loan market but to manage for value (run down the business of BOSI and not write any new business) with a view to managing down the BOSI portfolios in the future. But this plan would leave substantial amounts of losses trapped in BOSI so various options were put forward and considered to use the losses. The option which was selected was a cross-border merger under which BOSI was absorbed into BOS, an existing LBG company which was a regulated entity in the UK. Under this merger, BOSI's assets and liabilities were transferred to BOS and BOSI ceased to exist, without being liquidated. The merger happened on 31 December 2010 which, subject to meeting the conditions for the UK's cross-border loss relief, would mean the substantial Irish losses of BOSI incurred in 2010 would be available for surrender to the taxpayer and other UK companies in the LBG.

The FTT's finding of fact that 'LBG had no intention to exit Ireland prior to identification of the potential tax benefits' was fatal to the purpose test analysis. As were the findings that there were 'valid commercial reasons for LBG exiting Ireland but it was the identified potential tax benefits' that determined LBG's decision to exit Ireland, the choice of mechanism for exiting Ireland and the timing of that exit: commercial reasons were then sought to justify the decision to exit. There was nothing in the documentary evidence to show that the commercial decision to withdraw from Ireland was taken before exploring the exit options and the FTT was unpersuaded by the commercial reasons put forward by the witnesses for meeting the 31 December 2010 deadline which were not supported by the documents.

Witness evidence: adverse inference based on who not called

Under s 127 it is the purpose or object of the arrangements which needs to be ascertained. The parties disagreed on whose purposes were relevant when determining this. The FTT agreed with HMRC that it was not constrained to only consider what was in the minds of the directors who made the decision to exit Ireland but to consider the views and advice of senior individuals in BOSI, Group Finance and Tax which informed and shaped the arrangements by which the LBG decision makers effected the exit from Ireland.

HMRC successfully persuaded the FTT to draw an adverse inference based on who LBG had not chosen to call as witnesses. LBG relied on witness evidence from group CEO, CFO and a senior director but did not call anyone from the tax team despite the fact the contemporaneous evidence showed their material involvement. Because their evidence would clearly have been relevant to the role that tax and tax planning had played and they would have been able to confirm their role, remit and instructions received (and noting some of them were even present in court!), the FTT drew the inference that if they had been called as witnesses their evidence would not have supported the taxpayer's case.

Documentary evidence carried more weight than witness evidence

The FTT criticised the witness evidence that was provided and gave examples to support that it 'found elements of the witness evidence troubling.' The witnesses made little reference to contemporaneous material in their statements and some of what they said was clearly contradicted by the documentary evidence. The witnesses were also described as argumentative, discursive in answers and keen to advance the taxpayer's legal case.

The FTT considered that what Leggatt J (as he then was) had said about witness evidence in the *Gestmin* case [2013] EWHC 3560 (Comm) is apposite to the witness evidence here. In essence, because of the fallibility of human memory, it is best for a judge to place little if any reliance on witnesses' recollections of what was said in meetings and conversations and base factual findings on documentary evidence and known or probable facts. Understandably, the FTT assessed the witness evidence by reference to the contemporaneous documentary evidence and cross-examination and where the witness evidence contradicted, or was not supported by the documents, the FTT attached greater weight to the documentary evidence.

Failure to disclose some legal advice: cherry-picking

The FTT also drew an adverse inference from the taxpayer's failure to disclose legal advice on the Irish and UK tax analysis of one of the alternative options (the total return swap) that the failure to disclose was because it did not assist or support the taxpayer's case. If a party wishes to waive privilege in respect of a piece of legal advice to rely on it, they must waive privilege on other related advice - 'cherry-picking' is not permitted.

References to tax removed from final versions of documents

The FTT also had some concerns with some of the documentary evidence as it found that that references to tax planning and tax benefits were removed from final versions of documents and that face-to-face or telephone conversations had been held to avoid references to tax in emails and meeting notes to 'downplay the importance of tax in the decision-making process'.

Many taxpayers under enquiry at the moment where any main purpose test is in point will be aware of HMRC seeking disclosure not just of final steps plans, board minutes etc. but of every draft of each such document. This is the reason why. It follows the similar success HMRC had before the FTT in *Syngenta Holdings Ltd v HMRC* [2024] UKFTT 998 of persuading the court that the taxpayer requested a reference to debt be removed from a PwC tax opinion as 'part of a general approach of downplaying any tax avoidance purpose'.

***Royal Bank of Canada*: a good result for the taxpayer but shame about *Ramsay* differences**

In *Royal Bank of Canada v HMRC* [2025] UKSC 2, the Supreme Court, by a majority decision of 4:1, decided that the UK does not have taxing rights over oil-related payments received by the Canadian bank, RBC, under rights assigned to it on the receivership of a Canadian borrower which had an outstanding loan from RBC. RBC treated the receipts as income of its Canadian banking business and paid Canadian corporate tax on them and accordingly did not include them in its UK return. The total amount of tax in dispute, without interest, was around £19m.

The niche point in the case is whether for the purpose of the UK/Canada double tax treaty the payments were consideration for the 'working of, or the right to work, … natural resources'. If they were, they would come within the expanded definition of 'immoveable property' in Article 6 and, because the relevant oil field was in the UK, the UK would have taxing rights over the income. Looking beyond this niche point, however, the case is of more general interest as a case on treaty interpretation and for the difference of opinion between the majority and Lord Briggs in his dissent on the application of purposive construction (aka the *Ramsay* principle).

Principles of tax treaty interpretation

The Supreme Court unanimously agreed that the UK/Canada treaty was to be construed in accordance with Articles 31 and 32 of the Vienna Convention and endorsed Lord Reid's explanation of this in the *Anson* case [2015] STC 1777. What must be established is the 'objective common intention to be ascribed to the parties by reference to the ordinary meaning of the terms of the

treaty in their context and in the light of the treaty's object and purpose.'

But how should the treaty be construed and applied to the facts? This is where the differences lay. Lord Briggs said the treaty may 'loosely be treated as analogous to a taxing statute, at least in relation to the effect of Article 6' and so his starting point was to take a realistic view of the transaction in the round pursuant to which the payments were made. It is well established in case law that *Ramsay* is not a special principle limited to avoidance cases but is a general principle of statutory construction. As Lord Briggs says: 'The need to take a realistic view of the transaction simply reflects the intention which may reasonably be attributed, in the case of a statute to the legislature, and in the case of a treaty to its parties. It is not just some magic weapon with which to defeat tax avoidance.'

According to Lord Briggs, the purpose of the relevant part of Article 6(2) was engaged 'wherever there is an income stream being received as of right as the quid pro quo for the ability of someone other than the recipient to work UK situated mineral deposits or sources, or natural resources'. If that purpose is engaged, then the right to receive that income stream is deemed to be immovable property, and the treaty gives a prior right to tax that income to the State where the sources or deposits are situated. Accordingly, in his dissent he concluded that the payments received by RBC were consideration for the right to work.

Lady Rose, giving the judgment for the majority, on the other hand, seemed to have a narrower view of when the *Ramsay* principle applies referring to the 'greater tendency of the courts to neutralise the effect of tax avoidance schemes by looking at the reality of a transaction to see whether it is a transaction that was intended to be caught by a particular taxing provision' and did not consider it appropriate on the facts of this case to look at the transaction as a whole: 'No one here has suggested that the *Ramsay* principle has any application to the present facts and nothing in this judgment casts doubt on the efficacy of those principles where they apply.' The majority adopted a narrower view than HMRC and Lord Briggs of the scope of immovable property in Article 6(2) and concluded that the rights RBC acquired were too remote to have been within that definition of immoveable property.

It is unusual to have a dissent at the Supreme Court on a matter of purposive construction and it is unfortunate if this now muddies the waters and leads to another flurry of cases on the application of *Ramsay*!

Salaried member rules: condition C guidance to be revised

The salaried member rules within ITTOIA 2005 ss 863A-863G are intended to apply where a member of an LLP has the characteristics of an employee rather than a self-employed partner. For the salaried member rules to apply, all of conditions A to C have to be met (ITTOIA 2005, s863A) so in order for the rules not to apply, you have to break one of the conditions. You also need watch out for the targeted anti-avoidance rule (TAAR) in s 863G which applies to ignore arrangements if the main purpose, or one of the main purposes, of the arrangements is to secure that the salaried member rules do not apply.

To break Condition C (the contribution condition), the partner must make a partnership contribution of 25% or more of the 'disguised salary' expected to be payable to the partner in respect of their performance during the year. It is common practice to make additional contributions to stay outside the salaried member rules in response to rising compensation. Before the February 2024 guidance, HMRC did not apply the TAAR in s 863G to additional contributions made under Condition C but the February 2024 guidance said the TAAR in s 863G would apply and the additional contribution would not be considered when looking at Condition C.

HMRC/HMT have now confirmed that they intend to 'in effect reverse' the guidance released in February 2024. After much lobbying, HMRC/HMT now accept that an arrangement which results in a genuine contribution (including top-up arrangements) to the LLP, intended to be enduring and giving rise to real risk will not trigger the TAAR. This is a very welcome development but it is a shame that there was no engagement with stakeholders before the February 2024 U-turn in policy as this could have saved a lot of anxiety and financial stress over the past year for members of UK LLPs!

What to look out for:

- The Co-ownership Contractual Schemes (Tax) Regulations 2025 (SI 2025/200) come into effect on 19 March 2025 providing the relevant tax rules for investors in a new type of investment fund, the Reserved Investor Fund (RIF), and an administrative framework for co-ownership schemes to enter the RIF regime. To ensure consistency on the interaction between parts of the capital allowances and capital gains rules that are relevant for life insurance companies investing in RIFs and CoACS, the regulations also provide minor changes to the tax rules for life insurance companies investing in CoACS. Guidance in relation to these tax rules will be incorporated into the relevant HMRC manuals.
- On 19 March, the Supreme Court is scheduled to start hearing the appeal in the *Prudential Assurance* case concerning the interaction of the VAT grouping rules and the time of supply rules.
- Also on 19 March the Court of Appeal is scheduled to hear the appeal in the *Alexander Beard* case on whether a distribution from a Jersey company out of share premium is a dividend of an income nature.
- The Financial Services Growth and Competitiveness Strategy will be published in the Spring and will form part of the government's Industrial Strategy to be published later this year. The Chancellor is engaging with financial services leaders to seek views about the best way to deliver long-term growth in the sector which will inform the strategy.

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