

A taxpayer's appeal on reconstruction relief (Lecture B1265 – 10.56 minutes)

Euromoney Institutional Investor plc v HMRC (2021) is a First-Tier Tribunal case heard in May last year but where the decision was only published on 4 March 2021. It concerned a taxpayer company (E) appealing against an amendment to its corporation tax return for the year ended 30 September 2015 which had the effect of increasing its tax liability by nearly £10,500,000.

The amendment related to a transaction between E and a company called Diamond Topco Ltd (D) whereby E exchanged its shareholding in a third company (C) for ordinary and preference shares in D.

HMRC's amendment was made on the basis that E was liable to corporation tax on a gain following the disposal of its preference shares in D. This was because the tax authorities contended that the share-for-share exchange took place as part of a scheme or arrangement, of which one of the main purposes was the avoidance of a liability to corporation tax on a chargeable gain. This in turn meant that the 'no disposal' rule in S135 TCGA 1992 was disapplied by S137(1) TCGA 1992.

E is a UK-resident company, founded in 1969 by Sir Patrick Sergeant (a former financial journalist), which provides news, data and analysis to various business markets. It is listed on the London Stock Exchange and is a member of the FTSE 250 Index.

As part of the negotiations for the sale of the shares owned by E, that company initially agreed to receive ordinary shares and cash from D. Subsequently, the cash element was replaced by preference shares. Cash proceeds would have generated an immediately taxable gain on E, but an exchange of preference shares brought the provisions of S135 TCGA 1992 into play. It was anticipated that the preference shares would, in due course, be redeemed, in which case any gain was free of tax under the substantial shareholding exemption as long as the shares had been held for at least 12 months.

On 17 January 2016, the preference shares were duly redeemed. This was some 14 months after the deal was done.

On 8 September 2016, E filed its CT600 for the year ended 30 September 2015, along with supporting tax computations which were prepared on the basis that there was no chargeable gain on the disposal of the C shares because of the share-for-share exchange rules. Advance clearance from HMRC under S138 TCGA 1992 had been sought by E, but the transaction was completed before a response was received.

HMRC opened an enquiry into this return on 2 November 2016 which ultimately led to the hearing before the First-Tier Tribunal.

Before the First-Tier Tribunal, HMRC denied the availability of reconstruction relief on the ground that one of the main purposes of the arrangements was tax avoidance. Note that there was no dispute between the parties about the exchange of shares being effected for bona fide commercial reasons.

When considering the nature of the arrangements, the First-Tier Tribunal decided that they must be considered as a whole and that they were not limited to arrangements which only concerned the acquisition of the preference shares. This follows from a principle established by the House of Lords in *Brebner v CIR* (1967).

Avoiding a liability to tax was held by the judge to be a purpose of the arrangements, but it was not a main purpose. He said:

‘I . . . accept that a more than trivial purpose is not necessarily a “main” purpose. A main purpose will always be a more than trivial one, but the converse is not the case. A purpose can be more than trivial without being a main purpose. “Main” has a connotation of importance.’

He went on:

‘Whether a tax purpose is one of the “main” purposes of the arrangements is a matter of subjective intention, involving a careful analysis of all the reasons the taxpayer had for carrying them out (see *Versteegh Ltd v HMRC* (2014) and *Brebner v CIR* (1967)).

The witness evidence in this appeal, which I accept, is that E’s main subjective purposes were commercial and the tax considerations were not important in this context.’

The e-mail and the verbal evidence in this case showed that the taxpayer company would not have substituted preference shares for cash if that change would have endangered the deal. The tax at stake was not significant, compared with the overall transaction value, and the taxpayer’s advisers did not invest much effort in exploring the tax outcomes.

The anti-avoidance rules did not deny reconstruction relief and E’s appeal was upheld.

Contributed by Robert Jamieson