

DECISION

Introduction

- 5 1. In outline, the commercial background to these two lead appeals is a scheme for the recapitalisation of two companies (Stagecoach Holdings Ltd [*Holdings*], the second appellant and Stagecoach Services Ltd [*Services*] by its ultimate parent, Stagecoach Group plc [*Group*], the first appellant, by means of forward subscription agreements [FSAs], between *Group* and *Holdings* and *Group* and *Services*. The FSAs
10 provided that *Group*'s funding would be calculated largely by reference to sums to be paid in repayment by another subsidiary, Stagecoach Transport Holdings plc (*Transport*), of a pre-existing loan to it from *Group*, with the funding for the share subscription capped at £20m.
- 15 2. In exchange for the funding by *Group*, *Holdings* and *Services* agreed to issue ordinary shares to their immediate parent companies, The Integrated Transport Company Ltd (ITCO), and Stagecoach Bus Holdings Limited (*Bus*) respectively. The fiscal consequences of the accounting treatment of these arrangements were the subject of these appeals. The accounting treatment was not in dispute although it featured prominently in the evidence and in submissions.
- 20 3. These appeals raise two broad issues. The first relates to the statutory loan relationship regime in Part 5 of the Corporation Taxes Act (CTA) 2009¹ and its application to the scheme. The question arises whether the sum of about £39,471,087, derecognised (removed from part of the parent's [*Group*] balance sheet), debited to investments in *Group*'s balance sheet and subsequently paid to *Holdings* and *Services*
25 as part of the recapitalisation transactions, falls to be treated as a deduction in computing the ultimate parent company's (*Group*'s) profits for corporation tax purposes. The derecognition reduced the sum recorded in *Group*'s balance sheet attributable to the pre-existing loan (a financial asset) granted by it to another subsidiary (*Transport*). The debit increased the sum recorded in the *Group*'s Balance
30 Sheet attributable to investments (which included *Group*'s investment in its various subsidiaries including *Holdings* and *Services*). This first issue affects the first appellant, *Group*.
- 35 4. The second broad issue is whether, if the loan relationship regime is otherwise applicable and the sum deductible, the deduction is nevertheless, in effect, negated by the arbitrage rules contained in Part 6 of the Taxation (International and Other Provisions) Act 2010 (TIOPA). Part 6 contains a number of provisions intended to prevent the exploitation of tax differences in the treatment of deductions and receipts. In considering this issue, it is assumed that the deduction from *Group*'s taxable profits is justified.

¹ Various provisions of Part 5 have been amended by Schedule 7 to the Finance (No 2) Act 2015, but these are not relevant for the purposes of the present appeals.

5. The question is whether those rules require each of the two recapitalised companies to increase their taxable income by the sum paid to each of them by *Group* under the FSAs (£19,735,543.50 - being one half of £39,471,087), thus in effect taxing the sum deducted by *Group*. This issue affects *Holdings*, the second appellant; it is one of these recapitalised companies. The other is *Services*.

6. A Hearing took place at George House, Edinburgh on 13, 14, 15 and 16 July 2015. The appellants were represented by Nicola Shaw QC, and Michael Firth, barrister of the English Bar on the instructions of KPMG LLP (UK) [KPMG]. Ms Shaw led the evidence of John Hamilton CA, Taxation Director of *Group*; he spoke to his signed witness statement. HMRC were represented by Julian Ghosh QC, of the English and Scottish Bars, and Ruth Jordan and Barbara Belgrano, barristers of the English Bar, on the instructions of Eric Brown of the Office of the Advocate General on behalf of HMRC. Mr Ghosh led the expert evidence of Peter Drummond, CA, who spoke to his Report dated 28 January 2015.

7. Various bundles of documents, authorities, skeleton arguments and a Statement of Agreed Facts were also produced. The appellants arranged for the proceedings to be recorded, and (instantaneously) transcribed by stenographers. A transcript of the whole proceedings is available.

8. Although mentioned separately from time to time in the documents, evidence and submissions, there is no significant distinction to be drawn between the recapitalisations of *Holdings* and *Services*.

Procedural History

9. *Group* and *Holdings* submitted their corporation tax self-assessments for the period ending 30 April 2011 on 27 April 2012. Enquiries were opened into the returns² on 31 July 2012. A Receipt (arbitrage) Notice was issued to *Holdings* under section 249 TIOPA but it did not amend its return.

10. On 27 September 2013, HMRC issued to *Group* a notice of completion of enquiry (Closure Notice³) and two letters explaining the basis on which the Closure Notice proceeded. Essentially, HMRC said there should be no deduction from taxable profits of *Group* in respect of the derecognition of the loan asset because a debit that meets the conditions set out in s320 can be brought into account only if the conditions of s307(3) are satisfied. These conditions, it was said, cannot be met because the debit is not one which fairly represents a loss arising from *Group*'s loan relationships. They further explained that *if* there was **no** such allowable deduction, the arbitration notices and the alleged consequent tax liability of *Holdings* and *Services* **would not** be pursued. But *if* HMRC are wrong and there should be such a deduction, the arbitration notices and consequent tax liability of *Holdings* and *Services* **would** be pursued.

² Under paragraph 24 of Schedule 18 to the Finance Act 1998

³ FA 1998 Schedule 18 paragraph 32

11. The effect of the Closure Notice was to disallow the deduction claimed of £39,471,087.

12. A similar Closure Notice, based on the tax arbitrage provisions, was sent to *Holdings* on the same date. The explanation given by HMRC in letters dated 5 27 September 2013 in relation to *Holdings* was that (i) the total subscription amount of £20,000,000 payable by *Group* to the subsidiary in terms of the FSA was a qualifying payment under s250 TIOPA, (ii) the criteria in ss249-254 TIOPA were met, (iii) the transactions that arise from the FSA being entered into and the subsequent shares issued give rise to a mismatch which is subject to adjustment under 10 s256 TIOPA, (iv) the sum of £19,735,543.50 specified in an arbitrage notice (dated 21 September 2012) is the element of the qualifying payment of £20,000,000, and should therefore be included in *Holdings*' corporation tax return as taxable income.

13. The effect of the Closure Notice was to amend *Holdings*' corporation tax return for the same period by increasing its taxable profits by £19,735,543.50. The 15 difference between that figure and £20,000,000 is not entirely clear but it does not appear to be material to the outcome of the appeals.

14. *Group* and *Holdings* appealed to HMRC on 25 October 2013. They waived their right of statutory review and lodged notices of appeal with this Tribunal on 29 October 2013.

20 15. By Directions dated 8 October 2014 in the appeals of *Group* and *Holdings*, the Tribunal directed that *Group*'s appeal be designated a Lead Case under Rule 18(2)(a) of the Tribunal's Rules and that the similar appeal by Mitie Facilities Services Ltd (TC/2014/01173) be designated a Related Case and sisted in accordance with Rule 18 (2)(b). These Directions also provided that *Holdings*' appeal be designated a 25 Lead Case and that *Services*' similar appeal (TC/2013/07422) be designated a Related Case, and similarly sisted.

16. The parties subsequently identified that the present appeals raise facts and issues which are common or related to those facts and issues which arise in other appeals before the First-tier Tribunal (Tax Chamber) at the instance of Inmarsat Investments 30 Ltd (TC/201501907) and Inmarsat Global Xpress Ltd (TC/2015/01908) for whom KPMG also act. They agreed that these two appeals should be designated related cases to the present appeals and that the Directions dated 8 October 2014, as subsequently amended, should apply to these related appeals. This was given effect to by Directions in the two related appeals dated 17 June 2015.

35 17. At the outset of the hearing, HMRC moved an application (dated 6 July 2015) in the instant appeals and in the appeals of several other appellants⁴ to amend the Directions dated 8 October 2014 by adding the following issue:-

Whether the debit claimed by the Appellant (*Group*) is in respect of a company's loan relationship within section 320 Corporation Taxes Act 2009 ("CTA 2009") ("**Issue aa**")

⁴ *Services*, MITIE Facilities Services Ltd, Inmarsat Investments Ltd, Inmarsat Global Xpress Ltd, Canary Wharf Holdings Ltd, and Canary Wharf Investments Ltd.

The application was granted unopposed.

18. At the outset of the Hearing, HMRC's combined Statement of Case in the two lead appeals was also allowed, without objection, to be amended⁵ by including the same further issue for our determination.⁶ Ms Shaw submitted a Supplementary Skeleton Argument responding to the amendment and the additional issue, again without objection.

19. After the Hearing was concluded, the parties applied to amend the Directions dated 17 June 2015 to introduce the same additional issue mentioned above, namely (aa). Although there may be some unnecessary overlap, the intention appears to be to bring the lead and related cases into line. This paragraph should be treated as giving effect to that intention and granting the joint application of the parties dated 23 July 2015 to these related appeals.

20. Following the Hearing in July, we received several documents from the parties, namely (i) HMRC's Requested Findings of Fact, (ii) a topic list extending to 22 pages containing extracts from the evidence, (iii) Appellant's Response to HMRC's Requested Findings of Fact, (iv) Appellants' Submissions on *Abbey National Treasury Service plc v HMRC*,⁷ and (v) HMRC's Further Submissions on *Abbey*.

Statutory Framework

20 *Loan Relationships*

21. In relation to the first broad issue, the principal statutory provisions falling under the spotlight are sections 307 and 320 of CTA 2009. We quote them below. In order to place these provisions in context, we summarise the loan relationship code, its operation, purpose and effect insofar as relevant to *Group's* appeal.

22. Part 5 of CTA 2009⁸ sets out how profits and deficits arising to a company from its loan relationships, and related transactions,⁹ are brought into account for corporation tax purposes.¹⁰ A company has a loan relationship if it stands in the position of a creditor or debtor as respects a loan of money.¹¹ Here, *Group* had a loan

⁵ The application, dated 6 July 2015, related not only to the appeals of *Group* [TC/2013/0413], and *Holdings* [TC/2013/07414], but also to the appeals of *Services* [TC/2013/07422], and Mitie Facilities Services Limited [TC/2014/01173].

⁶ This now also applies to the appeals by *Services*, and Mitie Facilities Ltd.

⁷ 14/7/15 (TC/2012/02613 and 02722); see now [2015] UKFTT 341 (TC) [2015] SFTD 929.

⁸ Ss292-476; Part 6 (ss477-569) deals with relationships treated as loan relationships; part 7 (ss570-710) deals with derivative contracts

⁹ S293(1); related transaction is defined in s304

¹⁰ S292(1)

¹¹ S302(1)

relationship with *Transport*. They had entered into a contract of loan. *Group* stood in the position of creditor, and *Transport* stood in the position of debtor as respects a money debt.¹²

23. A transaction which disposes or acquires, in whole or in part, rights or liabilities under a loan relationship is a related transaction.¹³ In Part 5, profits or losses from loan relationships include profits or losses from such related transactions. It is a matter of agreement that neither of the FSAs referred to¹⁴ is a related transaction.

24. The general rule is that all profits arising to a company from its loan relationships are chargeable to corporation tax as income in accordance with Part 5¹⁵ and are to be calculated using the credits and debits given by that Part.¹⁶ This charge applies to non-trading profits¹⁷ as well as trading profits.¹⁸ The non-trading credits and non-trading debits given by Part 5 are used to determine whether a company has non-trading profits or a non-trading deficit from its loan relationships.¹⁹ Here, we are concerned with *Group's* non-trading profits with respect to its loan relationship with *Transport*.²⁰ A company's non-trading profits for an accounting period from its loan relationships are equal to its non-trading credits less any non-trading debits.²¹

25. Chapter 3 of Part 5²² contains rules of general application about the credits and debits to be brought into account for the purposes of this Part of CTA 2009;²³ they set out how profits and deficits from a company's loan relationships are to be brought into account for corporation tax purposes.²⁴ In particular, it sets out general principles²⁵ to be applied in determining the amounts to be brought into account as credits and debits, including the application of generally accepted accounting

¹² S302(1),(5),(6); s303(1)(3)

¹³ for the purposes of Part 5 of CTA 2009-s304(1).

¹⁴ Paragraphs 1 and 12 above

¹⁵ s295(1)

¹⁶ s296

¹⁷ s299

¹⁸ s297(2)

¹⁹ s301(1)

²⁰ s299(1)

²¹ s301(5)

²² ss306-334

²³ s306(1)

²⁴ s292(1)

²⁵ s307-312

practice.²⁶ Chapter 3 also sets out some general rules that differ from generally accepted accounting practice.²⁷

26. Section 307 (headed *General Principles about the bringing into account of credits and debits*) begins by noting that Part 5 operates by reference to company accounts and amounts recognised for accounting purposes,²⁸ the general rule being that the credits and debits to be brought into account for corporation tax purposes are those that are recognised, in accordance with generally accepted accounting practice,²⁹ in the company profit and loss account and other similar statements of items taken into account in calculating the company's profits and losses for the period in question.³⁰

27. S307, so far as material, provides as follows:-

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

(3) The credits and debits to be brought into account in respect of a company's loan relationships are the amounts that, when taken together, fairly represent for the accounting period in question:

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

(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.

...

(6) Subsection (2) is subject to the provisions of this Part and, in particular, subsection (3).

28. It can be seen, therefore, that the credits and debits to be brought into account *in respect of* a company's loan relationships must be amounts that, when taken together *fairly represent* for the accounting period in question *inter alia all profits and losses that arise* to the company *from its loan relationships*.

²⁶ s306(2)(a)

²⁷ s306(2)(d)

²⁸ s307(1)

²⁹ s307(1)(2); s292(1); GAAP compliant accounts are assumed to have been drawn up-s309

³⁰ s308(1); the list may be altered by the Treasury-s310; but this is not relevant for this appeal

29. Ss311 and 312 deal with the situation where, for various reasons, amounts have not been fully recognised for accounting purposes. Ss313 and 314 deal with the application of various bases of accounting (amortised cost basis, fair value etc) and their regulation. Ss 316-319 deal with changes in a company's accounting policy from time to time. None of these provisions was the subject of detailed submissions by the parties, and we do not consider their detail further.

30. S320 provides as follows:-

320 Credits and debits treated as relating to capital expenditure

(1) This section applies if generally accepted accounting practice allows a credit or debit for an accounting period in respect of a company's loan relationship to be treated in the company's accounts as an amount brought into account in determining the value of a fixed capital asset or project.

(2) Despite that treatment, the credit or debit is to be brought into account for the purposes of this Part, for the accounting period in which it is given, in the same way as a credit or debit which is brought into account in determining the company's profit or loss for that period in accordance with generally accepted accounting practice.

(3) But subsection (2) does not apply to a debit which is taken into account in arriving at the amount of expenditure in relation to which a debit may be given by Part 8 (intangible fixed assets).

(4) Subsections (5) and (6) apply if a debit is brought into account as mentioned in subsection (2).

(5) No debit may be brought into account in respect of the writing down of so much of the value of the asset or project as is attributable to that debit.

(6) No debit may be brought into account in respect of so much of any amortisation or depreciation as represents a writing off of the interest component of the asset.

31. No further provisions of the loan relationship code were referred to in detail or relied upon by either of the parties, although there was some reference to ss354, 455A, and 465 by the appellants in their Skeleton Arguments and submissions. Various other sections are also quoted but were not discussed in detail.

Tax Arbitrage Rules

32. If HMRC's primary case is not well founded, their fall-back case is that the tax arbitration provisions set forth in TIOPA and, in particular, ss 249-254 apply with the result that the bulk of the subscription proceeds under the FSA is chargeable to corporation tax in the hands of *Holdings*.

33. In broad terms, tax arbitration rules (sometimes referred to as anti-arbitrage legislation) seek to negate the profiting from differences between the way transactions are treated for different purposes. There may be a mismatch between the characterisation of transactions in different jurisdictions, or where a taxable deduction is not matched by a taxable receipt, sometimes referred to as tax symmetry.

34. Part 6 provides *inter alia* for the giving of a receipt notice to a UK resident company in relation to a scheme, where an officer of HMRC considers on reasonable grounds that each of four receipt scheme conditions is met.³¹ The result of the service of the notice, if well founded, is that the company must calculate or recalculate its income or chargeable gains or liability to corporation tax (less advantageously), treating the relevant part of the payment in question (known as a *qualifying payment*) as a chargeable receipt.³² *Holdings* argues that not all the receipt scheme conditions have been met.

35. These conditions are set out in s250 of TIOPA as follows:-

250 The receipt scheme conditions

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- (1) This section sets out the receipt scheme conditions.
 - (2) Receipt scheme condition A is that a scheme makes or imposes provision as between the company and another person ("the paying party") by means of a transaction or series of transactions.
 - (3) Receipt scheme condition B is that that provision includes the paying party making, by means of a transaction or series of transactions, a payment--
 - (a) which is a qualifying payment in relation to the company, and
 - (b) at least part of which is not an amount to which section 251 (amounts within corporation tax) applies.
 - (4) A payment is a qualifying payment in relation to a company for the purposes of this section and sections 251 to 254 if it constitutes a contribution to the capital of the company.
 - (5) Receipt scheme condition C is that on entering into the scheme the company and the paying party expected that a benefit would arise because at least part of the qualifying payment was not an amount to which section 251 applies.
 - (6) Receipt scheme condition D is that there is an amount in relation to the qualifying payment that--
 - (a) is a deductible amount, and
 - (b) is not set against any scheme income arising to the paying party for income tax purposes or corporation tax purposes.

.....

36. *Scheme* is defined in s258(1) as any scheme, arrangements or understanding of any kind whatever, whether or not legally enforceable, involving one or more transactions. It was not disputed that the receipt notice related to a scheme.

37. S254 provides as follows:-

³¹ S249

³² S231(1), 254(2)

254 Rule for calculation or recalculation of income etc following receipt notice

- (1) This section applies in relation to a qualifying payment if--
 - (a) a receipt notice specifying the payment is given to the company in relation to which it is a qualifying payment, and
 - (b) when the notice is given, each of the receipt scheme conditions is met in relation to the company.
- (2) The company must calculate (or recalculate)--
 - (a) its income or chargeable gains for the purposes of corporation tax for the accounting period specified in the notice, or
 - (b) its liability to corporation tax for that period.

as if so much of the qualifying payment as falls within subsection (3) were a receipt of the company that is chargeable for that period under the charge to corporation tax on income.

- (3) The qualifying payment falls within this subsection so far as--
 - (a) receipt scheme condition D (see section 250(6)) is met in relation to it, and
 - (b) it is not an amount to which section 251 (amounts within corporation tax) applies.

Miscellaneous statutory provisions

5 38. *Holdings* has a fall-back argument that even if the receipt conditions are met, any charge to tax is exempted by the language of s979 CTA 2009. That section provides as follows:-

**Chapter 8
Income Not Otherwise Charged**

979 Charge to tax on income not otherwise charged

- (1) The charge to corporation tax on income applies to income that is not otherwise within the application of that charge under the Corporation Tax Acts.
- (2) Subsection (1) does not apply to--
 - (a) annual payments,
 - (b) income in respect of which no liability to corporation tax arises because of an exemption, or
 - (c) deemed income.

39. Finally, there was mention in the course of the hearing of the *DOTAS* “rules”. The relevant provisions applicable at the time are to be found in Part 7 of the Finance Act 2004. We need only refer to s306 which provides *inter alia* as follows:-

10 306 Meaning of “notifiable arrangements” and “notifiable proposal”

(1) In this Part “notifiable arrangements” means any arrangements which—

.....

(b) enable, or might be expected to enable, any person to obtain an advantage in relation to any tax that is so prescribed in relation to arrangements of that description, and

15 (c) are such that the main benefit, or one of the main benefits, that might be expected to arise from the arrangements is the obtaining of that advantage.

40. It was submitted by Ms Shaw that the test for disclosure of a scheme pursuant to DOTAS was the expectation of benefit; it had nothing to do with purpose. Be that as it may, it does not affect our conclusions on Part 5 of CTA 2009 or the arbitrage provisions under TIOPA.

5 41. Parties agreed that these rules were applicable to the arrangements to which these appeals relate and that the arrangements were notified to HMRC.

Grounds of Appeal

10 42. In summary, *Group* contends that it is entitled to deduct from taxable profits the sum of £39,471,087 as a non-trading loan relationship debit in its corporation tax return for the year ended 30 April 2011 by virtue of s320 CTA 2009. It argues that s320 is not subject to the provisions of 307(3), but even if it is, the conditions therein specified are met. Accordingly, *Group* contends that it has non-trading relationship deficits of £39,471,087 in the period to 30 April 2011, which are available for surrender as group relief.

15 43. There were further grounds of appeal relating to the taxation of interest of about £125,000. However, *Group* accepted, at some point before the hearing, that the interest income should have been brought into account. These further grounds have been withdrawn.

20 44. *Holdings* contends that there is no amount to be brought into account under ss249-254 TIOPA. The relevant conditions applicable to the Receipt Notice, in particular, receipt scheme conditions C and D, have not been met. The *qualifying payment* was not an amount to which s254 applied. There was no expectation that a benefit would arise. There was no deductible amount in relation to the qualifying payment. There could be no charge to tax under Case VI of Schedule D as the
25 relevant provisions were repealed for accounting periods ended on or after 1 April 2009.

45. Finally, it can be noted that an argument by *Holdings* based on the timing of the Receipt Notice was withdrawn.

Issues for Decision

30 46. The parties, at an early stage, presented the Tribunal with a list of issues they wished to be determined. After various revisions by the parties, the list was incorporated into Directions dated 8 October 2014. After subsequent amendment,³³ the issues for determination are

35 Whether the debit claimed by the Appellant (*Group*) is in respect of a company's loan relationship within section 320 Corporation Taxes Act 2009 ("CTA 2009") ("**Issue aa**")

³³ See paragraphs 17-19 above. Because of the terms of the application to amend the Directions dated 8 October 2014, issue (aa) does not have number.

- 1) whether the deductibility of debits under section 320 Corporation Tax Act 2009 (“CTA 2009”) is subject to the provisions of section 307(3) CTA 2009 (“**Issue a**”);
- 2) if so, whether section 307(3) CTA 2009 requires the debits and credits to be tested to establish their nature (“**Issue b**”);
- 5 3) if so, the issue of whether the debits claimed by the Appellants fairly represent losses arising from their respective loan relationships under section 307 CTA 2009 (“**Issue c**”);
- 4) whether there is an amount to be brought into account under the relevant provisions of the Taxation (International and Other Provisions) Act 2010 (“TIOPA 2010”), and in particular whether the receipt scheme conditions in section 250 TIOPA 2010 were satisfied (“**Issue d**”);
- 10 5) whether, under section 254 (1)(b) TIOPA 2010, each of the receipt scheme conditions has to be met in relation to the company at the time the notice is given, so that notices given after the ‘schemes’ have been completed are invalid (“**Issue e**”);
- 15 6) whether there could be a charge to tax under Case VI of Schedule D in the relevant periods, as stated in HMRC’s closure notices (“**Issue f**”).

47. The appellants intimated in their Skeleton Argument that they no longer contend that the receipt scheme conditions referred to must be satisfied at the time of the notice.³⁴ Issue (e) has therefore fallen away.

48. Counsel tended to focus their submissions along the broad issues outlined above. We shall do the same but will provide our conclusions on each of the remaining specific issues.

Facts

49. A Statement of Agreed Facts is reproduced below. Although we have been able to deal with what came to be HMRC’s primary argument without making any further findings of fact both parties led evidence and invited us to make further factual findings. We discuss the more important aspects of that additional evidence below. In order to make sense of the evidence and the additional facts found we have inserted further factual findings in *italics* within the body of the Statement. Hopefully, this will preserve the logic and chronology of the existing Statement and amplify the relevant background and events in an understandable way. We have changed parties’ abbreviations to those we have adopted at the outset of this Decision.

50. Statement of Agreed Facts

BACKGROUND

- 1) The Appellants are Stagecoach Group plc (“*Group*”), a company registered in Scotland (SC100764) with its registered office at 10 Dunkeld Road, Perth, PH1 5TW and quoted on the London Stock Exchange, and one of its subsidiaries Stagecoach Holdings Limited

³⁴ Paragraph 5; this relates to issue (e).

(“Holdings”). *Group* has a number of subsidiaries in which it holds, directly or indirectly, 100% of their share capital, including the following:

- (i) Stagecoach Transport Holdings plc (“*Transport*”), a subsidiary of *Group*;
- (ii) The Integrated Transport Company Ltd (“ITCO”), a subsidiary of *Transport*;
- and
- (iii) *Holdings*, a subsidiary of ITCO.

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- 2) The Stagecoach group (“the group”) is a leading international transportation group that is listed on the London Stock Exchange. The group employs around 30,000 people, and operates bus, coach, rail and tram services. The group has three main divisions: UK Bus, UK Rail and North America. *Group*, the parent company of the group, is a public limited company and is incorporated in Scotland and tax resident in the UK. A diagram illustrating the relevant group structure is attached at **Tab 54**³⁵ of the Bundle of Documents, Volume C.

The transactions to which these appeals relate concern a wholly but indirectly owned subsidiary of *Group*: *Holdings*, a wholly owned subsidiary of ITCO which is itself a wholly owned subsidiary of *Transport*.

- 3) *Holdings* is one of the group’s two main management and shared services companies, and provides centralised management, accounting, payroll and IT services to the operating companies within the Group. SHL *Holdings* employs approximately 150 employees and provides director and executive management services. SHL *Holdings* also employs all of the UK-based senior group executives and UK Bus managing directors.

Group had entered into a loan facility with *Transport* on 18 December 2009 (the “Loan Asset”). Under the terms of the loan £88,105,104 was repayable by *Transport* to *Group* on 31 March 2010. On 31 March 2010 the repayable date for the Loan Asset was changed to 31 December 2010. On 30 June, the parties agreed a further amendment in respect of the calculation of interest on the sums lent. ***The loan was made for good commercial purposes, general investment purposes to finance ongoing working capital requirements. The maturity date of the loan was changed in March 2010 in order to align the terms of the loan with other group loans.***³⁶

By early 2010, the balance sheet of *Holdings* disclosed a cumulative profit and loss account deficit of £14.864m. These results in turn led to *Holdings* having net liabilities of

³⁵ Tab 54 is Appendix 1 to this Decision

³⁶ This was proposed by Ms Shaw (Day 2/31); it is justified by the evidence and seems uncontroversial. Mr Ghosh accepted it (Day 3/49)

£10.818m. *Holdings* was therefore technically insolvent and steps were taken to recapitalise *Holdings*. *The initial commercial drivers for re-capitalisation were the poor state of the subsidiary's balance sheet, making it difficult to obtain acceptable terms from third party suppliers; and increasing costs in relation to the Pension Protection Fund (PPF).*³⁷

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3A *The Pension Protection fund was established under the Pensions Act 2004 as a statutory body with a duty to provide compensation to members of defined benefit schemes where the relevant employer becomes insolvent.*

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4) In July 2010, Mr Hamilton, *Group's* Taxation Director and Director of Pensions and Employee Benefits, considered the Pension Protection Fund ("PPF") levy scores and levy costs of *Holdings*. On 26 July 2010 he sought advice from KPMG LLP. In relation to the proposal to recapitalise *Holdings* using a Forward Subscription Agreement ("FSA"), he budgeted £125,000 as the cost of implementation tax and accounting input and

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£50,000 as the cost of reviewing the accounts and tax computations post-implementation after 30 April 2011.

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5) Mr Hamilton, *who was also a director of Holdings*³⁸ estimated the annual PPF levy savings which could be achieved by *Holdings* and Stagecoach Services Limited ("*Services*") (in respect of whom the same recapitalization scheme was being considered) as in the range £175,000 and £238,000.³⁹

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6) KPMG provided initial advice in early August 2010 and on 20 August 2010 issued a letter of engagement to *Group*, accepted on its behalf by Mr Hamilton that day. The fixed fees agreed were the same as those budgeted for by Mr Hamilton in July, plus a "success" fee.

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6A *By this stage, the possible tax savings had become a significant feature of the whole exercise. Much time and expense was incurred on obtaining tax advice. The FSAs were structured with a view to obtaining a tax advantage or benefit. Group decided to proceed on that basis. While they may well have proceeded, in any event, with some form of recapitalisation, the possible fiscal benefits identified were a significant*

³⁷ This is a modification of a finding of fact proposed by Ms Shaw (Day 2/32); in our view the evidence read as a whole did not justify her version. Had we accepted her proposed finding it would have made no difference to the outcome.

³⁸ Witness statement paragraph 10

³⁹ Mr Hamilton's evidence was a little different as noted by Ms Shaw in her closing submissions (Day 2 page 34). This does not matter so we have left the agreed fact as it stands.

feature.⁴⁰ Even although Group expected there to be a reduction in the PPF levy the amount of the reduction was small in comparison with the fees charged by KPMG which was principally for tax advice).

5 **6B** By letter to Group dated 20 August 2010, KPMG set out confirmation of their engagement “to deliver tax advisory services ...in connection with the recapitalisation of (Group’s) subsidiaries”. The letter records that it is proposed to recapitalise Holdings and Services and is “assessing doing this by subscription for further share capital under Forward Share Subscription Agreements, and in a tax efficient manner.” The scope of the services set out in the letter was primarily tax related; however, the services included an accounting opinion on the recapitalisation of the subsidiaries, “including an accounting opinion on the derecognition of the intercompany receivable and the resulting accounting entries in the effected (sic) companies.” The letter proposed fees of in total £175,000 plus VAT of which £50,000 related to commenting on the statutory accounts of the subsidiaries and assistance with the disclosure of the transactions in the corporation tax computations and returns for the year to 30 June 2011. An additional sum of £30,000 plus VAT was an outlay for obtaining Tax Counsel’s opinion.

20 **6C** KPMG reported (on behalf of Group) the recapitalisation to HMRC under the DOTAS provisions. They described the transactions as “Tax-efficient recapitalisation of subgroup by dercorgintion (sc derecognition).” The Scheme reference number was notified to Group by HMRC on or about 28 October 2010. Such schemes are intended to produce a tax advantage. One of the main benefits that Group must have expected to arise from the arrangements, namely the recapitalisation was the obtaining of a tax advantage

25 **6D** There were various means by which Holdings and Services could have been recapitalised. Group received tax and accountancy advice from KPMG. While Group was concerned about PPF levy it did not ask KPMG to advise on that topic. The bulk of the advice and most of the expense was tax related rather than the accounting treatment. They were not asked to advise on the PPF Levy. The thrust of the advice was that if the recapitalisation proceeded by way of a forward subscription agreement, the contingent subscription amount would not be taxable in the hands of Holdings or Services and would be given tax relief as a “derecognition debit”. The mechanism of

⁴⁰ We are not prepared to make the finding proposed by Ms Shaw (Day 2 page 32) that absent the tax advantage, Group would have had to have re-capitalised Holdings in any event. The evidence read as a whole does not justify it. Again, we do not consider that this matters for the purposes of the s320 or s307 issues.

the FSAs was suggested for that reason. Group relied on that advice and proceeded to enter the FSAs on that basis. Holdings and Services were also aware of that advice, and proceeded in reliance upon it. They all proceeded with the FSAs in the expectation that the consideration for the shares, would be relievable in the hands of Group and not taxable on receipt in the hands of Holdings or Services, and thus provide a benefit to all three companies. One of the main purposes of the structure of the FSAs was to obtain a tax benefit or advantage, ie a relievable debit in Group's accounts and non-taxation of the receipts in the hands of Holdings. Thus, one of the main purposes of Group, Holdings and Services in entering the FSAs, was to obtain a tax advantage. These companies expected that in doing so an overall tax advantage would be obtained which was beneficial to each of them.

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7) On 4 October 2010, quorate meetings of the directors of the Group, Holdings, ITCO and SBH⁴¹ were held. At the meeting of the Group's directors, a briefing paper outlining the proposed recapitalisation of Holdings (and Services) was taken as read and FSAs were outlined and discussed. Group resolved to pay £20,000 ("Prepayment Amount") to Holdings and, following the repayment of the loan by Transport, to pay "an amount of 22.4% of the amount received from Transport to Holdings as further consideration for the allotment of shares to its parent company by Holdings. At its directors' meeting, Holdings resolved to approve the FSA and to issue and allot to ITCO 20,000 ordinary £1 shares for £20,000 plus 22.4% of the amount to be repaid by Transport on 31 December 2010. An appropriate resolution was made at the meeting of the Directors of ITCO to enable the scheme to progress.

25

8) On 6 October 2010, Group and Holdings entered into the FSA pursuant to which Holdings agreed to issue 20,000 ordinary shares of £1 each to ITCO on 31 December 2010 and Group agreed to pay the nominal subscription amount of £20,000 plus a contingent subscription in a sum equal to 22.4% of the principal and interest repaid to Group under the Transport loan up to a maximum of £20m.

30

8A *Clause 2.1 of the FSA provides:-*

The Contributor (sc Group) agrees to pay the sum of (i) the Prepayment Amount and (ii) the Contingent Subscription Amount (up to a combined maximum amount of £20,000,000) as a contribution to the capital of the Issuer (sc Holdings), and the Issuer agrees to allot and issue the Shares to (ITCO) subject to the terms of this Agreement

Clause 2(2) provides inter alia as follows:-

⁴¹ The tribunal notes that this appears to be a reference to Stagecoach Bus Holdings Ltd (Bus). See the Appendix to this Decision.

The Consideration for the allotment and issue of the Shares shall be the Contribution Amount⁴² which shall be satisfied as follows;

(a) *the Contributor shall pay the Prepayment Amount to the Issuer on the date hereof, such amount to be held as prepayment for the allotment and issue of the Shares; and*

(b) *the balance of the Contingent Subscription Amount payable subject to and conditional upon the provisions of Clause 3.1 and 4.2 being;*

(i) *22.4% of amounts received in respect of the repayment of the Loan Agreement on or about 31 December 2010.*

..

Clause 3.1 provides inter alia as follows:-

If, before the Issue Date, the Contributor shall receive.....any amount under the Loan Agreement.....from... the Borrower..., then within one business day after.....the Contributor shall pay to the Issuer an amount equivalent to 22.4% of the amount of the Payment.

Clause 3.2 provides inter alia as follows-

.....nothing in this Agreement shall constitute the transfer of the Loan Agreement or an assignment to the Issuer of any of the Contributor's rights and obligations under the Loan Agreement.

- 9) On entering into the FSA on 6 October 2010, *Group* derecognised an amount equal to £19,735,543.50⁴³ representing a proportionate share of its loan relationship asset that would now be passed to *Holdings* on the event of settlement. The corresponding debit was to investments.
- 10) On the same day, 6 October 2010, KPMG LLP disclosed a scheme to HMRC in terms of the Disclosure of Tax Avoidance Regulations (DOTAS) as "Tax-efficient recapitalisation of sub-group by recapitalisation".
- 11) In consideration for receiving the Contribution Amount from *Group* under the FSA, *Holdings* agreed to issue 20,000 £1 ordinary shares to its immediate parent company, ITCO. The terms of the FSA stated that on 31 December 2010 *Holdings* would issue shares to its parent company regardless of whether any amounts (other than the Prepayment Amount) had been received from *Group*. Under the FSA the Prepayment

⁴² Contribution Amount means *the capital sum of up to £20,000,000, being the sum of (i) the Prepayment Amount (sc £20,000) and (ii) the Contingent Subscription Amount.*

⁴³ The full amount derecognised by *Group* was £39,471,087 which took into account the identical FSA entered into with *Services*

Amount was payable on the date of the FSA and equalled the nominal value of the shares to be issued to ITCO.⁴⁴

- 5
- 12) The nominal subscription amount of £20,000 was paid to *Holdings* on 7 October 2010.
- 13) On the same day, 7 October 2010, HMRC advised KPMG LLP that the Scheme was allocated the reference number 11460710 under DOTAS.
- 10
- 14) On 26 October 2010, the *Group's* Group Taxation Director prepared a journal for the recapitalisation of SHL. On the same day, KPMG LLP told *Group* that the Scheme was allocated the reference number 11460710 under DOTAS.
- 15
- 15) On 2 November 2010 KPMG LLP wrote to SG *Group* to set out the proposed accounting for the recapitalisation of *Holdings*, in accordance with the second bullet point in para 1 of the letter of engagement of 20 August 2010.
- 20
- 16) As the number of shares to be issued under the FSA was fixed, irrespective of whether *Group* received any repayments of principal or interest under the Loan, *Holdings* assumed a proportion of the economic risk of any delays or defaults by *Transport* in repaying the Loan to *Group*.
- 25
- 17) On the maturity of the Loan on 31 December 2010, *Transport* repaid the full amount of outstanding principal and accrued interest, totalling £90,111,876.80.
- 18) In the event, 22.4 per cent of the amount received from *Transport* exceeded the £20m cap in the FSA. Accordingly, a payment of £19,980,000 was made to SHL *Holdings* on 31 December 2010⁴⁵.
- 30
- 19) Also on 31 December 2010, *Holdings* issued 20,000 shares of £1 each to ITCO.

ACCOUNTING TREATMENT UPON ENTERING INTO THE FORWARD SUBSCRIPTION AGREEMENT

⁴⁴ The Tribunal notes that under the FSA with *Services*, shares in another group company, (*Bus*) were to be issued.

⁴⁵ ie £20,000,000 minus the £20,000 prepayment

- 20) As at 5 October 2010, *Group's* balance sheet showed a cost of investment in subsidiaries of £978.5m (representing an asset in respect of *Group's* holding of shares in *Transport*) and a loan debtor of £88.1m (representing an asset in respect of the *Transport Loan*)⁴⁶.
- 5 21) On 6 October 2010, as a result of entering into the FSA, *Group* was, under UK GAAP (FRS 26), required to derecognise 22.4% of the principal amount of its loan to *Transport*, crediting (ie decreasing) the loan receivable due from *STH Transport* and debiting (ie increasing) the cost of its investment in *Holdings*⁴⁷. Both entries were in *SG's Group's* balance sheet and both in the amount of £19,735,543.50⁴⁸.
- 10 22) A further debit to *SG's Group's* cost of investment in *Holdings*⁴⁹ was posted in respect of the nominal subscription amount of £20,000. It is not claimed that any immediate tax consequences flow from this, and so no further reference has been made to this amount.
- 15 **22A *The parties are agreed that the accounting entries in this paragraph and in paragraph 21 were made in accordance with generally accepted accounting practice.***⁵⁰
- 20 23) From *Holdings'* perspective, on 6 October 2010, as a result of entering into the FSA, it recognised in its balance sheet an asset equal to the sum of the nominal subscription amount and the present value of the contingent subscription amount expected to be received on 31 December 2010, thereby immediately increasing its net assets by that amount.
- 25 **23A *If Transport had defaulted and not repaid the loan to Group, subsequent accounting entries to reflect that would not have invalidated the derecognition entry or the debit to investments in the books of Group. Subsequently entries would reflect the changed position but would not retrospectively remove the derecognition entry.***⁵¹

⁴⁶ *Group* had also separately recorded an asset of £1.07m in respect of accrued interest due from *Transport*.

⁴⁷ The Statement of Agreed Facts refers to *STH* ie *Transport* which must be an error; the investment was in *Holdings*

⁴⁸ Equivalent accounting credits and debits arose in respect of the same proportion of the loan relationship cash flows economically disposed of *Services* under a second forward subscription agreement. As the numbers are identical to those in relation to *Holdings*, no further reference has been made to the transaction with *Services*. The total adjustment in *Group* is therefore £39,471,087.

⁴⁹ The Statement of Agreed Facts refers to *STH* ie *Transport* which must be an error; the investment was in *Holdings*

⁵⁰ Ms Shaw requested that this be noted (Day 2/36-37)

⁵¹ This is a modification of a finding of fact proposed by Ms Shaw (Day 2/42-43). It makes no difference to the decision on s320, and 307 but may have a bearing on the tax arbitrage receipt scheme conditions.

24) Between 6 October and 31 December 2010, income accrued to *Holdings* as the contingent subscription amount accreted (that is to say increased) from its present value at 6 October 2010. Those amounts were recognised in *Holdings* profit and loss account as they accreted.

On 31 December 2010, when the contingent subscription amount was paid and shares were issued by *Holdings*, a number of accounting entries resulted in the books of *Holdings*. The full amount of cash received at 31 December 2010 plus the nominal subscription amount (a total of £20m) was credited to share capital/share premium account with matching debits to equity (shares to be issued - equal to amounts previously credited to this account) and to the profit and loss reserve (equal to the accretion of income previously recognised in the profit and loss account over the period). *Holdings'* net assets were unaffected by these entries.

24A *All the relevant accounting entries in Group's books and accounts were triggered by the recapitalisation of Holdings and Services.*

24B *Generally, where a loan is obtained by a company to pay for the construction of an asset, generally accepted accounting practice permits, but does not require, interest payable on the loan to be capitalised rather than debited in the profit and loss account of the company, that is to say it is charged to capital in the company's accounts as part of the carrying value of the asset. Thus, if the interest is capitalised, then fixed assets in the balance sheet are debited with the interest, instead of the interest being debited to the profit and loss account, where interest payable under a loan would otherwise normally be recognised.⁵²*

TAX TREATMENT ADOPTED BY GROUP IN ITS CORPORATION TAX RETURN

25) *Group* brought into account a non-trading deficit of £37,721,456 in respect of its loan relationships for the accounting period ended 30 April 2011.

⁵² This relates to the proposed finding of fact by Ms Shaw (Day 2/45 to 48). Our finding is based on the evidence of Mr Drummond and our own experience. We do not understand this to be contentious. We do not need to rely on it for our decision on the principal issue (aa).

- 26) Among the elements making up this deficit is a loan relationship debit claimed under s320 CTA 2009 pursuant to *Group's* entry into the forward subscription agreement with *Holdings*.
- 5 27) In its tax computation for the period ended 30 April 2011 *Holdings* has not recognised as taxable any amounts receivable from *Group* under the terms of the FSA.
- 10 28) *Group* submitted its corporation tax self-assessments, for the period ending 30 April 2011, on 27 April 2012 and disclosed the Scheme's reference number in the returns. *Group*, *ITCO*, *Bus*, *Holdings*, *Services* and *Transport* all prepare their accounts in accordance with UK GAAP. In addition, *Group* has adopted FRS 26.
- 15 29) Enquiries were opened into the returns pursuant to paragraph 24 of Schedule 18 to the Finance Act 1998 ("Schedule 18") on 31 July 2012. Arbitrage notices under section 249 TIOPA 2010 were issued by HMRC to *Holdings* and *Services* on 21 September 2012. *Holdings* and *Services* did not amend their corporation tax return for the period to include the amounts of £19,735,543.50 in their taxable incomes for the period in accordance with section 254 TIOPA 2010.
- 20 30) On 27 September 2013 HMRC completed its enquiries into *Group's* returns by issuing closure notices pursuant to Paragraph 32 of Schedule 18. The conclusion of the notice sent to *Group* was that *Group* was not entitled to claim a deduction of £39,471,087 for the derecognised amount representing a proportionate share of the Loan Asset to be passed to *Holdings* and *Services*.⁵³
- 25 31) *Group* appealed against those closure notices on 29 October 2013.

Submissions

Group

- 30 51. In summary, *Group* submits that s320 can be contrasted with s307. S320, differing from GAAP, identifies amounts that capture the credits or debits in respect of a company's loan relationship which are brought into account in determining the value of a fixed capital asset. An example is capitalised interest where interest on a loan to construct a fixed asset is added to the cost of the fixed asset. The undisputed accounting treatment upon entering into the FSA was to derecognise part of the loan.
- 35 The consequential accounting entries were *in respect of* the loan. Those entries were to debit the cost of investment (the fixed asset) and to credit loans. The debit

⁵³ See also paragraphs 9-13 of this Decision.

recognises the increased cost of the asset. S320 has been drafted widely and is not limited to interest and expenses where relief would otherwise be denied because of their accounting treatment. Reference was made by comparison to CTA 2009 s604 which introduced identical provisions for derivatives which do not carry interest.

5 52. It was simply wrong to say that the debit to fixed assets was not *in respect of* a
loan relationship. The partial derecognition of *Group's* loan required a debit to fixed
assets and a credit to loans. Both were in respect of the same thing, namely the
derecognition of the loan. This accords with the system of double entry bookkeeping
10 which recognises two corresponding but opposite entries to different accounts *in*
respect of each single event or transaction. A debit to fixed assets on the partial
derecognition of a loan (following an FSA) is *in respect of* a loan relationship,
notwithstanding it also reflects the additional cost of investment. Reference was also
made to CTA 2009 ss455A and 354.

15 53. Further, it was submitted that s320 debits are not subject to s307(3). This
argument is said to be supported by the structure of the legislation, the wording and
purpose of ss320, and 307, by previous legislation, and by a comparison with the
derivatives contracts regime under CTA 2009 Part 7. The debit in question represents
a loss arising to Group from its loan relationship; it represents the economic outflow
from Group's loan relationship into the enhancement of its investment in *Holdings*.
20 The concept of profits and losses includes amounts recognised in other account
statements which relate to movements in a company's net asset position. Any gain in
value of Group's investment in *Holdings* is irrelevant. The substance of the
transaction is that *Group* has lost its economic interest in the part of the cash flows
committed to *Holdings*; the loss arises from the fall in the economic value of the loan
and therefore arises *from* the loan relationship. Even if the s307(3) test is applicable
25 the debit in question passes that test.

Holdings

30 54. Ms Shaw acknowledged that the tax arbitrage issues only arose if HMRC were
wrong about the proper application of the loan relationship code. In relation to the
receipt scheme notices and the tax arbitrage rules, *Holdings* submits that receipt
scheme conditions B, C and D are not satisfied. In relation to receipt condition B,
reference was made to a statement in an HMRC Manual that *A contribution to the*
capital of a company is any payment that directly increases the company's capital
*value as represented by its value to shareholders.*⁵⁴ It is said that the increase in
35 *Holdings'* capital value occurred at the time the FSA was entered into when *Holdings*
recognised the transaction for accounting purposes, and not when the contingent
premium was paid. The agreement to pay the contingent premium in the future was
not of itself a payment. Reference was made to *First Nationwide v HMRC*.⁵⁵ The
payment of the contingent premium itself was not a contribution to the capital of

⁵⁴ INTM595560

⁵⁵ [2012] EWCA (Civ) 278 at paragraph 30

Holdings. It did not directly increase its capital. Rather, it satisfied an existing obligation.

55. Condition C was not satisfied because neither *Group* nor *Holdings* expected a benefit to arise because of the non-taxation of the receipt. Subscriptions for share capital are not taxable. Moreover, non-taxation of a receipt is not a benefit. The parties did not regard the non-taxation of the payment as a benefit. The payment can only be a *qualifying* payment, per condition B, if it is non-taxable. Condition C would always be satisfied. Here, the expected benefit arose because of the loan relationship debit in the books of *Group* and not because of the non-taxation of the receipt by *Holdings*. There was no causative link between the payment to *Holdings* and the derecognition debit. The statutory focus is on the receipt of payment. *Biffa (Jersey) Ltd v HMRC*⁵⁶ was wrongly decided, but is in any event distinguishable.

56. Condition D is not satisfied because it is not the payment of the contingent sum that is deductible, it is the amount of the derecognised loan brought into account in determining the value of *Group's* investment in *Holdings* that is deductible. There was no direct link between the deduction in respect of the derecognised loan and the qualifying payment.

57. Finally, it was submitted that even if *Holdings* were required to recalculate its income so as to bring the sum of £19,735,543.50 into account there is no mechanism for charging that amount to tax. S254 TIOPA was not a charging provision or a charging Act. The charge to corporation tax has effect in accordance with the provisions of the CTA 2009 that deal with its application. Reference was made to ss2(1)(4), 35 (the charge applies to trade profits), 299 (non-trading profits in respect of loan relationships), income not otherwise within the application of the charge under the Corporation Tax Acts (s979). The amount brought into charge was deemed to be Schedule D, Case VI under Finance (No 2) Act 2005 s27. However, Schedule D Case VI was repealed by CTA 2009 for accounting periods on or after 1 April 2009.⁵⁷ The replacement legislation, s979 CTA, does not impose a charge as deemed income is expressly exempted by s979(2)(c). The surprising result is therefore said to be that even if all the receipt conditions are satisfied the charge to corporation tax cannot be applied and so *Holdings* is not liable for any additional tax.

HMRC

58. In summary, HMRC submit that (i) the use of the proceeds (here, part of the sums repaid by the debtor) of a loan relationship to fund a share acquisition is not a debit attributable to or *in respect of* the loan relationship; and is accordingly outwith the scope of s320 CTA 2009; (ii) if the use of the proceeds is within the scope of s320, it is subject to the general principles of the loan relationship code, and in particular s307; (iii) it does not, moreover, represent a loss to *Group* arising out of the loan relationship or at all; and in the alternative, and (iv) the derecognised sum of

⁵⁶ [2014] UKFTT 982 (TC) at paragraph 69

⁵⁷ CTA 2009 Schedule 1 paragraphs 668 and 671

£39,471,087,⁵⁸ even if otherwise a tax deductible debit, gives rise to a mismatch which is subject to adjustment under the tax arbitrage rules of Part 6 of TIOPA and therefore taxable thereunder or as miscellaneous income brought into charge by virtue of s979 of the Corporation Taxes Act 2010.

5 The Evidence and Additional Findings of Fact

Peter Drummond

59. Mr Drummond gave evidence as an expert accountant on behalf of HMRC. He was well qualified and experienced to do so. Before joining HMRC, he held a senior position in one of the *Big 4* accountancy firms for about 18 years. Although now employed by HMRC, his independence and impartiality were not in doubt and were not challenged. He has been an advisory accountant in HMRC's *Large Business* service since 2004. He advises tax colleagues on accountancy matters relating to the largest businesses in the UK. He is familiar with UK GAAP and other accounting standards. We found him to be careful, thoughtful and straightforward in giving evidence. He was generally reliable and credible.

60. His task in preparing a report was to provide a detailed explanation of how and why the debit to investments of £39,471,087 arose in *Group's* accounts. He proceeded on the assumption that there was no dispute about that accounting treatment. He therefore considered what the accounting treatment meant, what it represented, and whether it complied with accounting standards. He was also asked to assume that *Group* prepared its 2011 accounts in accordance with UK GAAP.

61. In his report, he emphasised identifying the substance of the transactions, ascertained by identifying whether there have been changes to the reporting entity's existing assets and liabilities. He identified the relevant part of the definition of financial assets as defined in FRS 25 as *a contractual right... to receive cash or another financial asset from another entity*. He described the transaction as involving the provision of additional capital to *Holdings* and *Services*. He concluded that, in substance, the effect of the FSAs was to transfer part of the economic interest in the loan (a financial asset) to *Holdings* and *Services*.

62. He considered FRS 26 which addresses the detail of derecognition of financial assets. The main focus was on the risks and rewards of ownership of the financial asset and control. His conclusion was that partial derecognition of the loan was an acceptable accounting treatment. He had a doubt in relation to the assertion that the cap of £20m contained in the FSAs meant that what was being recognised was a fully proportionate share of the cash flows from the financial asset (ie the loan) (a requirement of FRS 26 paragraph 16(a)). He did, however, note that there was, in reality, no retained risk for *Group* because it was a parent company of *Transport*.

⁵⁸ One half (£19,735,543.50) related to the recapitalisation of *Holdings*; the other half related to the recapitalisation of *Services*

63. In summary, Mr Drummond concluded that partial derecognition of the loan reflected the economic effect of the transaction. He was satisfied that the amount derecognised in *Group's* balance sheet correctly reflected the proportion of the carrying value of loan transferred to *Holdings* and *Services*.

5 64. In relation to what he described as the corresponding debit entry, he considered
that the substance of the transaction was that the value of *Group's* subsidiaries
(*Holdings* and *Services*) had been enhanced, the net assets of these companies
increasing as a result of the transaction. The debit in *Group's* books recognised the
10 control *Group* has over its subsidiaries which gives it rights to future economic
benefits such as the proceeds of sale of the enriched subsidiaries or dividends from
their profitable trading. He rejected the notion of the debit entry being treated as a
distribution or a loss. The transfer of assets was to *Group's* subsidiaries and not to its
shareholders. Moreover, it would be wrong to treat the debit as a loss because the
15 substance of the transaction was that the value of *Group's* subsidiaries, *Holdings* and
Services, would be enhanced; their net assets, as shown in their balance sheets, would
be increased as a result of the transactions ie their recapitalisation by way of the
FSAs.⁵⁹

65. He noted that the debit in *Group's* balance sheet was not intended to represent
the market or fair value of the additional investment, but to record the cost of the
20 assets, transferred to *Holdings* and *Services*. This accorded with the historical costs
accounting rules.⁶⁰

66. He summarised his views by observing that the recapitalisation of the
subsidiaries by way of FSAs was shown in *Group's* accounts as a partial
derecognition of the loan with the corresponding debit entry taken to investments, the
25 credit entry representing *Group's* decreased interest in the loan to *Transport* and the
debit entry representing *Group's* increased investment in its subsidiaries. The debit to
investments reflected the recapitalisation of and *Group's* increased investment in the
subsidiaries.

67. While, as already noted, he had some doubt as to whether all the rules of
30 derecognition contained in FRS 26 had been met, Mr Drummond considered, after
careful analysis, that either they had been or that it did not matter. It is of some
interest to note that he considered that, given *Group's* position as ultimate parent,
there was no real risk that the loan would not be repaid in full. This had a bearing on
one condition of FRS26 which the part of the loan being derecognised had to meet.
35 That condition was that that part comprised only a fully proportionate (*pro rata*) share
of the cash flows from the loan. The terms of Clause 2.1 of the FSAs⁶¹ were such
that, on one view, the part of the loan to be recognised was strictly speaking not fully

⁵⁹ See also Day 1/102-103 (cross)

⁶⁰ Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008/410 Schedule 1, Part 2 Section b, Historical Cost Accounting Rules, 001, Fixed Assets, General rules, paragraph 17(1) - *the amount to be included in respect of any fixed asset must be its purchase price or production cost.*

⁶¹ in paragraph 8A of the Statement of Agreed Facts referred to above.

proportionate, as, in theory, *Group* retained some of the risk of the part of the loan being transferred in respect that if there were some shortfall in repayment the risk of that shortfall would be borne entirely by *Group*. Nevertheless, he viewed the lack of full proportionality in Clause 2.1 as, in effect, immaterial as he accepted that the condition was met or fell to be treated as met.

68. Mr Drummond examined the other conditions of FRS 26 which required to be met⁶² and concluded that they had been met. He again pointed out that *Group* had overall control of the recapitalisation transaction. There was no real risk that the transfer would not be carried into effect.⁶³

69. Overall, HMRC were content to accept that the FSAs gave rise to accounting double entries of *credit loans*, *debit investments*. However, there was some dispute between the parties as to the effect of these entries.

70. Mr Drummond amplified his report in evidence. He said that if the contingent subscription amount had been for cash rather than by reference to a proportion of the loan, the debit entry would still have been to *investments* but the credit entry would have been to *cash* and there would have been no derecognition.⁶⁴

71. He acknowledged the soundness of the accounting example given in paragraphs 23-25 of HMRC's Statement of Case, namely where a loan is obtained to fund the purchase of a fixed asset at a cost of £100, the proper accounting treatment is *Debit Cash £100, Credit Loan £100*, followed by *Debit Fixed Assets £100, Credit Cash £100*. Where there are borrowing costs of say £25, these may be capitalised in the balance sheet under *Fixed Assets*. The £100 is in respect of the purchase price. The £25 is in respect of the loan relationship and it attracts the relief under s320(1) that would have been available had the accounting treatment been to record the interest as an expense in the profit and loss account instead of capitalising it. Mr Drummond also observed that capitalising the interest was a matter of accounting policy choice.⁶⁵ That choice may, he said, be exercised where a lengthy period elapses before the asset is brought into use. The expense is entered in the balance sheet as part of the cost of bringing the asset into use. That cost, (including the interest) reflected as an asset in the balance sheet, is depreciated over time through the profit and loss account.

72. Mr Drummond was also asked to consider the accounting entries arising on total default in repayment of the loan. He stated that in *Group's* books these would have been - *debit profit and loss account* with the balance of the loan, and *credit loans* with the same balance thus eliminating the loan from the balance sheet. There would be no entries made in *Transport's* accounts as its liability as debtor under the loan remained. In the books of *Holdings* and *Services* they would write off the asset previously recognised in their balance sheets by debiting their profit and loss accounts with the

⁶² See paragraphs 18-22 of Appendix A to Mr Drummond's Report.

⁶³ Day 2/13-15 (questions by the Tribunal).

⁶⁴ Day 1/66-67 (chief).

⁶⁵ Day 1/67-70 (chief).

amount of the balance (the contingent subscription amount) and crediting the asset on their balance sheets, thereby eliminating it.⁶⁶

73. Mr Drummond also expressed the view that where there is a transfer of an asset (as here) to a group company, the debit is an asset, whereas if the transfer had been to an unrelated third party, the debit would be a cost and not an asset.⁶⁷ While the debit reflected the cost of the asset, it was nevertheless an asset and reflected and represented future economic benefit and therefore there was value inherent in it.⁶⁸ The substance of the transaction was the capitalisation of the subsidiaries effected through the FSAs; there was an investment in the subsidiaries which should be reflected in the accounting.⁶⁹

74. More generally, he considered that the derecognition rules dealt with the effect of the transaction in question on the assets already in the balance sheet.⁷⁰ He thought credits and debits occurred simultaneously and corresponded with and equalled each other.⁷¹

75. In cross examination, he acknowledged that the carrying value of the loan asset had been diminished.⁷² Overall, he did not depart from the points mentioned above. We accept his views (which we have summarised) as sound.

John Hamilton

76. We found Mr Hamilton to be generally reliable and credible. He provided a comprehensive witness statement. He was *Group's* director of Pensions and Benefits and its taxation director. He was also a director of *Holdings*. He was well able to appreciate the need for recapitalisation of *Group's* subsidiaries, *Holdings* and *Services*, and the technical details involved. We do not review all his evidence here. Much of it was unchallenged and formed the basis of the Statement of Agreed Facts.

77. Overall, viewing his written and oral evidence along with the other documents before us it seems to us reasonably clear that by 6 October 2010, when the FSAs were entered into, the purpose in proceeding with the recapitalisation in that way, or at least one of the main purposes, was to generate a relievable debit with no corresponding tax charge on the subsidiaries on the contingent subscription amounts. These considerations were not incidental to the transaction; they were to a material extent, the rationale for it. The other, or at least another, main purpose was to enable the balance sheets of the subsidiaries to be repaired (with appropriate accounting entries)

⁶⁶ Day 1/70-77; 105 (cross)

⁶⁷ Day 1/80-81; 100-101 (cross)

⁶⁸ Day 2/19 (questions by the Tribunal)

⁶⁹ Day 2/20 (questions by the Tribunal); and 22 (further cross)

⁷⁰ Day 1/92 (questions by the Tribunal)

⁷¹ Day 1/96 (cross)

⁷² Day 1/99-100 (cross)

as soon as the FSAs were entered into. Group's expectation, by 6 October 2010, was that the debit to investments would be relievably and that the contingent subscription amounts would not be taxable in the hands of the subsidiaries. This was a positive expectation rather than a negative expectation, that for example it would not expect the recapitalisation exercise to be subject to VAT. One of the purposes of using an FSA as a vehicle to carry into effect the recapitalisation of each subsidiary was to obtain a tax advantage (a relievably debit with no corresponding tax charge on the subsidiary). That was a benefit that *Group, Holdings* and *Services* expected to be obtained as a consequence of recapitalising *Holdings* and *Services* by means of the FSAs.

78. *Group* therefore hoped that the tax effect of the FSA would be to create a relievably debit. That was the reason the recapitalisation was structured in that way. Other means could have been used to effect immediate repair of the balance sheets of the subsidiaries although these may have been administratively more complex. For example, a subscription through ITCO could have achieved the same result as Mr Hamilton accepted.⁷³ If there was any other reason than achieving a tax advantage for specifying the consideration for the shares by reference to a calculation of a proportion of the loan proceeds it was not the subject of evidence or submissions.

79. Mr Hamilton said in his written statement⁷⁴ that the tax benefit contemplated was incidental and that the recapitalisation was going to happen in any event. However, in our view, the evidence of Mr Hamilton read fairly as a whole leads us to conclude that the anticipated tax benefit was not merely incidental. It was a significant feature of the decision making process.⁷⁵ *Group* spent significant sums on obtaining tax advice. It received such advice.⁷⁶ It relied on it as did *Holdings* and *Services*.⁷⁷ It carried it into effect by entering into the transactions with *Holdings* and *Services*.⁷⁸ These transactions were the recapitalisation of these two companies by means of FSAs.⁷⁹

80. Mr Hamilton did not suggest any non-fiscal reason for expressing the contingent subscription amount as a percentage of the loan. Under pressure of cross-examination, he accepted that *Group, Holdings* and *Services* relied on the tax advice received from KPMG and counsel and expected to obtain a tax benefit from recapitalisation through the FSAs.⁸⁰

⁷³ Day 1/25 (cross).

⁷⁴ Paragraph 28.

⁷⁵ Day 1/25-27; 43 (cross).

⁷⁶ Day 1/24; 35/36 (cross).

⁷⁷ Day 1/43 and 47 (cross).

⁷⁸ Hamilton, Day 1/27 (cross).

⁷⁹ Drummond D2/22 (cross).

⁸⁰ Day 1/ 42-47 (cross).

81. It seems to us plain that on entering into the recapitalisation scheme in the manner in which they did, both *Group*, on the one hand, and *Holdings* and *Services* on the other hand expected that tax benefits or advantages would arise. The benefit or advantage was expected to be that the consideration under the FSAs would create a tax relievable debit of an equivalent amount, thus benefitting *Group*, without any consequent fiscal liability falling on *Holdings* or *Services* by virtue of the receipt of the capital sums identified in and calculated by reference to the FSAs.

82. It is correct that *Group*, *Holdings* and *Services* also expected that there would be a reduction of the PPF levy and we have made findings of fact about that. However, that does not eliminate or dilute the importance of their fiscal expectations. This is relevant to the consideration of the tax arbitrage provisions in TIOPA, which we discuss below.

Discussion and Decision

Issue (aa); In respect of a company's loan relationship (s320(1))

83. HMRC submit that the debit relied upon was not *in respect of Group's loan relationship* at all. Rather, it was in respect of the FSA. If that is correct, all *Group's* arguments must be rejected and the appeal dismissed.

84. This raises a question of statutory construction applied to the basic facts of the transaction. Many of the facts in the Statement of Agreed Facts have no bearing on this question. The same can be said for much of the oral evidence. If it is correct, as Ms Shaw submitted, that the purpose of the transaction was not relevant to the issue, the purpose of the statutory provisions *is*, nevertheless, relevant to the determination of the question of statutory construction. In short, do the basic facts, realistically assessed, fall within the scope of the statutory provision, purposively construed?

85. The phrase *in respect of* has a causative flavour but it is not a *but for* test. The phrase *in respect of* is more pointed than *relating to* or *in relation to*. One might ask how did the debit arise; what was the reason for it? Will any tenuous connection suffice or must one ascertain the root cause of the debit before one can conclude what it is *in respect of*? Such an approach might correlate to a wider or a narrower statutory construction. We endeavour to give the relevant statutory provisions a purposive construction bearing in mind that it has been accepted at all hands that the accounting treatment was in accordance with generally accepted accounting practice.

86. The purpose of Part 5, CTA 2009 is to set out how profits and deficits arising to a company from its loan relationships are brought into account for corporation tax purposes.⁸¹ Profits and deficits arising to a company from its loan relationships are to be calculated using the credits and debits given by Part 5.⁸² Profits and losses from loan relationships may include profits or losses of a capital nature.⁸³ Debits are

⁸¹ S292(1)

⁸² S296

⁸³ S293(3)

equiparated with deficits. Profits and losses from loan relationships include reference to profits or losses from related transactions.⁸⁴ A related transaction means a disposal or acquisition of rights or liabilities under the loan relationship.⁸⁵ That would include assignment and a variation. A related transaction therefore has to affect the rights and obligations of the parties under the loan relationship. A transaction which is related in some way to a loan relationship which does not affect rights or liabilities under the loan relationship is not a related transaction. The parties are in agreement that we are not concerned with a related transaction.

87. Whatever causative or other type of test is applied to determine whether the debit was in respect of *Group's* loan relationships, it is not met. The loan by *Group* to *Transport* already existed on 6 October 2010 when the FSAs were entered into and the debit brought into account in determining the value of fixed capital assets in *Group's* accounts, namely its investment as ultimate parent in two of its subsidiaries, over which it had complete control. The *but for* test of causation is not met. It would however, be correct to say that but for each FSA there would be no debit. This at least illustrates the causative potency of the FSAs. It is incorrect to say that but for the loan relationship the debit would not have been brought into account. Mechanisms other than the medium of the loan to *Transport* could have been deployed. *Group* could have injected cash into *Holdings* in exchange for the allotment and issue of shares. That would have led to the same debit but would not attract relief. *Group* could have obtained a loan for the express purpose of funding the project. The finance cost of doing so (interest and expenses) could have been a debit to investments in accordance with generally accepted accounting practice. That would be a debit in respect of the company's loan relationship. Thus, capitalised interest is brought into account by virtue of s320 as if it were not being capitalised. These finance costs, despite their treatment in the company's accounts, are thus brought into account in the same way as a debit (ie an expense) which is normally brought into account in determining the company's profits or loss in accordance with generally accepted accounting practice.

88. *Group* sought support from the underlying rationale of the accounting treatment, even although the accounting treatment itself was not in dispute. To that end, technical accounting matters were examined in evidence in some detail with Mr Drummond. However, such an examination does not assist *Group* to elide the fundamental point that the debit in question was in respect of the re-capitalisation of the subsidiary; that was the transaction, rather than the transaction being the loan or its repayment. The reference to the Loan Agreement in the FSA clause 2.2(b)(i) is made as a means of calculating the balance of the consideration (the Contingent Subscription Amount). This is made clear by clause 3.2 which provides that the FSA is not to constitute an assignment of any rights under the Loan Agreement. This dilutes rather than strengthens any connection between the FSA and the Loan Agreement. The inclusion of the loan to *Transport* was a deliberate but incidental mechanism designed as a means of identifying the price payable for the shares and to

⁸⁴ S293(1)

⁸⁵ 304(1)

secure a tax advantage. *Transport* was not a party to the FSA and *Holdings* was not a party to the Loan. The source of the amount which constitutes the debit (which in turn anticipates receipt) is the general funds of *Group*, calculated by reference to the repayment of the Loan. The FSA does not ring fence any part of the proceeds of the Loan or impress any such part with some sort of constructive trust.

89. We repeat that the transaction was the re-capitalisation of each subsidiary through the medium of an FSA. The pre-existing loan relationship was incidental; it was essentially the mechanism by which the contingent subscription amount was calculated; that sum was not in respect of the loan relationship; it was in respect of the FSA which determined its amount and specified the obligations to be implemented in respect of it.

90. Ms Shaw relied heavily on the evidence of Mr Drummond to support the conclusion that the debit *is* in respect of the loan relationship. We consider that Ms Shaw was wrong to do so. In the first place, while his evidence may be relevant, it is not determinative. We know what the loan relationship was. That is a question of fact which is not in dispute. The loan relationship is essentially the contract of loan between *Group* and *Transport*. That was a transaction for the lending of money.⁸⁶ *Group* stood in the position of creditor and *Transport* stood in the position of debtor.⁸⁷ There was no debit attributable to the partial derecognition of the loan. The derecognition of the loan was recorded in *Group's* books in accordance with generally accepted accounting practice as a credit.

91. Moreover, in the second place, our assessment of Mr Drummond's evidence is that he did not say that the debit was in respect of the loan relationship. We have examined his Report and reviewed the transcript of his evidence. We do not consider that his evidence, fairly read, is that the debit is in respect of the loan relationship or the derecognition. He said that, for each transaction, the debits must always equal the credits; they correspond to each other.⁸⁸ He described the transaction as the capitalisation or re-capitalisation of the subsidiary.⁸⁹

92. Both the debit and the credit were thus in respect of the recapitalisation. All the accounting entries were triggered by recapitalisation. *Group*, *Holdings* and *Services* expected that the tax effect of the FSAs would be to create a relievable debit and no tax liability on the recipients. That was the reason the recapitalisation was structured in that way. As we have already noted, other means could have been used.⁹⁰

93. *Group* submits that the source of the debit is the loan and the accounting characterisation of it is determined by the recipient. While it may be correct that the recipient determines the accounting characterisation of the debit, that does not identify

⁸⁶ s302(1)(b).

⁸⁷ s302(1).

⁸⁸ Day 1/96 (cross).

⁸⁹ (Day 2/22 (cross)).

⁹⁰ See paragraph 78 above.

the source of the debit. Here, we do not accept that the source is the loan. The debit is in respect of the rights and obligations created by the FSA. Entering into the FSA triggered the debit. The FSA creates the obligation and right to acquire⁹¹ shares, the obligation to pay and the right to receive payment for them. The sums to be paid and received are determined by the terms of the FSA. The *debit to investments* anticipates the receipt of the balance of the purchase price for the shares. In that sense, the debit is dealing with and thus in respect of the consideration for the shares. The amount to be paid and the date of payment are specified by reference to the terms of the Loan and the amount repaid by the debtor (*Transport*) under it. The entry in the balance sheet, in accordance with historical cost accounting rules,⁹² reflects the purchase price of the shares to be issued. That price could have been calculated in a variety of ways without reference to the Loan between *Group* and *Transport*.

94. The debit is not a loss from a loan relationship. It does not represent a loss at all. The loan principal and interest were repaid in full. That loan relationship led to a profit for *Group* or at least did not give rise to any loss. The debit represents increased investment and future economic benefit. That is its justification. The balance sheet of the subsidiary is repaired. The repair is reflected in the increased carrying value of *Group's* investment in the subsidiary (future expected economic value rather than actual market value), and in the balance sheet of *Holdings*. As Mr Drummond pointed out,⁹³ the assets *Group* could recognise in its balance sheet were greater as a result of the transaction; this was so, as assets represent future economic benefits; so, in that sense, *Group* obtained something in return for the investment. In these circumstances, the *debit to investments* is different in substance from a *debit* that is brought into account in the profit and loss account.

95. It is of some interest to note that even the appellants in their Skeleton Argument, albeit in relation to the arbitrage/receipts notice case, state that *The debit in SG* (ie *Group*) arose because of the FSA.⁹⁴ We agree. It is difficult to see how the appellants can sensibly argue that the debit was *in respect of* the loan relationship with *Holdings* when it is accepted in effect that it is attributable to, arises from and was thus caused by the FSA.

96. It makes no sense to give s320 a wider meaning and permit such a deduction in determining a company's profits and losses. S320 must be construed in the context of the overall purpose of Part 5 of CTA 2009, namely to determine how profits and deficits arising to a company from its loan relationship are brought into account for corporation tax purposes. The debit in question is not or at least does not create a deficit in respect of a loan relationship.

97. It makes good sense to permit a deduction from profits which is a legitimate business expense and thus a deficit, or which at least may cause a deficit, which,

⁹¹ or, more accurately, the right to have shares issued to another subsidiary (ITCO).

⁹² See above at paragraph 65.

⁹³ Day 1/110 (cross).

⁹⁴ Paragraph 107.

because of generally accepted accounting practice, may feature in the balance sheet (for example, as capitalised interest) rather than as a debit in the profit and loss account. It also respects the overarching purpose of Part 5 of CTA 2009 which is concerned with how profits and deficits arising from a company's loan relationships are to be brought into account for corporation tax purposes. Interest on a loan is an expense; it is a deficit that would often be found in the debit side of a profit and loss account. Capitalising it and entering it in the balance sheet instead of entering it in the profit and loss account does not deprive it of its inherent nature as a debit causing or contributing to a deficit. S320 allows it to be brought into account in determining the company's profit or loss even although generally accepted accounting practice may bring it into account, not in the profit and loss account, but in the balance sheet in determining the value of a company's fixed capital asset.

98. Properly analysed, the debit to investments enhances the assets of the subsidiaries (*Holdings* and *Services*). One of the purposes of the transactions was to repair the balance sheets of these companies. Repairing the balance sheet, of its very nature, improves the financial standing of the subsidiary companies in the eyes of third parties, including creditors, and makes trading with the subsidiaries a more attractive proposition. In like manner, the value of *Group's* increased investment in the subsidiaries is reflected in its balance sheet (under historical cost accounting rules) by reference to the cost paid by *Group* in terms of the FSAs. As Mr Drummond put it, *Group* obtains as an asset, a further and increased investment in its subsidiary, which, in accounting terms, was of a greater amount than it had been before.⁹⁵

99. If, however, the transactions are considered by reference to the group of companies together, the consolidated accounts, as Mr Drummond pointed out, would contain no entries for the transactions.⁹⁶ The group is simply moving funds from one corporate pocket to another, over which *Group* has, ultimately, complete control. Nothing is gained and nothing is lost. It would be wrong in principle to recognise such re-arrangements as creating a tax allowable loss or debit without any corresponding charge to tax. This has been described as an unusual *intra* group transaction⁹⁷ and there is no obvious reason to conclude that Parliament intended that the general principle of tax symmetry should be violated which would be the result if the appeal were to be allowed.⁹⁸ While we are not concerned directly with entries or the absence of entries in consolidated accounts, as Ms Shaw has pointed out, viewing matters from a group perspective underlines the surprising consequence which flows from *Group's* principal argument, that an entry which is unconnected with the calculation of a company's profits and losses, and which represents a capital payment, should nevertheless create a tax relievable sum.

⁹⁵ Day 2 page 7 (re-examination).

⁹⁶ Day 1 page 72-74 (cross).

⁹⁷ Day 2 page 12 (Drummond; re-examination).

⁹⁸ See the discussion in *Barclays Finance Ltd v Mawson* [2005] 1 AC 684 paragraph 37, per Lord Nicholls of Birkenhead. See also *DCC Holdings* referred to below.

100. While it may not be relevant to the question whether the debit in question was *in respect of Group's* loan relationship with *Transport*, it seems to us that the key to the application and operation of s320 (which was much discussed throughout the hearing) is where generally accepted accounting practice *allows* (but does not require) a debit to be treated in a company's accounts as an amount brought into account in determining the value of a fixed capital asset. Accounting practice may permit such treatment but the debit could instead be treated as a debit in the company's profit and loss account. Capitalisation of interest and other costs of financing a loan, such as an arrangement fee, are examples of a debit that could have been treated as an expense in the profit and loss account and deducted as a debit in determining a company's profits and losses. Instead, because generally accepted accounting practice permits it, the debit, if capitalised, appears in the balance sheet and not in the profit and loss account. Nevertheless, the debit is brought into account in the same way as an item of expense in the profit and loss account for tax purposes. That is so because the debit is an item of expense that would, but for the accounting treatment, have been brought into account in determining the company's profit or loss.

101. Thus, although the debit is capitalised as allowed by generally accepted accounting practice, s320 restores any relief to the debit that would otherwise have been given by s307 but for the accounting treatment. It is brought into account *in the same way* as a debit which is brought into account in determining the company's profit or loss.

102. Putting matters more broadly, Part 5 of CTA 2009 sets out how profits and deficits arising to a company from its loan relationships are brought into account for corporation tax purposes. Normally, they are brought into account in accordance with generally accepted accounting practice. Profits and losses are generally concerned with income and expenses. If an expense arising from a loan relationship would be denied relief only because of its accounting treatment, s320 gives relief. If accounting treatment of an item allocates it to the balance sheet, such as the cost of purchase of shares, because it would never appear in the profit and loss account as an item of relievable expense, s320 cannot magically transform it into a relievable expense. Such an item could never be characterised as or creating a deficit or a loss or expense arising from a company's loan relationship. S320 gives relief for an expense in respect of a company's loan relationship (such as the payment to a creditor of interest on a loan), where, because, and only because, of the accounting treatment, that relief would otherwise be denied. The general rule in s307 applies even where generally accepted accounting practice places the item in the balance sheet, provided the item when taken with the other items in the profit and loss account fairly represent the company's profits and losses. This seems to us to reflect and give effect to the purpose of s320 having regard to its context and the scheme of Part 5.

103. For what it may be worth, the foregoing analysis is consistent with paragraph 1081 of the Explanatory Notes⁹⁹ to s320 of CTA 2009.

⁹⁹ 1081 *This is the first of several sections which require debits and credits to be brought into, or not brought into, account or not to be brought into account under this Part where normal accounting*

104. Here, the sum paid by *Group* for the allotment and issue of shares in a subsidiary would only be treated in its accounts as a debit brought into account in determining its profits or loss if s320 applied to it. No one has suggested any other basis on which it could be so treated. It would never feature in *Group's* profit and loss account and no one has suggested that it would.

105. Ms Shaw sought support from the accounting treatment that would have arisen if the loan had been waived. We did not find this helpful. Waiver affects the formal rights and obligations of debtor and creditor in a loan relationship. The formal position and economic substance are the same between the two contracting parties, debtor and creditor. The true focus here is the FSA with the loan relationship being a subsidiary relationship between one contracting party (*Group*) and a different (third) party, used as a mechanism to calculate the price payable under the FSA.

106. It was also argued that HMRC's principal contention was inconsistent with s354 and s455A CTA 2009. S354 is concerned with the exclusion of debits for impaired or released connected company debts. However, that section does not appear to be helpful or relevant to the proper construction of s320 or the correct application of the facts as we have found them to be. Neither excludes HMRC's principal argument that the debit is simply not in respect of *Group's* loan relationship with *Transport*.

107. We do not consider s455A to be relevant. S455A(2) could not apply because the debit, as we have found, would *not* be brought into account under s320. Accordingly, there is no debit that would, apart from s455A, be brought into account for the purposes of Part 5 of CTA 2009. S455A does not therefore deal with the circumstances (as we have found them to be) of *Group's* appeal.

108. If we are wrong, and the debit *prima facie* falls to be brought into account under s320, it does not affect our decision on this or any other issues in the appeals, that the debit might also have been caught by s455A (had it been in force, as Mr Ghosh may have been prepared to accept¹⁰⁰). This is because of our findings in relation to the FSA to the effect that one of the main purposes of *Group* and *Holdings* in entering it, was to obtain a tax advantage. Our findings of fact would fall within the definition of *tax advantage* in s1139 of the Corporation Tax Act 2010 subsequently applied to s455A CTA 2009 by s476(1) of CTA 2009. *Tax advantage* includes relief from or the avoidance or reduction of a charge to tax, whether by accrual of receipts in such a way that the recipient does not bear tax on them or by a deduction in calculating profits.

109. We do not need to decide whether the debit would have been caught by s455A. S455A was introduced by the Finance Act 2011, Schedule 4, paragraph 5, and applies to accounting periods beginning on or after 6 December 2010. It has no relevance here and we decline to construe s320 in the light of the subsequent legislative

treatment is not followed....This section provides that a credit or debit which has been capitalised but which is in respect of a loan relationship is, in certain circumstances, to be brought into account (underlining added).

¹⁰⁰ Day 4/37.

enactment of s455A. It is perhaps worth noting that a tax avoidance provision can be applied even if there are other provisions which could be invoked to prevent the avoidance of tax. It is said to be an unremarkable consequence that HMRC should have overlapping taxation powers; such a construction cannot cause any unfairness to the taxpayer since he cannot be taxed twice in respect of the same income.¹⁰¹

110. Nor did we derive assistance from reference to earlier incarnations of the relevant legislation or what were said to be mirror provisions in the derivatives' code. We were referred to FA 1996 s84 and Schedule 9, and FA 2002 schedule 26, as well as to ss595 and 604 CTA 2009 and relative Explanatory Notes.¹⁰² The language and context are not identical¹⁰³ and the analogy advanced, unsupported by authority, was not in our view, persuasive, notwithstanding Ms Shaw's able and powerful presentation. While we accept that it is permissible, where there is ambiguity in rewritten legislation, to refer to a previous legislative iteration,¹⁰⁴ we do not consider it appropriate to do so here. The relevant statutory provisions in the present appeals have been the subject of competing interpretations and submissions, but that does not mean they are ambiguous. Neither party appears to assert that there is statutory ambiguity. Had there been binding authority on an earlier version or iteration of a critical statutory provision, then it might well have assisted us. However, our attention has not been drawn to any such authority.

111. Further, in our view, the principles of double entry book-keeping do not lead to the conclusion that the debit to investments is in respect of a loan relationship. Ms Shaw submitted that double entry bookkeeping is a method of accounting by which a single event is recorded twice in the accounts, once to the credit of one account and once to the debit of another account. We acknowledge that to be correct in principle. The event was said to be the partial derecognition of the loan. The question is to identify the event.

112. We do not agree that the event is the partial derecognition of the loan. That is the credit entry or rather what the credit entry does. The event is the transaction for the recapitalisation of each subsidiary, which is essentially an agreement to subscribe for the issue of shares for a sum, calculated by reference to the loan agreement between *Group* and *Transport*, with a cap on the price of £20m. This is consistent with Mr Drummond's analysis of the nature of the transaction; he referred to *the derecognition through the FSA*.¹⁰⁵ The fact that credit and debit entries arise

¹⁰¹ *IRC v McGuckian* [1997] STC 1 at 11 (per Lord Steyn).

¹⁰² We acknowledge that Explanatory Notes are an admissible aid to construction - see for example *R (Westminster Council) v National Asylum Support Service* [2002] UKHL 38, 2002 LGR 2 at paragraph 5, per Lord Steyn.

¹⁰³ for example, s595(7) has no exact counterpart in s307.

¹⁰⁴ *Eclipse Film Partners (No 35) LLP v HMRC* [2013] UKUT (TCC) 0639, which concerned *inter alia* the nature of trading activity, at paragraphs 97 and 98 where reference back to earlier legislative versions is discouraged unless an applicable provision is found to be ambiguous.

¹⁰⁵ Day 24 (cross); Day 2/20 (questions by the Tribunal). The transaction was *the capitalisation of a subsidiary, simple as that*. Throughout his Report he refers to the *Transaction* as the *recapitalisation*

simultaneously, as Mr Drummond pointed out,¹⁰⁶ seems to us, at the end of the day to be neither here nor there. That is the essence of double entry bookkeeping.

113. More precisely, the event is the entering into the FSAs on 6 October 2010. On that date, rights and obligations were created between *Group* and each subsidiary.
5 The substance of those rights and obligations was reflected in the bookkeeping entries. The debit entry relating to each subsidiary represented the bulk of the anticipated purchase price for or cost of the subsidiaries' shares which were to be issued to ITCO and *Bus*, namely £19,735,543.50. What was booked was an asset not an item of expenditure. The figure inserted reflected the cost of the asset but that, in
10 turn, measures its value under historical cost accounting rules. The credit entry was the partial derecognition of the loan to *Transport*. The event was the entering into the FSA. The, or at least, a consequence was the debit entry reflecting the anticipated price, and the credit entry reflecting in substance the diminished economic interest of *Group* in the loan to its subsidiary even although there had been no actual change in
15 the loan relationship between *Group* and *Transport*. The loan was subsequently repaid in full with interest; that had the effect of capping the calculation of the sum payable in terms of the FSA at £20m. Accordingly, £19,980,000 (£20m less £20,000 - the nominal subscription amount already paid on 7 October 2010) was paid by *Group* to each of the subsidiaries on or about 31 December 2010.

20 114. Finally, we note a further argument for *Group* that it was enough for the debit to be in respect of both the loan relationship and the recapitalisation. That is tantamount to saying that the debit was in respect of the contractual relationship between *Group* and *Holdings* (the FSA/recapitalisation) and between *Group* and *Transport* (the contract of loan).

25 115. We consider that *in respect of* will not bear such duality. While it may be true that the debit has some connection with the derecognition, that is only because the FSA refers to the loan between *Group* and *Transport* as the mechanism for identifying whether the conditional element of the FSA is purified and the amount payable thereunder. The amount payable under the FSA is not a money debt arising
30 from a transaction for the lending of money. The debit reflected by the anticipated price payable for the shares to be issued under the FSA, cannot in any sense be properly described as being in respect of the pre-existing loan relationship. The debit was the purchase price for the shares being created and issued. As such, it did not affect the loan relationship between *Group* and *Transport*; it could not, in any sense,
35 be *in respect of* that loan relationship.

116. Overall, even if Ms Shaw's analysis on cost accounting and the effects of repairing the balance sheet are sound, it does not destroy or even prejudice the simple argument that the debit is *not* in respect of a loan relationship. The existence of the
40 debit is entirely attributable to the FSA and its precise amount attributable to the method of calculating the consideration for the shares by reference to the loan agreement. The making of the debit and the consequent payment of it had no effect

¹⁰⁶ Day 1 page 96 (cross); Day 2 page 22 and 24 (cross).

on the loan relationship between *Group* and *Transport*. The loan was not varied and it was paid in full in accordance with its terms.

117. We answer **issue (aa)** by holding that the debit claimed by *Group* is **not** in respect of a company's loan relationship within s320 CTA 2009.

5 118. On this basis *Group's* appeal must fail. On this basis, too, the receipt notices directed at *Holdings* and *Services* are no longer required. They will fall away and the appeal against *Holdings* must be allowed. Any view we express on the remaining arguments in these appeals will be *obiter*. However, as this decision may be appealed, we give our views on the remaining issues identified in paragraph 46 above.

10 *Issue (a):- whether the deductibility of debits under s320 CTA 2009 is subject to the provisions of section 307(3)*

Issue (b):- whether s307(3) requires the debits and credits to be tested to establish their nature?

15 *Issue (c):- if so, whether the debits (sic) claimed by Group fairly represent losses arising from their respective loan relationships under s307*

119. Issues (a), (b) and (c) do not now arise. Issues (a) and (b) are the second issue discussed by Ms Shaw in her closing submissions and Issue (c) is her third issue. They are all academic because we have held that the debit in question is not deductible under s320 CTA 2009. It was not in respect of a loan relationship within
20 s320 CTA 2009. It is not therefore necessary for us expressly to consider s307(3). However, as the parties wish us to determine these issues, we do so on the basis that their determination is not required for the decision on issue (aa) which we have reached.

120. We have already considered the structure or architecture of part 5 of the 2009 Act. Chapter 3 of Part 5, as s306 itself records, contains rules of general application
25 about the debits and credits to be brought into account for the purposes of Part 5. Both ss307 and 320 lie within Chapter 3. The general rule is that for *credits and debits* (arising from a company's loan relationships) to be brought into account for corporation tax purposes, they must be recognised in determining the company's
30 profit or loss in accordance with generally accepted accounting practice. That is a general rule. Our overall view is that the debit in question does not *arise* from the loan relationship with *Transport*. Even if it did, it does not represent a loss. It cannot therefore *fairly* represent a loss.

121. That general rule¹⁰⁷ is subject to s307(3).¹⁰⁸ It expands the general rule by
35 stating that the credits and debits brought into account in respect of a company's loan relationships are the amounts that, when taken together, fairly represent profits and

¹⁰⁷ S307(2), 292(1)

¹⁰⁸ S307(6)

losses arising from its loan relationships. The fact that it is set out in the third of six subsections¹⁰⁹ is not relevant.

122. S307(3) applies generally to *credits and debits* arising to a company from its loan relationships brought into account for corporation tax purposes. That must include a *debit* allowed by s320. A s320 debit is not expressly excluded from the scope of s307(3). By s320(2), a credit or debit is brought into account *in the same way* as such a credit or debit. To enable it to be brought into account, a s320 debit must therefore comply with s307(3) notwithstanding its accounting treatment (in the balance sheet) in the company's accounts. Any other view makes no sense, because s307(6) requires that any credit or debit, brought into account by generally accepted accounting practice under s307(2), must also meet the requirements of s307(3). If the requirements of s307(3) are not met, then the credit or debit cannot be brought into account, whatever the accounting treatment may have been.

123. What are the ingredients of s307(3)? The credits and debits must be *in respect of Group's* loan relationships. They are not, for the reasons already given. However, assuming that they are, they must, when taken together, fairly represent (i) all profits and losses that arise to it from its loan relationships, (ii) all interest under that relationship, and (iii) all expenses incurred under or for the purposes of that relationship and transaction. We are not concerned with (ii) or (iii). The credit or debit must *arise* from the loan relationship. This raises the question of causal connection. Thus, the way or route for a credit or debit to achieve recognition is there set out. A s320 debit is to be recognised *in the same way*. Thus, the general requirement of fair representation and causation apply to a s320 debit if it is to be brought into account. Neither of these requirements is met.

124. The phrase *in the same way* provides the connection between ss320 and 307(3). Otherwise, it seems to have no function. *Group* appears to read s320(2) as if the words *in the same way as a credit or debit which is brought into account* were omitted. That does not seem to us to be the correct approach. *In the same way* seems to us to refer to the general circumstances in which the credit or debit may be brought into account and these are set forth in s307(3). The Parliamentary draftsman has used a different form of cross reference in s332, perhaps for emphasis because that section is dealing with specific types of financial arrangements (repo or stock lending arrangements).

125. S320 does not say that the credit is to be brought into account *as if it were a credit or debit which has been brought into account in determining the company's profit or loss*. It is therefore necessary to consider the way in which a credit or debit is brought into account in respect of its loan relationships in determining the company's profit or loss. It is only brought into account if it fairly represents a profit or loss arising to it from its loan relationships (s307(3)(a)). That is or at least may be a test over and above the test of generally accepted accounting practice. Normally, if the debit or credit is recognised in accordance with generally accepted accounting practice it will fairly represent a profit or loss.

¹⁰⁹ A point mentioned by *Group* in submissions.

126. *Group* submits that s307(3) should be read as a composite whole and not as a broad anti-avoidance rule applying a generalised notion of fairness; rather, it should not be read in isolation at all but as an element in the process of identifying the relevant accounting debits and credits. Reference was made to *DCC Holdings*¹¹⁰ and to the fact that a company's statutory accounts must give a *true and fair view*.¹¹¹ The suggestion seemed to be that the phrase added nothing and was not intended to be a freestanding enquiry into the worthiness of an accounting credit or debit.

127. As we have concluded that there is no loss (see below), the proper construction of *fairly represent* in s307(3) does not arise. However, we do not, in any event, consider that it can be ignored which seems to be the effect of *Group's* submissions. It may be a question of emphasis or some form of cross-check, but if it is, that fits with our analysis of the relationship and connection between ss320 and 307.

128. In *DCC Holdings*, the main question was whether certain loan transactions (five fixed price repo transactions) gave rise to taxable interest. There was a patchwork of anti-avoidance legislation to consider and a number of difficult issues to resolve. The loan relationship code (and predecessor legislation) was discussed in detail under particular reference to repo transactions. The courts had to determine whether the relevant statutory provisions could be construed so as to avoid what was described as an absurd asymmetrical result, namely DCC's deemed income receipts being different from its deemed interest payments as a borrower which was party to a loan relationship.¹¹² The need for a symmetrical solution lay at the heart of the appeal and came from the statutory purpose of the relevant statutory provisions.¹¹³ The decision in the Supreme Court, affirmed the decision of the Court of Appeal but for different reasons. The result expressly satisfied the equivalent statutory requirement of fair representation.¹¹⁴ *Group's* reference to *composite whole* is presumably taken from paragraph 35 of the Supreme Court's Judgment, where the parties' view of the subsection was adopted without analysis. The views expressed on this point in the Court of Appeal by Moses LJ were doubted, but without explanation. In the Court of Appeal,¹¹⁵ Moses LJ, clearly thought that s84(1) contained two distinct criteria applicable to the sums to be brought into account, the first being the accounting method and the second being that the sums should when taken together fairly represent all the interest under DCC's loan relationships.¹¹⁶ This, he said, gave rise to the possibility of some adjustment. Rix LJ said the statutory phrase *taken together*

¹¹⁰ [2010] UKSC 58, 2011 1 WLR 44, [2011] STC 326 at paragraph 35; 2009 EWCA Civ 1165.

¹¹¹ Companies Act 2006 ss393-396.

¹¹² Paragraph 25.

¹¹³ Paragraph 26.

¹¹⁴ Paragraph 43. The relevant provision was section 84(1) of FA 1996 which provided *inter alia* that *The credits and debits to be brought into account in the case of any company in respect of its loan relationships shall be the sums which, in accordance with an authorised method of accounting and when taken together, fairly represent.....(a) all profits, gains and losses of the companywhich arise to the company from its loan relationships.....*

¹¹⁵ 2010 STC 80 where a more readable and comprehensible summary of the facts is to be found.

¹¹⁶ Paragraphs 13, 63.

fairly represent were important words and had to be given their full effect; this was a matter for the court rather than expert evidence.¹¹⁷

129. Whatever view one takes of the statutory phrase, it does not affect our overall decision on any of the issues discussed.

5 130. The questions therefore come to be *Was there a loss? If so Did the loss arise to Group from its loan relationship with Holdings?* In our view, the answer to both questions is No. The debit does not represent a loss at all. It represents the future economic benefit of an investment by a parent company into one of its subsidiaries over which it has complete control, whether directly or indirectly. It undertook contractual obligations to make capital contributions to its subsidiaries, calculated by reference to its loan previously granted to another subsidiary (*Transport*). No loss was made by *Group* which arose from its loan relationship.

15 131. The sum paid by *Group* to *Holdings* on or about 31 December 2010 (£19,980,000) implemented the final part of *Group's* obligations under the FSA. It had already paid £20,000 on 7 October 2010. The sums paid to *Holdings* came from *Group's* general funds rather than an assignation of the right to the actual receipts of the loan relationship. The loan was not assigned in whole or in part.

20 132. Accordingly, the debit in question does not represent a loss of *Group* that arises to it from its loan relationships. It represents the cost of a capital investment. Such a cost, however expressed, has no place in a company's profit and loss account, unless s320 magically converts, by some unintended process of fiscal alchemy, the transfer of *Group's* funds from one corporate pocket to another corporate pocket, both under its ultimate control, into a tax relievable debit. In our view, it does not do so.

25 133. The debit thus does not arise from a loan relationship at all, but from the contractual obligations in the FSAs. In terms of the Loan, *Transport* borrowed money from *Group* long before the FSAs were entered into. *Transport* repaid the whole loan plus the contractual interest. That transaction made a profit (not a loss) for *Group*, namely the receipt of interest at the contractual rate and repayment of the loan in full.

30 134. It was, however, submitted by *Group* (on the assumption that the debit to investments fell within s320) that it fairly represented a *loss* arising from its loan relationship. This is a reference to the loan relationship with *Transport*. Reliance was placed on a dictionary definition of *loss* as meaning being *deprived of* or *ceasing to have*. That led to the argument that the debit represented the partial deprivation of *Group's* loan relationship. This argument does not stand up to close scrutiny. We do not regard the debit as a loss at all. It arises from and because of the FSA which was a contract to subscribe for shares at a price calculated by reference to *Group's* loan relationship with *Transport*. There is no loss to *Group* in any real sense. The definition of *loss* may also connote disadvantage or detriment. There is none here. The deprivation of part of the loan is balanced by the additional carrying value attributable to its fixed assets, namely its further investment in its subsidiaries,

¹¹⁷ Paragraph 97

measured by the cost of doing so, ie the price specified in the FSA. If there is a loss, it *arises* not from the loan relationship, but from the FSA.

135. In support of the argument on the meaning of *loss*, we were also referred to *Explainaway Ltd v HMRC*¹¹⁸ which concerned the effectiveness of tax planning designed to avoid corporation tax which would otherwise have arisen on the disposal of certain shares by means of derivative transactions. The scheme ultimately failed entirely, on appeal to the Upper Tribunal. Both the First-tier and the Upper Tribunals applied the *Ramsay* approach or principle to statutory references to *profits or gains* and *loss*. This meant real profits or losses as opposed to arithmetical differences. The Upper Tribunal, contrary to the view of the First-tier Tribunal, found that there was no loss as the transaction in question was self-cancelling, noting that the relevant statutory provisions were concerned with gains and losses having a commercial reality.¹¹⁹ The emphasis on losses having a commercial reality does not assist *Group* even although the statutory context is different. It is difficult to see how the *inter* group transactions created a commercial loss, or any form of disadvantage or detriment, so far as *Group* was concerned. They purchased shares which were directed to be issued to another subsidiary under their complete control. The expenditure was made in consideration for the issue of shares. The book entries reflect neither a gain nor a loss. There is no other evidence suggesting that there was a real loss at any stage. Such entries are intended to reflect the substance of transactions which has a clear resonance with the notion of commercial reality. Here, the reality is that the *loan receivables* were not lost, as Ms Shaw put it.¹²⁰ They were in-gathered in full with interest, and a sum from *Group's* general funds was expended in implement of *Group's* obligations under the FSAs. *Group* recorded an asset in its books which pound for pound represented future economic benefit and matched the so-called loss of the loan receivables. The assumption in the accounting treatment is that future economic benefit will be obtained from the investment.¹²¹ That is simply not a loss at all.

136. In the course of the hearing, our attention was drawn to *Abbey National Treasury Services Plc v HMRC*.¹²² There, the First-tier Tribunal considered *inter alia* whether a substantial sum was deductible as a debit arising from certain derivative contracts. That tribunal concluded that there was no loss arising from the derivative contracts and dismissed the appeal. In doing so, the tribunal expressly considered and gave content to (under reference to *DCC Holdings*) the statutory phrase *fairly represents*¹²³ as a restraint on accounting treatment that is divorced from commercial reality. It also considered whether the debit in question arose from a derivative contract. The tribunal's approach was to identify what triggered the debit, and to

¹¹⁸ [2012] UKUT 362 (TCC).

¹¹⁹ Paragraphs 46-48, 52 and 54.

¹²⁰ Day 2/93 submissions.

¹²¹ As Mr Drummond observed- Day 2/27 (cross).

¹²² TC/2012/02613 released 14/7/15.

¹²³ Paragraphs 29 and 86.

consider whether there was a direct nexus between the debit and the derivative contract, rather than a more remote causal link or connection.¹²⁴ Adopting that approach, the tribunal concluded that the loss in question did not arise from a derivative contract.¹²⁵

5 137. The tribunal's approach in *Abbey* in relation to similar statutory language is consistent with our approach to ss320 and 307 CTA.

138. Overall, it seems to us that there is a serious tension between *Group's* argument that partial derecognition of the loan constituted a loss of loan receivables but that it was not cancelled out by the additional cost of *Group's* investment in *Holdings*. That cost is entered in the balance sheet and is used to measure the additional investment adding to the carrying value of *Group's* fixed assets. The FSA itself repaired the balance sheet of each subsidiary with its anticipated injection of up to £20m cash. Repairing a balance sheet improves the overall financial picture of a company. It gives it more substance, and becomes more attractive to traders. We find it difficult to see how the debit to investments fairly represents a *loss* to *Group* in any meaningful sense.

139. Here, generally accepted accounting practice does not classify the cost of the investment (the debit to investments) as a loss or a deficit but as an addition to the balance sheet. It is impossible to see how such an amount can fairly represent a loss which is what is claimed here, particularly as there was no loss to *Group* arising out of its loan relationship with *Transport*. It is difficult to accept that a loan relationship on which a creditor receives full payment including interest and thus made a profit, somehow yields a relievable loan relationship loss. It is counter-intuitive to say the least.

140. Reference was also made on behalf of *Group* to s465 of CTA 2009 (which concerns amounts which fall to be treated as distributions) as being an example of an exclusionary rule, to be contrasted with s307(3) which was said to be an *inclusionary rule*. Again, we did not find this helpful. S307(3) can be described as exclusionary or inclusionary. S307(2) states the general proposition under reference to generally accepted accounting practice. S307(3) is more specific. Thus, a debit when taken with other credits and debits, must fairly represent a profit or loss, interest or expenses, arising from, under or for the purposes of loan relationships or related transactions. That is the way that these credits and debits are to be brought into account. Any other debit or credit is excluded. Thus, as we have explained, capitalised interest falls within ss320 and 307(3).

141. Accordingly, even if, contrary to our view, the debit to investments, as a contribution to the capital of a subsidiary, is somehow a debit in respect of a loan relationship and falls within s320, it does not fall within the debits specified in s307(3) and cannot be brought into account in determining *Group's* profit and losses for corporation tax purposes.

¹²⁴ Paragraph 97.

¹²⁵ Paragraph 98.

142. For the foregoing reasons we answer **issue (a)** by holding that the deductibility of debits under s320 is subject to the provisions of s307(3). We answer **issue (b)** by holding that s307(3) **requires** the debits and credits to be tested to establish their nature. We answer **issue (c)** by holding that the debit claimed by *Group* **does not** fairly represent losses arising from its loan relationships under s307.

*Issue (d):*¹²⁶ *whether there is an amount to be brought into account under the relevant provisions of the TIOPA 2010, and in particular, whether the receipt scheme conditions in s250 TIOPA 2010 were satisfied.*

143. This part of the appeal proceeds upon the basis that, contrary to the view of HMRC and contrary to our decision in relation to issue (aa), and our views on Issues (a), (b) and (c), the sum of £39,471,087 is deductible in terms of ss320 and 307, or 320 (without the need to meet the terms of s307 CTA 2009), and is thus properly brought into account as a relievable expense for the purpose of calculating *Group's* liability for corporation tax. It is not therefore necessary for us expressly to consider TIOPA. However, as the parties wish us to determine these issues, we do so on the basis that their determination is not required for the decision on issue (aa) which we have reached.

144. Tax arbitrage is the exploitation of asymmetries between different tax regimes to achieve a reduction in the overall tax liability of entities such as companies, often in a group. Usually, there is a mismatch between two tax regimes or codes; one example is where there is a tax deduction by one company which is not matched by a taxable receipt in the hands of another company. Similar or identical transactions may be characterised or classified in different ways by different tax codes giving rise to the opportunity to seek a reduction in tax liability or some other tax advantage. Such mismatches and other contrived arrangements to avoid liability to tax have been the subject of anti-arbitrage rules such as those now contained in Part 6 of TIOPA 2010.

145. Part 6 provides for the service on companies of two kinds of notice, deduction notices and receipt notices as a result of which the company must calculate or recalculate *inter alia* its liability to corporation tax less advantageously. We are concerned with a receipt notice, dealt with in ss249-254 TIOPA 2010. In broad terms, HMRC may give a UK resident company a receipt notice if it considers, on reasonable grounds, that the receipt scheme conditions are or may be met in relation to that company.¹²⁷ There are four receipt scheme conditions (A, B, C and D). Essentially, the receipt notice triggers liability, if the company has received a payment in a transaction which is a contribution to its capital, and which payment is deductible for corporation tax purposes by the payer but is not chargeable as part of the company's income arising from the transaction and is not otherwise taxable. It is also

¹²⁶ We have already noted that Issue (e) no longer arises.

¹²⁷ S249

a condition that, on entering the scheme, the company and the paying party must have expected a benefit to arise because the payment or part of it was not taxable.¹²⁸

146. Satisfaction of the scheme essentially identifies a mismatch. There is to be assumed, contrary to our view, a deductible sum in the hands of *Group* (by reason of s320 CTA) but no corresponding charge of the same sum to corporation tax in the hands of *Holdings*. This, so the argument runs, creates a mismatch defeating the underlying purpose of much fiscal legislation, namely to produce fiscal symmetry by giving a right of deduction in respect of any payment which gave rise to a liability to tax in the hands of the recipient. If the receipt scheme notice is well-founded and the conditions thus met, the payment, already deductible in the hands of the payer (*Group*) becomes a chargeable payment taxable in the hands of the recipient (*Holdings*) thus correcting the mismatch and restoring fiscal symmetry.

147. If the receipt scheme conditions are satisfied, a further issue is whether the contingent subscription amount is, nevertheless, not actually chargeable to tax in the hands of *Holdings* under any relevant legislation.

148. We therefore begin by considering each of the receipt scheme conditions in turn. **Receipt scheme condition A** is that

a scheme makes or imposes provision as between the company and another person (“the paying party”) by means of a transaction or series of transactions.

149. Here, *Group* is the paying party. *Holdings* is the company. The transaction is the FSA. We consider the nature of the transaction in more detail below.

150. *Group* accepts that receipt scheme condition A has been met. We therefore say no more about receipt scheme condition A.

151. **Receipt scheme condition B** is that

that provision includes [*Group*] making, by means of a transaction or series of transactions, a payment-

(a) which is a qualifying payment in relation to [*Holdings*], and

(b) at least part of which is not an amount to which section 251 (amounts within corporation tax) applies.

152. S250(4) provides that a receipt is a qualifying payment in relation to [*Holdings*] for the purposes of this section and sections 251 to 254 if

it constitutes a contribution to the capital of [*Holdings*]

153. HMRC say that the undertaking given in Clause 3.1 of the FSA together with the actual payment in December 2010 constitutes the *contribution to the capital* of *Holdings*. HMRC accept that the *payment* has to be a payment in cash otherwise there

¹²⁸ S250 where the details are more fully set out.

could be no contribution to the capital of *Holdings*. The natural meaning of *contribution* was when the money came in.

154. *Group* say that the FSA itself when entered into was a valuable asset which *Group* recorded in its books. The rights under the FSA could have been assigned for cash. The FSA was the capital contribution. A capital contribution need not be made in cash. The recognition of the event on entering into the FSA in October 2010 was a capital contribution. The obligation to pay created by the FSA could not be regarded as *payment* within the ordinary meaning of that word. The actual payment in December 2010 did not contribute or further contribute to the capital of *Holdings*. It satisfied an existing obligation but was not a contribution to capital. Under reference to an HMRC Manual,¹²⁹ *Group* argues that the payment has to *directly* increase the company's capital. Accordingly, *Group* submit that receipt scheme condition B has not been met.

155. There was no dispute about paragraph (b) (s251 etc). It has been met. The payment was *not* an amount within the charge to corporation tax.

156. In our view, receipt scheme condition B has been met. The provisions require that a payment be made and that it is a contribution to the capital of *Holdings*. The argument that the injection of about £19.8m into *Holdings* was somehow not a contribution to its capital cannot be accepted.

157. It was put to Mr Drummond in cross-examination that, as at 6 October 2010, an asset of £20m would be recognised in the subsidiary (*Holdings*).¹³⁰ He accepted that proposition. That sum must represent the value of the right to obtain payment of the contingent subscription sum on or about 31 December 2010. There must, as a matter of common sense, be a material difference in the eyes of a creditor or third party between the right to payment and the receipt of such payment. While the difference may be more theoretical than real in the context of inter-group dealings, that cannot be said to be correct where a third party is involved.

158. Whatever effect the accounting treatment had in October 2010, the fact is that *Holdings* had about £19.8m more liquid funds on 31 December 2010 than it did on 29 December 2010 or earlier. From the stand point of a trader or creditor of *Holdings* that must be viewed as a significant contribution to its capital thereby increasing it for all practical purposes, and making it a more attractive (or less unattractive) business with which to do business or against which to enforce its rights.

159. The purpose of part 6 of TIOPA 2010 is to redress the imbalance created by statutory mismatches which have been deployed to create a tax advantage. We endeavour to take a practical and realistic view of the facts. Adopting that approach, the payment of some £19.98m cannot simply be ignored because of a technically correct accounting entry.

¹²⁹ INTM595560.

¹³⁰ Day 1/107.

160. If it is assumed that the purpose or main purpose of the transaction was to repair the balance sheet of *Holdings*, then the accounting entries in the books of *Holdings* must have led to an improvement in its balance sheet reflecting the rights conferred by the FSA. However, it is difficult to see how those rights could have been enforced by a creditor on insolvency. In any event, once the FSA is implemented by issue of shares in ITCO and payment of £19.98m¹³¹ or thereby by *Group* to *Holdings*, the position of any creditor of *Holdings* must be improved. Their rights are enforceable against the increased funds of *Holdings*; they will or at least may be paid Xp more in the £ on liquidation than they would have been paid had the FSA not been implemented. In that sense, the transaction (the FSA) involves two parts both of which make a contribution to the capital of the company. Thus, the actual payment in December 2010 constitutes a contribution to the capital of *Holdings*. It makes no sense to hold that such an injection of funds makes no contribution at all to the capital of *Holdings*. The statutory provision expressly contemplates the making of a payment by means of a series of transactions.

161. We therefore see no difficulty in considering the FSA as a transaction with several components both of which form part of the payment process. The provisions of the FSA thus *include* the making of a payment that constitutes a contribution to the capital of *Holdings*. The actual amount of the payment is part of the overall transaction, and it is that payment with which ss250 and 254 are concerned. It is a direct payment which plainly contributes to the capital of *Holdings*. It directly increases the core value of *Holdings* as represented by its value to shareholders as noted in the HMRC Manual founded on by *Group*.¹³² Receipt scheme condition B is therefore met. To hold otherwise would be to take too narrow a view of the facts and the statutory purpose of Part 6 and, in particular, receipt scheme condition B.

162. Put more simply, the ordinary meaning of *contribution* to the capital of a company is or at least includes, as Mr Ghosh put it, when the money comes in.¹³³ It is difficult to avoid the conclusion that a contribution to the capital of the subsidiary was made when actual payment occurred as part of the overall transaction.

163. *Dicta* relied on by *Group* as to the scope of complex but carefully articulated provisions in a different statutory context, such as *First Nationwide*, do not negate the conclusion we have reached. The Court of Appeal was there drawing the distinction between the creation of shares (acquisition by subscription), and the purchase of existing shares by transfer in relation to a repo transaction.¹³⁴ It was not considering the scope of the word *payment*. While we recognise the juridical difference between an obligation to pay, and the implementation of that obligation, that does not affect our conclusion that, in the circumstances as we have found them to be, receipt scheme B is met.

¹³¹ The correct figure is £19,735,543.50 per HMRC revised Statement of Case paragraph 52

¹³² INTM595560

¹³³ Day3/104

¹³⁴ Paragraphs 30 and 31.

164. **Receipt scheme condition C** is that

on entering into the scheme [*Holdings*] and [*Group*] expected that a benefit would arise because at least part of the qualifying payment was not an amount to which section 251 applies.

165. For present purposes, it is sufficient to say that s251 applies to amounts which are income or chargeable gains for the purposes of Corporation tax. An amount to which s251 does not apply is essentially non-taxable.

166. HMRC say that the mismatch of the tax treatment between *Group* and *Holdings* was the benefit they both expected. Tax relief for the debit and no tax charge for the receipt of the subscription amount in the hands of the subsidiary, *Holdings*, is a benefit. That was the advice *Group* and *Holdings* received from their tax accountants and lawyers.

167. *Holdings* say that the condition does not apply because (i) the UK tax code does not impose tax on receipts of subscriptions for share capital; no liability to tax is being avoided (ii) the fact of non-taxation is not a benefit within the meaning of receipt scheme condition C because a payment is only a *qualifying payment* if it is non-taxable; this would make receipt scheme condition C redundant, as, if receipt scheme condition B were satisfied, receipt scheme condition C would automatically be satisfied; the whole focus of the provisions is on receipt. Reference was made to the HMRC Manual,¹³⁵ to the Explanatory Notes to the Finance Bill 2005 and to *Biffa (Jersey) Ltd v HMRC*¹³⁶.

168. This raises questions of fact as to what evidence there is about the expectations of *Group* and *Holdings*. The corporate structure of the companies in the group, the evidence about it and the appellants' evidence generally require us to consider them together. Either the appellants both had such expectations or neither had any. In our view, it is clear from the facts as we have found them to be, that *Group* and *Holdings*, expected that a benefit (within the meaning of receipt scheme condition C) would arise. That expectation arose from the advice given to them prior to entering into the FSA. They chose the structure of the FSA and entered into it to achieve a benefit. The benefit which *Group*, and *Holdings* expected to arise on entering into the FSA was that the cost of investment (the £20m or thereby) would be a relievable expense (reducing *Group's* taxable profits) and that there would be no taxable charge on *Holdings* as recipient of that sum.

169. The two aspects of the benefit plainly go together. Both are needed to make the scheme work. Otherwise, the tax liability is moved around the group but is not eliminated or reduced. It either remains with *Group* who are taxed on £20m or thereby which is not relieved from liability, or it is transferred, as a tax relievable expense, to *Holdings* who are taxed on the £20m in accordance with well-known principles of tax symmetry. On the facts as we have found them to be, *Group* and *Holdings* (Mr Hamilton being a director of both) expected both aspects of the

¹³⁵ INTM595570 and 598140.

¹³⁶ [2014] UKFTT 982 (TC) paragraph 69.

perceived benefit to arise and liability to tax on that sum of £20m avoided within any part of the group.

170. HMRC in its Manual explains that a benefit arises as a result of the receipt escaping taxation in the absence of the arbitrage legislation.¹³⁷ Elsewhere in its Manual, and referred to by *Holdings*, it states that one of the conditions to be satisfied is that the arbitrage (a mismatch in tax treatment) is a reasonable expectation of the parties to the scheme.¹³⁸ The Explanatory Notes to clause 106 of the Finance Bill 2005 to which we were referred by *Group*, explain that arbitrage is the exploitation of differences between or within national tax systems. This, it says, can result in a deduction being given for a payment when tax on the corresponding receipt has been avoided.¹³⁹

171. Leaving aside the weight which may be attached to such materials, we accept that it is difficult to say that tax on receipt of the contingent premium would have been avoided or that the result would have been that the receipt would escape taxation. Such a receipt, as a contribution to the capital of a company, would (but for effective arbitrage legislation) never have been subject to tax under UK law.

172. However, the language of the Manuals and the Explanatory notes are not the language of the statutory conditions. In any event, for what it is worth, the HMRC Manual (in a passage founded on in *Group* and *Holdings*' Skeleton Argument¹⁴⁰), states that a mismatch itself is a reasonable expectation of the parties to the scheme.

173. The focus of receipt scheme condition C is the *benefit* that would arise. For receipt scheme condition C to bite, receipt scheme condition B (payment not subject to corporation tax) will already have been met. Receipt scheme condition C, using language¹⁴¹ almost identical to receipt condition B,¹⁴² links the satisfaction of receipt condition B with the condition required by receipt scheme condition C, namely the expectation that a *benefit would arise*. We do not see that as duplication, or as a flaw in our analysis. The legislation does not require that the expected *benefit* arises to the company (*Holdings*) rather than the paying party (*Group*) or vice versa. Here, when the FSA was entered into, *Group* and *Holdings* had an expectation, based on advice received, that both aspects of the benefit discussed above, would arise.

174. In *Biffa*, similar arguments to those advanced by *Holdings* were rejected by the tribunal.¹⁴³ There, as a result of a number of transactions, one company in a group (BHL) became entitled to deduct about £14m as an expense as deemed interest on a

¹³⁷ INTM595550.

¹³⁸ INTM5995520.

¹³⁹ Paragraphs 1 and 15.

¹⁴⁰ Paragraph 120; INTM595520.

¹⁴¹ *not an amount to which section 251 applies*.

¹⁴² *(amounts within corporation tax)*.

¹⁴³ Paragraphs 67-69.

deemed loan from another company in the same group (BJL). The issue was whether BJL was liable to tax on the deemed interest. BJL said the transactions were genuine commercial transactions designed to recapitalise the main company in the group.¹⁴⁴ HMRC said it was a tax avoidance scheme designed to achieve a corporate tax deduction for BHL without any corresponding taxable receipt for BJL.¹⁴⁵ HMRC's primary argument, based on its analysis of FA 2003 s195, was upheld by the First-tier Tribunal and led to the dismissal of the appeal.¹⁴⁶

175. As an alternative, HMRC invoked the tax arbitrage provisions then in force.¹⁴⁷ The equivalent of receipt scheme condition C was Condition E quoted in paragraph 45 of the tribunal's decision. The tribunal held that Condition E was satisfied. In particular, the tribunal did *not* accept that, in considering whether Condition E was satisfied, it could only have regard to the tax treatment of the qualifying payment as a contribution to capital. It considered that it should also take into account the (assumed) fact that the sum of £14m was deductible;¹⁴⁸ thus, the two companies intended that the arrangements would produce a benefit (a corporation tax deduction for BHL without any corresponding taxable receipt for BJL).¹⁴⁹

176. It was submitted that *Biffa* was wrongly decided, but in any event distinguishable on the basis that here, the debit (not the payment) was allowable under s320. That seems to us to be a distinction without a difference. The tribunal's views on Condition E in *Biffa* were *obiter*. However, we detect no flaw in its approach, which accords with our own view and with the general principle of tax symmetry.

177. To say, for the reasons advanced by *Holdings*, that receipt scheme condition C is not met is to take too narrow a meaning of *a benefit*. If *Holdings'* argument is correct, then receipt scheme condition C can never be satisfied because a contribution to the capital of a company is never of itself income or gain to that company. Receipt scheme condition C contains a simple causative test linking *benefit* with non-taxability. While non-taxability may rarely be in issue, the question of *benefit* will often be in issue.

178. We therefore do not agree that we can only have regard to the tax treatment of the qualifying payment as a contribution to capital. We can and should take account of the treatment of the debit under s320 on the assumption, contrary to our views, that it is allowable and the subscription price is brought into account. Here, as we have explained, tax relief on the debit and no tax charge on the receipt constitute a benefit for *Group* and/or *Holdings*. That constitutes *benefit* within any reasonable construction of that phrase as it appears in receipt scheme condition C. The statutory

¹⁴⁴ Paragraph 5.

¹⁴⁵ Paragraph 6.

¹⁴⁶ Paragraphs 6 and 8.

¹⁴⁷ Paragraph 7; F(No)A 2005 ss26 & 27.

¹⁴⁸ The tribunal was proceeding here on the basis that it was wrong to give effect to HMRC's principal argument. In the event, it held that not all the arbitrage conditions would have been satisfied.

¹⁴⁹ Paragraph 69.

focus is on the benefit expected to arise *on entering into the scheme*. In short, by that stage, the benefit expected was a tax relievable debit without any liability to tax in the hands of the recipient subsidiary.

179. Ultimately, the question is whether there was an expectation that a benefit would arise. The statutory language does not identify who the recipient of the benefit is expected to be. Whoever it is must include *Holdings or Group* or both. It might even extend to any company within the group as that would indirectly, at least benefit the ultimate holding company, *Group*. Here, it is clear that *Group* benefits as it would secure a tax relievable debit, and consequent reduction in its profits for corporation tax purposes, and its subsidiary, *Holdings*, is not taxed on the receipt. That creates an obvious mismatch, and an infringement of the principle of tax symmetry; the mismatch is remedied by this and the other conditions of the arbitrage rules.

180. **Receipt scheme condition D** is that

there is an amount in relation to the qualifying payment that-

- 15 (a) is a deductible amount, and
(b) is not set against any scheme income arising to [*Group*] for income tax purposes or corporation tax purposes.

181. A deductible amount is one available as a deduction for the purposes of the Tax Acts.¹⁵⁰ Here, the deductible amount is the (assumed) allowable debit under s320. *Scheme income* means income arising from the transaction or transactions forming part of the scheme.¹⁵¹ There is none here.

182. HMRC say that the debit claimed by *Group* is the tax deductible amount which arises because of the FSA, which contains the contractual obligation on the part of *Group* to make a contribution to the capital of *Holdings*. Absent the FSA, there would be no debit to seek. Accordingly, the deductible amount relates to the qualifying payment. It is *in relation to* it.

183. *Holdings* say that it is not the payment of the contingent premium that is deductible, but the amount of the derecognised loan that is brought into account in determining the value of *Group's* investments in *Holdings* that is deductible. There is no direct link between the payment and the deduction. If *Transport* had defaulted on the loan there would have been no contingent premium paid and thus no qualifying payment made but the debit would have remained intact. *Holdings* also point out that the timing, amount and nature of the payment are each different from that of the deductible amount.

184. In our view, this condition is met. The facts, as we have found them to be, make it plain that there is a relationship between the deductible amount and the qualifying payment for the simple reasons advanced by HMRC. The link seems to us

¹⁵⁰ This includes the Income Tax Acts and the Corporation Tax Acts; see Interpretation Act 1978 Schedule 1.

¹⁵¹ S250(7).

to be inextricable. Whether it is described as *direct* does not matter as that is not the language of the condition. The phrase *in relation to* is a broad phrase unlike *in respect of* which is generally more pointed having a direct causative flavour to it. There is a relationship between the deductible amount and the qualifying payment, that is neither remote nor fanciful. That is enough.

185. It does not accord with our understanding of the accounting evidence and generally accepted accounting practice that if *Transport* had defaulted on the loan, the debit would have remained intact. While the debit entry would have remained, it would not have remained intact. It would be affected by other entries in *Group's* books recording and reflecting the default. The profit and loss account would have been debited with the balance of the unpaid loan. The *Loans* account would have been credited with the same amount. This eliminates the loan balance as an asset in the balance sheet. If the carrying value of the investment needed to be repaired (reducing its value in the balance sheet) then *Investments* would be credited and the Profit and Loss account would be debited.

186. There would be no entries on default in *Transport's* books. In *Holdings'* books the profit and loss account would be debited and the asset would be credited in the balance sheet (thereby eliminating or writing it off); it having previously been recognised as an asset when the FSA was entered into.

187. Finally, we consider that any differences in the timing, amount and nature of the payment and the deductible amount are not material as they do not destroy the relationship between the deductible amount and the qualifying payment which we have identified. That relationship exists and that is sufficient to meet the requirement of the condition. No specific issue on quantum has been raised.

188. The receipt scheme conditions have been met. The consequence is that, if we are wrong in our conclusion that there is no allowable s320 debit, then *Holdings* are under obligation to recalculate its liability to corporation tax for the period specified in the Notice to *Holdings* dated 27 September 2013. On that basis, the Notice and the amendments to *Holdings'* corporation tax return for the period ending 30 April 2011 stand good, and *Holdings'* profits for that period remain increased by the sum of £19,735,543.50.¹⁵²

189. We answer **issue (d)** by holding that there **is** an amount to be brought into account under the relevant provisions of TIOPA. We hold that the receipt conditions in section 250 thereof **were** satisfied.

Issue (f):- whether there could be a charge to tax under Case VI of Schedule D in the relevant periods, as stated in HMRC's closure notices

190. Our view on this issue is also *obiter*. The surprising argument for *Holdings* is that even if it is required to recalculate its income so as to bring £19,735,543.50 into

¹⁵² See paragraphs 9-13 above.

account, there is no mechanism for charging that amount to tax. *Holdings* say that s254 TIOPA is not a charging or application provision; nor is TIOPA a charging Act.

191. It is argued that the charge to corporation tax in s2(1) CTA 2009 only has effect when it is applied by another provision of the legislation such as s35 (profits of a trade), s299 (non-trading profits in respect of loan relationships), and s979 (see below). Such charging provisions are distinct from calculation provisions such as s46 (calculation of trading profits) and s301 (calculation of trading profits from loan relationships).

192. *Holdings* point out that the statutory predecessor of s254 TIOPA¹⁵³ deemed the relevant part of the qualifying payment to be income chargeable under Case VI of Schedule D. However, Schedule D Case VI was repealed for accounting periods ending on or after 1 April 2009. S979 CTA 2009 replaced the repealed provisions by creating a charge to corporation tax on income not otherwise charged. *Holdings* submit that that provision contained an exemption for *deemed income*.¹⁵⁴ Accordingly, s979 cannot apply and, as there is no other statutory charge on s254 amounts, they fall outwith the scope of the charge to corporation tax. This view is said to be supported by paragraphs 2501 and 2496 of the Explanatory Notes to CTA 2009.

193. The consequence, says *Holdings*, is that there is no charge to corporation tax that can be applied to the s254 amount; accordingly, *Holdings'* appeal must be allowed.

194. HMRC now say that s254, in terms, contains a charging provision. No question of deeming arises. Accordingly, s979 is not needed. If it is, then the charge is for miscellaneous income under s979(1).

195. In our view, if *Holdings'* argument were sound it would lead to an absurd result. The tax arbitrage provisions would be sterilised. There would be no means of enforcement and *Holdings* would escape the consequences of their liability. Parliament, in enacting legislation, will not normally, if ever at all, be taken to have intended such absurd consequences. The courts (and tribunals) will not usually, if ever, construe legislation in a manner which leads to such absurd results.

196. The history of the legislation and the current statutory provisions show that such absurd consequences were neither intended nor created. The predecessor of s252(2) of TIOPA is s27 FA (No 2) 2005. That sub-section provided that the company in question had to recompute its income or its liability to corporation tax

as if the relevant part of the qualifying payment were an amount of income chargeable under Case VI of Schedule D.

¹⁵³ Finance (No 2) Act 2005 s27, until 1 April 2009 when it was amended by CTA 2009 Schedule 1 paragraphs 668 and 671.

¹⁵⁴ S979(2)(c).

197. That provision was amended by CTA 2009¹⁵⁵ for accounting periods ending on or after 1 April 2009. The equivalent provision became

as if the relevant part of the qualifying payment were a receipt of the company which is chargeable for that period under the charge to corporation tax on income.

5 198. The amended s27 was rewritten and replaced by s254(2) TIOPA for accounting periods beginning on or after 1 April 2010.¹⁵⁶ The equivalent provision became

as if so much of the qualifying payment as falls within subsection (3) were a receipt of the company that is chargeable for that period under the charge to corporation tax on income.

10 199. This change was not intended to change the law. In general, the continuity of the law is preserved in a tax rewrite as is made clear by TIOPA s377 and schedule 1 paragraph 1.

200. The change founded on occurred when CTA 2009 was enacted. The purpose of that Act was to restate the existing law relating to corporation tax along with various changes. A re-labelling exercise was carried out which removed Case VI of Schedule D from tax legislation.¹⁵⁷ It was replaced in a variety of ways,¹⁵⁸ including by the use of the phrase *the charge to corporation tax on income*.¹⁵⁹ These are essentially administrative changes as paragraph 36 of Explanatory Notes to CTA 2009 records.

201. The charging provisions were accordingly not removed. Ss2 and 5 CTA 2009 impose a charge on profits that is to say income and chargeable gains. *Holdings* require to recalculate their income on the basis that the qualifying payment is chargeable to corporation tax.

202. S979 CTA provides that the charge to corporation tax on income applies to income that is not otherwise within the application of that charge under the Corporation Tax Acts. However, that sweeping up provision does not apply to *deemed income* (s979(2)(c)), or to annual payments or income otherwise exempted. Subsection (2) is essentially concerned with exemptions.

203. The Explanatory Notes to this section provide *inter alia* that subsection (2) disapplies the charge to “deemed income”. This term refers to amounts that are treated as income by a provision of the Corporation Taxes Acts, so that the charge to corporation tax on income applies to that amount. The disapplication applies in the event that such deemed income would not fall within any other application of the charge to corporation tax on income.

¹⁵⁵ Schedule 1 paragraphs 668 and 671.

¹⁵⁶ TIOPA s381(1)(a); the repeals were effected by TIOPA Schedule 1 Part 3 paragraphs 151, 152, and Schedule 10 Part 3.

¹⁵⁷ See for example CTA 2009 Schedule 1 paras 82.

¹⁵⁸ See for example CTA 2009 Schedule 1 paragraphs 238, 463, 468, 492, 538, 584, 725.

¹⁵⁹ See CTA 2009 Schedule 1 paragraph 220.

204. In other words, if deemed income is caught elsewhere in the Corporation Taxes Act it remains caught and subsection (2) does not extinguish liability. If there is no other charging provision for deemed income, then the sweeping up provision does not catch it either as it is disapplied to such deemed income by subsection (2)(c).
- 5 205. S254 TIOPA explains how tax on a qualifying payment is to be charged. It does so by reference to the sum specified in the receipt notice. It is charged on so much of the payment as meets receipt scheme condition D, and it must not be an amount to which s251 applies ie an amount chargeable to corporation tax.
- 10 206. The company must calculate or re-calculate its income for the relevant period as if the qualifying payment (insofar as receipt scheme condition D is met in relation to it) were a receipt chargeable to corporation tax. Ss255-257 make provision for amendment of returns, closure notices and discovery assessments consequent upon the service of receipt notices. It is plain from these and other provisions that a charge to corporation tax is imposed on the receipt or the relevant part of it. It becomes part
15 of *Holdings*' income as re-calculated. S979 therefore has no application because the re-calculated income *is* otherwise charged under the Corporation Tax Acts.
- 20 207. It seems plain that the combined effect of these provisions is to impose a charge to corporation tax on the relevant part of the amount that has been the subject of a receipt notice. That amount is to be treated as if it were a receipt that is chargeable under the charge to corporation tax on income.
208. That amount is a sum that *is* within the application of the charge to corporation tax on income under the Corporation Taxes Acts. S979(1) has no relevance because it applies to income that is *not* otherwise within the application of that charge under the Corporation Taxes Acts.
- 25 209. The exclusion of deemed income is not relevant because, as the Explanatory Notes make clear, that exclusion relates to deemed income that does not fall within any other application of the charge to corporation tax on income. Here, the re-calculated income plainly does fall within the charge to corporation tax on income by virtue of s254 TIOPA.
- 30 210. Thus, s979 creates no difficulty. Resort need not be made to it because the qualifying payment is or becomes part of the income of *Holdings* that is **otherwise** chargeable to corporation tax by virtue of s254 and ss2 and 5 CTA 2009.
211. Putting it another way, s979(2)(c) does not apply because s979(1) itself does not apply.
- 35 212. Overall, we consider that the fiscal legislation is amply sufficient to impose a charge to corporation tax on the qualifying payment. The qualifying payment is treated as a receipt that is chargeable under the charge to corporation tax on income. Every company must submit a tax return containing an assessment of the amount of

tax payable by it in the relevant period.¹⁶⁰ *Holdings* submitted a return with calculations showing its assessed liability to corporation tax. S254 TIOPA provides for its recalculation in circumstances which arise as a result of our decision. The qualifying payment must be added to the company's income.¹⁶¹ Corporation tax is charged on profits and profits include income and chargeable gains.¹⁶² It is difficult to see what more is needed to impose a charge to corporation tax on the qualifying payment or the relevant part of it. The conclusion that Parliament has somehow removed the charge to tax otherwise established is unsound and would wholly frustrate the obvious intention of Parliament.

213. In these circumstances, we answer **issue (f)** by holding that although there could not be a charge to tax under Case VI of Schedule D in the relevant period, as stated in HMRC's Closure Notices, there is a charge to tax by virtue of s254 TIOPA and ss2 and 5 CTA 2009.

214. We should add that the argument we have rejected proceeded on the basis that, on a proper construction of the legislation, there was no enforceable fiscal liability, and not on the basis that the infelicitous reference to Case VI of Schedule D in the Closure Notice issued to *Holdings* invalidated the Notice. This was an attack on the substance of the legislative charging provisions rather than the form of the Closure Notice. No point was taken on the basis that the Notice wrongly referred to Case VI Schedule D rather than mirroring the equivalent words of s254(2) TIOPA.

Summary

215. In summary:-

- (1) We answer **Issue (aa)** by holding that the debit claimed by *Group* is **not** in respect of a company's loan relationship within s320 CTA 2009.
- (2) Insofar as necessary, we answer **Issue (a)** by holding that the deductibility of debits under s320 **is** subject to the provisions of s307(3). We answer **Issue (b)** by holding that s307(3) **requires** the debits and credits to be tested to establish their nature. We answer **Issue (c)** by holding that the debit claimed by *Group* **does not** fairly represent losses arising from its loan relationships under s307.
- (3) Insofar as necessary, we answer **Issue (d)** by holding that there **is** an amount to be brought into account under the relevant provisions of TIOPA. We hold that the receipt scheme conditions in s250 thereof **were** satisfied.
- (4) Insofar as necessary, we answer **Issue (f)**¹⁶³ by holding that although there could not be a charge to tax under Case VI of Schedule D in the

¹⁶⁰ FA 1998 Schedule 18 paragraph 8.

¹⁶¹ TIOPA s254(2)(a).

¹⁶² CTA 2009 s2.

¹⁶³ A decision or view on Issue (e) is no longer required.

relevant period, as stated in HMRC's Closure Notices, there is a charge to tax by virtue of s254 TIOPA and ss2 and 5 CTA 2009.

Disposal

216. *Group's* appeal is dismissed. As a consequence, *Holdings'* appeal is allowed.¹⁶⁴

5 217. If *Group* obtains permission to appeal and does appeal, we would expect HMRC to appeal against our decision to allow *Holdings'* appeal. In that way, all the outstanding issues can be heard together again and their consequences determined without undue complexity.

10 218. The appeals before us are lead appeals. We draw the attention of parties (and to those interested in the related appeals referred to above, all of whom are also represented by KPMG and HMRC) to Rule 18(4) and (5) of the Tribunal's rules. We dispense with the need to send a copy of this decision to each of the parties in the related cases (appeals) as KPMG LLP are believed to represent all or most of them. Insofar as KPMG do not, HMRC are directed to send a copy of the Decision to those
15 parties in the related appeals not represented by KPMG.

219. We invite proposals, by written application within 28 days of the date of the release of this decision, for any further procedure (including expenses, if appropriate; but not in relation to appeal, as to which see below) the parties and those interested in the related appeals, or any of them, consider competent and expedient. If any person
20 wishes to extend the period for seeking permission to appeal, an application to do so will no doubt be made.

220. 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
25 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.

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**J GORDON REID QC FCIarb
TRIBUNAL JUDGE**

RELEASE DATE: 24 FEBRUARY 2016

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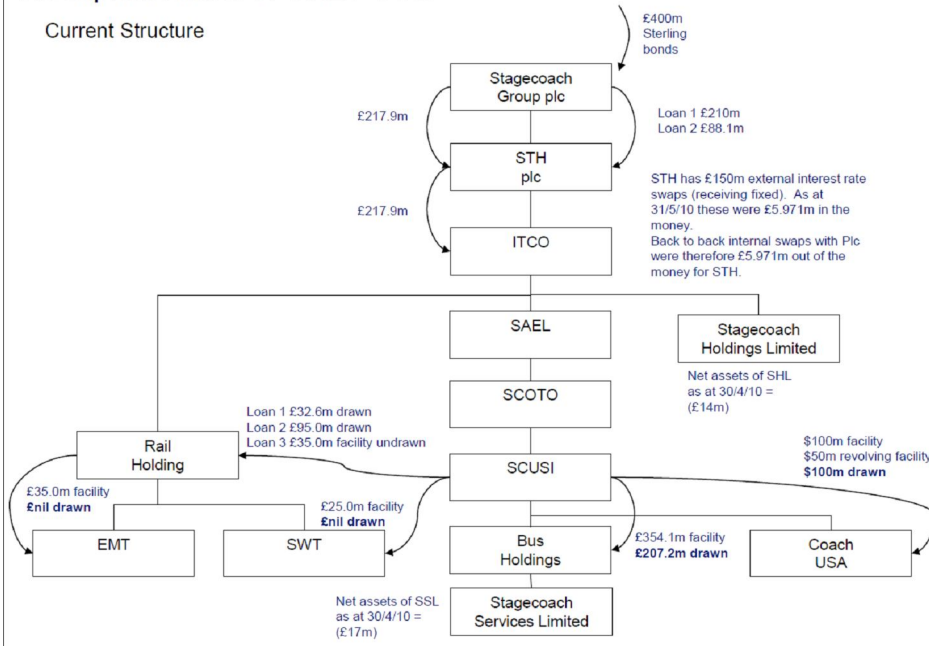
¹⁶⁴ See paragraph 10 above.

APPENDIX

1 Tab 54 (vol C)

Recapitalisation of SHL / SSL

Current Structure



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