

Business taxes (Lecture B1471 – 19.57 minutes)

Unallowable purpose rule

Summary - Corporation tax deductions for loan interest were denied on the basis that the taxpayer company was party to the loan for an unallowable purpose.

Syngenta Holdings Limited acquired the entire issued share capital of its sister company, Syngenta Ltd from its immediate parent company, Syngenta Alpha BV, issuing shares and paying cash for its acquisition.

The US\$950 million cash element of the consideration was funded by a loan, set at the maximum level the group thought HMRC would permit, with the lender being a Dutch group treasury company.

HMRC argued that those designing the arrangements understood the predominant reason was to obtain non-trading loan relationship debits under the loan relationship rules, which Syngenta Holdings Limited surrendered to UK group companies to reduce their corporation tax liabilities.

Decision

The First Tier Tribunal considered why the group entered into the arrangements as a whole, by reference to abundant relevant contemporaneous documentary evidence, as well as witness evidence (but explicitly keeping in mind 'the fallibility of human memory' in assessing the latter).

The First Tier Tribunal concluded that, for the group, the arrangements did achieve a single holding company structure in the UK and allowed a dividend to be paid by the parent company through the creation of distributable profits. However, this was not the main purpose of the arrangements. Rather, the First Tier Tribunal found that the tax considerations were why the group implemented the arrangements.

The First Tier Tribunal went on to consider why Syngenta Holdings Limited entered into the arrangements, finding that its directors were willing to play their part to support the group purpose of achieving the tax saving, provided that the purchase of Syngenta Ltd was not a 'bad' investment (i.e. one that could potentially trigger an insolvency event for the taxpayer). Syngenta Holdings Limited's directors understood Syngenta Holdings Limited's role in achieving that group purpose was to obtain the non-trading loan relationship debits by incurring interest on the loan.

Finally, the First Tier Tribunal turned to the purpose of Syngenta Holdings Limited's directors entering into the loan. It concluded that the company acquisition and the loan were offered to the company as a package, meaning the use Syngenta Holdings Limited made of the funds was less informative than it might otherwise be. Although the loan was used to purchase Syngenta Limited, the directors' purpose was not to buy a good investment, but to play their part in the wider arrangements.

The First Tier Tribunal held Syngenta Holdings Limited's only purpose in being party to the loan was to secure an interest deduction. That was a tax avoidance main purpose and none of the debits could be brought into account because they were all properly attributable to that unallowable purpose.

Syngenta Holdings Limited v HMRC (TC09346)

Advanced pricing agreement

Summary - As the five-year term to which the Advance Pricing Agreement related had expired, the Diverted Profits Tax notices had been correctly issued.

The three companies in this case provided services (including services in respect of software, new product and content development and data hosting) to a Swiss-based group entity which centrally held valuable intellectual property assets.

The Diverted Profits Tax notices charged the companies to tax for the 2018 accounting period by reference to a 'relevant alternative provision' (RAP) which utilised a 'profit-split' methodology (effectively apportioning the annual profits of the Swiss entity for the 2018 accounting period and profits accruing from the disposal of the relevant IP assets in the 2018 accounting period by reference to the claimants' respective contributions to such via the provision of the services). The total Diverted Profits Tax was in excess of £167 million.

The claimants contended that HMRC had acted inconsistently, and therefore acted unlawfully in public law terms. The claim was based on the assertion that the charge to tax contained in the Diverted Profits Tax notices, relating to the 2018 accounting period, was inconsistent with an advance pricing agreement, which the claimants had agreed with HMRC in 2013. This covered the provision of the relevant services (and which used an arm's length provision calculated by reference to a 'cost-plus' methodology) and had a contractual expiry date of 31 December 2014.

Decision

Before the Upper Tribunal, the claimants had sought an order quashing the Diverted Profits Tax notices to the extent they conflicted with the advance pricing agreement. They argued that the 2018 accounting period was one to which the advance pricing agreement 'related' for the purposes of s.220 TIOPA 2010 because services provided before 2014 and taxed on the basis of the advance pricing agreement were sought to be taxed again on a different basis. HMRC had accepted that the profits for the 2018 accounting period were in part referable to the services provided in the period for which the advance pricing agreement had effect. HMRC were therefore bound, on a public law basis, to apply the cost-plus methodology in the advance pricing agreement to those profits.

The Upper Tribunal rejected these arguments and dismissed the claim.

The Court of Appeal dismissed the claimants' appeal, finding that in the context of corporation tax, which is an annual tax, the chargeable periods to which the advance pricing agreement related were those included in its specified term.

Neither party to the advance pricing agreement could reasonably have contemplated that the advance pricing agreement should have a continuing effect on HMRC's approach to transfer pricing for accounting periods from 2015 onwards.

The Court of Appeal rejected the claimants' argument that the terms of the advance pricing agreement were expressed in terms of transactions, so they had 'vested or accrued contractual rights' to have them priced on a cost-plus basis. There was nothing in the language of the advance pricing agreement to support the idea that the agreed treatment should 'enjoy a potentially indefinite afterlife in future accounting periods once the term of the advance pricing agreement had come to an end'.

Data centres in an enterprise zone

Summary – The two LLPs were not entitled to 100% enterprise zone allowances in respect of the construction of two data centres.

Two SPVs were formed to develop land in an enterprise zone. One (the developer) held a lease of part of the site, and the other (the contractor) was to carry out the building works. The day before the ten-year period for the enterprise zone expired, they entered a 'golden contract' with the intention of enabling allowances to be claimed on buildings constructed in the following ten years while retaining flexibility on the type of development. The contract therefore allowed for a choice of different developments ('works options'), each linked to a specific part of the overall site. No work had to be done under the contract unless and until the developer issued a notice to proceed for one of the work options.

Subsequently, under the terms of a 'change order', a data centre (which was not within the scope of the existing works order options) was constructed. Following the assignment of the lease held by the developer to the two LLPs, two further data centres were constructed under further change orders and the LLPs claimed enterprise zone allowances.

For the claim for allowances to succeed, the data centres had to have been built under the golden contract (s.298 CAA 2001):

- HMRC argued that this was not the case;
- the taxpayers argued that the change orders providing for the later data centres gave effect to works option 1 in the golden contract either by variation or on exercise of the developer's unilateral rights to change under clause 12 of the contract.

The Court of Appeal found for HMRC, and the taxpayers appealed to the Supreme Court.

Decision

The first issue for the Supreme Court was whether s.298 CAA 2001 enabled expenditure incurred by reason of a variation after the end of the first ten-year period to qualify for allowances.

This required the court to ask whether, by the end of the ten-year period, a contractual relationship existed under which the relevant expenditure had either been agreed in terms or which arose from building work which the developer had at that time a contractual right to require or change. On a realistic assessment of the dealings of the parties, there was not, on the tenth anniversary, a contractual commitment to incur the expenditure on the data centres in terms or anything like it.

The second issue was whether the expenditure on the data centres was triggered by the exercise of the developer's unilateral change rights under clause 12. Here, the taxpayers' argument fell 'at the first hurdle'. There was an express limit on the changes which could be made under clause 12. It allowed only for changes to the design, quality and quantities of what would remain substantially the same building as envisaged in works option 1 (i.e. an industrial unit for the manufacture of eight-inch board). The right to require a change did not extend to choosing some completely different type of building on a different site.

The Supreme Court therefore dismissed the appeal.

SDLT group relief

Summary - SDLT group relief was not available on an intra-group transfer because that transfer formed part of arrangements of which one of the main purposes was the avoidance of a liability to corporation tax.

A group of companies was developing a site as residential property, which included a tower block. The group identified various commercial advantages to transferring that development (in the form of a 999-year lease) to a special purpose vehicle (The Tower One St George Wharf Ltd).

Following discussions with the group's tax advisers, this transfer was carried out in an indirect manner, with the relevant series of transactions carried out on the same day, seeking to achieve a tax-free 'step up' in the base cost of the lease for corporation tax purposes.

Following an enquiry by HMRC, it was accepted that the scheme did not achieve that corporation tax benefit.

HMRC denied the SDLT group relief that had been claimed on the transfer of the lease to the company, on the basis that the relief was not available because the transfer formed part of arrangements of which the main purpose, or one of the main purposes, was the avoidance to liability to corporation tax (FA 2003 Sch. 7 para 2(4A)). HMRC sought to collect the SDLT payable on the market value of the lease.

The First Tier Tribunal dismissed the company's appeal against that assessment, finding that the transfer formed part of arrangements which had a main purpose of achieving a corporation tax advantage, even if that tax advantage was ultimately not achieved.

In reaching its decision, the First Tier Tribunal had made the following key findings of fact:

- the group wanted to transfer the lease to the company for genuine commercial reasons, and the process leading to the series of transactions had not originally been initiated out of a motive to avoid tax;
- if the group had never been made aware of the possible corporation tax advantage that could be obtained, the group would likely have transferred the lease directly to the company in order to achieve its original purposes;
- once the group received the advice about the corporation tax advantage that could be obtained, it attached considerable importance to ensuring that the significant tax benefit was obtained; and
- the group would not have transferred the lease to the company solely for the corporation tax advantage.

Decision

Before the Upper Tribunal, The Tower One St George Wharf Ltd argued that the First Tier Tribunal had made several errors in law in concluding that it was not entitled to SDLT group relief.

Two of the alleged key errors were as follows:

1. As the arrangements did not in fact achieve their aim of producing a tax-free step up, they should not be regarded as having had a main purpose of avoiding tax;
2. It could not be said that the purpose of the arrangements was the avoidance of tax where the avoidance in question was contingent on there being a future sale.

Referencing the guidance provided by Falk LJ in the recent Court of Appeal decision in *BlackRock* throughout, the Upper Tribunal concluded that the First Tier Tribunal had made no errors in its analysis of the law or in its conclusions.

As to the first submission, the Upper Tribunal concluded that para 2(4A) applied where the relevant purpose existed, and the effect of the arrangements – namely, whether or not any tax was ultimately avoided – was irrelevant. The statute referred to purpose and this was tested at the time of the land transaction for which group relief was claimed. The Upper Tribunal did not agree with the appellant that there was a natural reading of para 2(4A) that meant that arrangements which did not have the effect of avoiding tax were not captured. The fact that arrangements ultimately failed to achieve their purpose did not retrospectively negate the fact they had that purpose.

As to the second submission, there was nothing in the language of para 2(4A) to indicate that a purpose of avoiding a liability to tax which would, or might, arise in the future was not caught. Furthermore, the Upper Tribunal did not agree that the intended avoidance in this case only arose in the future. While the cash benefit of the step up would only arise on a future disposal, the avoidance of tax – namely, an increase in base cost without any company being liable for corporation tax on that 'gain' – formed part of the arrangements and was not a result of future or contingent events.

A second ground of appeal concerned the deemed market value rule in FA 2003 s 53. After analysing the legislative provision, the Upper Tribunal concluded that the First Tier Tribunal had not erred in law in concluding that the exception to that rule in FA 2003 s 54(4)(b) did not apply.

The Tower One St George Wharf Ltd v HMRC [2024] UKUT 373 (TCC)

Adapted from the case summary in Tax Journal (29 November 2024)