[2012] UKFTT 104 (TC)

TC01800

Appeal number TC/2009/13433

Finance Act 1996 Schedule 9 paragraph 13 - whether loans made by the Appellant had an unallowable purpose - equity exchanged for shareholder debt – tax advantage main or one of main purposes- appeal dismissed

FIRST-TIER TRIBUNAL

TAX

A.H. FIELD (HOLDINGS) LIMITED **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: RACHEL SHORT
SANDY RADFORD

Sitting in public at 45 Bedford Square, London WC1 on 28 and 29 November 2011

Mr David Southern QC for the Appellant

Mr Michael Gibbon QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This is an appeal by the Appellant against closure notices for the 2003 and 2004 tax years which disallowed loan relationship debits and fee payments under Sections 82 and 84 Finance Act 1996 by virtue of paragraph 13 of Schedule 9 of Finance Act 1996 ("para 13").

2. HMRC disallowed fee payments under Section 84 Finance Act 1996 of £6,612 for the 2003 tax period and £3,000 for the 2004 tax period plus loan relationship debits under Section 82 Finance Act 1996 of £150,500 for the 2004 tax period on the basis that para 13 applied to disallow the full amount of these payments.

3. The grounds of appeal were that on the correct application of the law to the facts the loan relationships did not have an unallowable purpose and the debits claimed in the Appellant's accounts accordingly should be allowed in full.

Background and facts

4. The Appellant is a UK resident investment company, holding residential property, largely situated in the Birmingham area. All the shares of the Appellant are owned by A.H Field (Overseas Investments) Ltd ("Overseas") which is in turn owned by A.H. Field (Holdings) Jersey Ltd ("Holdings Jersey"), a Jersey resident company. The shares in Holdings Jersey are settled in the HJ Hirschfield New Trust Settlement ("the Trust"). The Trust is primarily for the benefit of the Hirschfield family.

5. The Appellant's accounting reference date is 31 December. During the financial year to 31 December 2003 the directors of the Appellant were N P Roberts, G A Hirschfield, M H Hirschfield and J W Rothwell.

6. In or around September 2003 the accountants, Bentley Jennison, (the "Accountants") advised the directors of the Appellant on various matters including "maximising the movement of funds from the UK to Jersey".

7. A "Tax Report Presentation" produced by the Accountants inter alia stated:

> **Description**
>
> The insertion of a discounted security between AH Field (Holdings) Jersey Limited and AH Field (Overseas Investments) Limited
>
> **Benefits**
>
> Annual savings to the group of 30% of the interest egg on a loan of £2m, net annual savings would be £30,000. (UK tax liabilities would be reduced by say £100,000 at 30% i.e. £20,000 with the tax saving being in the year of redemption; there is no withholding tax on a discount. To accelerate the tax savings, a series of 364 day discounted securities could be considered).
>
> **Implementation issues**

There is a need to shift borrowings from the UK group to AH Field (Holdings) Jersey Limited. This could be achieved by dividends paid up from the UK.

8. Amongst the documents provided to the Tribunal was a short extract from a KPMG report to the Trust which referred to an enquiry received as to whether a beneficiary's requirement for cash should be funded by drawing from an underlying company or drawing on the company's loan facilities from a third party lender.

9. The directors of the Appellant agreed to adopt one of the Accountants' proposals that the Appellant should take a short term loan in order to pay a dividend up the chain of companies to Holdings Jersey which Holdings Jersey would then loan back to the Appellant so that it could pay off the loan.

10. On 19 November 2003 Barclays Bank agreed to make a borrowing facility available for £2 million to the Appellant for three days, for a fee of £2,500.

11. On 15th December 2003 the Appellant borrowed £2 million from Barclays Bank in order to pay a dividend. The Appellant paid a dividend of £1,999,500 to Overseas on 17 December 2003. This was declared as a dividend and paid by Overseas to Holdings Jersey.

12. On 19 December 2003 the Appellant issued a zero coupon bond ("ZCN") to Holdings Jersey for £1,999,500, redeemable on 17 December 2004 for £2,150,000, effective interest rate 7.57%. The loan was for a period of one year minus two days.

13. On 19 December 2003 the Appellant repaid the loan from Barclays.

14. On 10 December 2004 the Appellant borrowed £2m from Barclays in order to repay the loan from Holdings Jersey. The ZCN was redeemed on the same day for £2,147,106 i.e. £147,606 more than the issue price.

15. The structure was repeated in 2005, 2006 and 2007. Assessments for those years are now under appeal and it is intended that they be decided in line with the decision on 2003 and 2004.

16. The effective rate on the ZCNs was not in excess of a normal commercial return.

17. By notice of enquiry dated 10 June 2005 issued under Finance Act 1998, Schedule 18 para 24, an enquiry was opened into the Appellant's Corporation Tax Self Assessment (CTSA) for the accounting period ended 31 December 2003. By notice of enquiry dated 11 January 2004 an enquiry was opened into the Appellant's CTSA for the accounting period ending 31 December 2004.

18. Closure notices were issued in relation to 2003 and 2004 under Finance Act 1998, Schedule 18 para 32 on 21 November 2008. The closure notices required that the amounts paid in respect of the loan discount payments and the ancillary payments be removed as they were disallowed by HMRC.

19. The Appellant declined to make these adjustments and instead appealed the closure notices under para 93 of Schedule 18 by letters of 4 December 2008 and 12 January 2009.

20. HMRC wrote setting out their view and offering a review under the Taxes Management Act 1970 ("TMA") Section 49C on 2 June 2009. The review resulted in the confirmation of the initial view by letter of 28 July 2009.

21. The Appellant notified the First-tier Tribunal (Tax Chamber) of its appeal by 28 August 2009 under TMA Section 49G.

Relevant Law – Para 13 Schedule 9 Finance Act 1996.

22. The relevant legislation is set out at para 13 of Schedule 9 Finance Act 1996 which introduced the "loan relationship" code for taxing debt instruments in the UK. The legislation was intended to be a comprehensive codification of the UK's tax rules relating to debt instruments and included an anti-avoidance provision at para 13 which is the focus of this appeal.

23. Para 13 states that:

> (1) Where in any accounting period a loan relationship has an unallowable purpose,
>
> (a) the debits… which for that period fall, in the case of that company, to be brought into account for the purposes of this Chapter shall not include so much of the debits given by the authorised accounting method used a respects that relationship as, on a just and reasonable apportionment, is attributable to the unallowable purpose.
>
> (1A)…..
>
> (2) For the purposes of this paragraph a loan relationship of a company shall be taken to have an unallowable purpose in an accounting period where the purposes for which, at times during that period, the company-
>
> (a) is a party to the relationship, or
>
> (b) enters into transactions which are related transactions by reference to that relationship,
>
> include a purpose ("the unallowable purpose") which is not among the business or other commercial purposes of the company.
>
> (3) For the purposes of this paragraph the business and other commercial purposes of a company do not include the purpose of any part of its activities in respect of which it is not within the charge to corporation tax.
>
> (4) For the purposes of this paragraph, where one of the purposes for which a company –
>
> (a) is a party to a loan relationship at any time, or

(b) enters into a transaction which is a related transaction by reference to any loan relationship of the company,

is a tax avoidance purpose, that purpose shall be taken to be a business or other commercial purpose only where it is not the main purpose, or one of the main purposes, for which the company is a party to the relationship at that time or, as the case may be, for which the company enters into the transaction.

(5) The reference in sub-paragraph (4) above to a tax avoidance purpose is a reference to any purpose that consists in securing a tax advantage (whether for the company or any other person).

(6) In this paragraph –

"related transaction" has the same meaning as in section 84 of this Act;

and

"tax advantage" has the same meaning as in Chapter I of Part XVII of the Taxes Act 1988 (tax avoidance").

The definition of "tax advantage" referred to in para 13 above is taken from Section 709 Income and Corporation Taxes Act 1988 ("ICTA") which is:

"In this Chapter tax advantage" means a relief or increased relief from, or repayment or increased repayment of tax, or the avoidance or reduction of a charge to tax or an assessment to tax or the avoidance of a possible assessment thereto, whether the avoidance or reduction is effected by receipts accruing in such a way that the recipient does not pay or bear tax on them, or by a deduction in computing profits or gains".

Appellant's Arguments

The Basic Argument.

24. On behalf of the Appellant, Mr Southern took us on a long and interesting journey through the application of para 13 via many of the UK's leading anti -avoidance cases, but in essence his argument was a very simple one; the Appellant was an asset rich but cash poor property company, under pressure to pay out cash in the form of dividends to shareholders. In response to this commercial pressure, the Appellant took a decision to fund a dividend payment by way of a shareholder loan.

25. Mr Southern submitted that that loan was not a sham because it had a commercial purpose. Since the loan had a commercial purpose, it could not have a fiscal purpose and para 13 could not be in point.

26. It was a consequence and not a main purpose of the loan that a deduction could be obtained for the interest payments made. If para 13 applied to this loan, it should

equally be applied to all other debentures issued throughout the land in respect of which debits were claimed for interest payments.

The Appellant's commercial situation

27. Mr Southern described the Appellant as asset rich, but cash poor, in his words "prosperous but highly illiquid". To demonstrate this Mr Southern pointed us to a number of documents, including board minutes of meetings during 2003, evidencing the fact that it had been a long term pre-occupation of the Appellant to raise loan finance and that the Appellant had entered into a number of loan facilities with other lenders, including Nationwide and AIB, prior to this arrangement with Barclays and the shareholders.

28. We were also directed to the accounts of the Appellant for the relevant years, which, in Mr Southern's view demonstrated that the company had large re-valuation reserves, it rarely disposed of properties, had very little free cash, and was dependent on bank financing to fund working capital even taking account of the shareholder loan from Holdings Jersey.

The business purpose of the ZCN

29. Mr Southern stressed that this ZCN had a commercial purpose and maintained that responding to the shareholders' requirements for cash was a commercial purpose.

30. In respect of the ZCN, Mr Southern directed our attention to a number of company documents evidencing the pressure which the Appellant was under to pay out dividends to the shareholders, in particular the KPMG memo (we were referred to the faxed copy dated March 2003) which stated that the shareholders and beneficiaries had some specific requirements for cash in 2003-4 including in order to finance property purchases for their offspring. The Tribunal was not given any evidence of cash requirements of the shareholders for any periods other than 2003-4.

31. Mr Southern pointed out that the pressure from shareholders to provide them with cash was a "commercial purpose" within the meaning of the definition at para 13(2) and that in this regard the fact that the loan in question is made by a shareholder does not change the analysis.

32. Mr Southern relied on the authority of *Salomon v Salomon* ([1897] AC 22), in support of the argument that a loan to a shareholder should be treated in exactly the same way as a loan to a third party.

33. Mr Southern further specified the business purposes of the ZCN in his skeleton argument as follows: to introduce debt rather than equity financing for the Appellant in order to conserve the Appellant's working capital; to provide an assured return on equity ("ROE"); and to achieve this in a tax efficient manner.

Whose purposes are relevant?

34. Given the inter linked nature of the chain of companies, from the Appellant through to the shareholders and ultimate beneficiaries of the Trust, Mr Southern spent some time distinguishing whose "purpose" was relevant in the context of para 13.

35. Mr Southern argued that in determining who provides the "purpose" for a corporate entity such as the Appellant, it was necessary to apply the rules which attributed purpose to the officers of a company with some care and not "willy nilly", and only in line with what the relevant legislation required. He relied on *Meridian Global Funds Management Asia Ltd v Securities Commission [1995] 2 AC 500,* to support this approach.

36. Mr Southern argued that the Appellant had a number of different stakeholders, namely investors, employees, customers and the public interest and that the purposes of the directors were commercial purposes to the extent that they were in response to one of these stakeholders. He referred us to the statement of Lord Pearce in *IRC v Brebner (43 TC 705)* at p 715

> "the object which has to be considered is a subjective matter of intention. It cannot be narrowed down to a mere object of a company, divorced from the directors who govern its policy or the shareholders who vote…."

Purposes and consequences

37. One of the main tenets of Mr Southern's argument was that HMRC were inferring, from the fact that a deduction for loan relationship debits had been claimed, that the obtaining of these debits must therefore be a purpose of the transaction.

38. In his view this was an unjustified inference; the fact that the debits had arisen as a consequence of the loan did not necessarily mean that they were the main purpose for which the loan was entered into. Since it is an intrinsic part of the UK tax code that loans give rise to deductible interest expenses, this was a natural and unavoidable consequence of the loan having been entered into, rather than a purpose.

39. Mr Southern did not attempt to argue that the Appellant's directors were not aware, or did not care, that the result of the loan was to give rise to a tax deduction, but his suggestion was that the directors did not have the saving of tax as the reason for entering into the loan. On the contrary it was viewed only as a natural consequence of entering into the loan. He referred us to the decisions in *Deliverance Ltd v R&C Cmrs* ([2011] STC 1049) and *Mallalieu v Drummond* ([57] TC 330) for other circumstances in which the courts had attempted to distinguish between unavoidable consequences and intent or purpose.

40. In Mr Southern's view there was no question that a company could choose to arrange its affairs so that any tax charges are mitigated, on the basis of cases such as *CIR v Wesleyan and General Insurance Society* ([30] TC 11) and Lord Upjohn in *Brebner*

> "no commercial man in his senses is going to carry out commercial transactions except upon the footing of paying the smallest amount of tax involved".

41. He conceded that the directors had taken sufficient account of tax to decide to structure the loan note as a zero coupon bond rather than an interest paying note in order to avoid any potential withholding tax which might otherwise have arisen in respect of payments to the Jersey bondholders.

Subsidiary and incidental purposes.

42. However, his point was that the tax deduction for the loan was a "subsidiary issue" or an incidental purpose. He referred us to the descriptions of Woodhouse P in the Challenge Corp decision (*CIR* v *Challenge Corporation* [1986] 2 NZLR 513) who described an incidental purpose as "something which is necessarily linked and without contrivance to some other purpose or effect so that it can be regarded as a natural concomitant" (p 533, para 45 of Woodhouse P judgment).

43. Even if it could be said that knowledge that the consequence of entering into a loan was the availability of a tax deduction, amounted to a purpose for entering into the loan, in Mr Southern's view that could only ever amount to an "incidental" or "subsidiary" purpose, which was not enough to trigger the "main purpose" rules in para 13.

44. Indeed, Mr Southern argued that the whole intention of para 13(4) was to ensure that circumstance such as this were not caught by para 13.

45. In Mr Southern's view, in order for a transaction to have an unallowable purpose it must have a "pure" tax avoidance purpose, which was not the case here. The unallowable purpose test was only intended to exclude loans which had no commercial purpose. If a transaction has a non fiscal purpose, that will be, in the terms of para 13, a business or commercial purpose and any "incidental" fiscal purpose cannot be treated as a "main purpose".

46. Mr Southern referred to the (SPC) decision in *Prudential plc v R&C Comrs* [2008] STC (SCD) 239, and the obiter statements of the Special Commissioners which, while not considering exactly the same test, was in his view authority for the proposition that a transaction would have an unallowable purpose only if, as in that case, it was there only with a tax saving purpose.

Was the loan a sham?

47. Mr Southern stressed that the loan changed the position of the Appellant. It was used to finance assets, and therefore it had a non fiscal purpose. It had a commercial purpose and a commercial effect. There was no question that the loan was a "sham"; there was a real lending with legal and financial consequences.

48. Having established that the loan was not a sham, Mr Southern took, particularly from the line of US cases starting with *Helvering v Gregory* (1934) 69F 2d 809, that if a transaction is not a sham, then it should be respected for tax purposes. In his view

these US cases were part of UK law via the House of Lords decision in *Furniss v Dawson*. ([55] STC 324).

49. Taking the approach of Hand LJ in *Helvering*, if a transaction is "germane to the conduct of the venture" then it cannot be disregarded for tax purposes. Transactions carried out in the normal course of business will be effective for tax purposes.

The circularity of the funds

50. In Mr Southern's view, the fact that there was some element of circularity of funds (from Barclays to the Appellant, from the Appellant to the shareholder, from the shareholder to the Appellant and back to Barclays and then eventually back to the shareholder plus a discount payment) did not necessarily mean that the transaction had a fiscal or unallowable purpose.

51. Mr Southern examined a number of the UK's leading anti avoidance cases (none of which deal with the specific para 13 point under consideration here), to stress the fact that in general the UK courts have taken a different approach to situations in which a taxpayer has not actually changed in position, or put another way, where a transaction has been described as having a commercial effect which it actually does not have, to cases in which there has been a real change of position.

52. Mr Southern compared the position of the taxpayers in *Ensign Tankers (Leasing) Limited v Stokes [1992]STC* 226 and *TowerMCashback LLP v R&C Cmrs [2011] STC 1143* (no change of position) with *Barclays Mercantile Business Finance Limited v Mawson* [2005]STC 1 and *Macniven* v *Westmoreland Investments Ltd* [2001] STC 237(change of position).

53. Mr Southern's view was that the Appellant in this case was in the latter and not the former position. A real commercial transaction had been undertaken and therefore there was no "mislabelling" and therefore no unallowable purpose.

Alternative taxable transactions.

54. Mr Southern also took some time to distinguish the many UK cases which have considered the meaning of a "tax advantage" for the purposes of the "transactions in securities" legislation (Sections 703 - 709 ICTA) arguing that the approach which had been taken in these cases to determining whether a tax advantage had been obtained, namely to consider whether there was an alternative transaction which the taxpayer could have undertaken which would have given rise to a less advantageous tax result, was not applicable when considering para 13 because para 13 is stated to be an "exclusive code" for taxing loan relationships. (Section 80 (1) Finance Act 1996).

55. The "alternative taxable transaction" approach to which he referred is set out in cases such as *CIR v Parker (*43 TC 396) and *Brebner*.

56. Therefore he rebutted any argument which suggested that if the Appellant could have achieved the same economic effect by a different legal route, which gave rise to different tax consequences, the loan had an unallowable purpose.

HMRC's Arguments

The Law

57. Mr Gibbon submitted that the important parts of para 13 for the present purposes were that loan relationship debts would be disallowable insofar as they were attributable to an unallowable purpose (13(1)) ; a loan relationship would be taken to have an unallowable purpose if one of the purposes for which the Appellant was a party to the loan relationship or for which it entered into a related transaction was not amongst the business or other commercial purposes of the Appellant (para 13(2)) ; and where one of the main purposes for which the Appellant was party to a loan relationship or for which it has entered into a related transaction is the reduction of tax or an assessment to tax, then the loan relationship will be taken to have an unallowable purpose (para 13(4) by reference to Section 709 of ICTA).

Alternative Taxable Transactions Section 709 Cases.

58. Mr Gibbon argued that the explicit adoption in para 13 of the definition of "tax advantage " from Section 709 of ICTA not only meant that authority relevant to the construction of that definition was directly applicable but also that the Tribunal would derive assistance from authorities in relation to Chapter 1 of Part XVII of ICTA generally.

59. In particular he reminded the Tribunal that tax advantages from transactions in securities were to be cancelled "unless it can be shown that that the transaction or transactions were carried out either for bona fide commercial reasons or in the ordinary course of making or managing investments and that none of them had as their main object or one of their main objects to enable a tax advantage to be obtained"

60. On the question of what constitutes a "tax advantage" Mr Gibbon quoted Lord Wilberforce in *CIR v Parker* (a case concerning s 709):

> "there must be a contrast as regards the "receipts" between the actual case where those accrue in a non-taxable way with a possible accruer in a taxable way, and unless this contrast exists the existence of the advantage is not established".

61. Mr Gibbon submitted that when investigating the objects of a transaction subjective intentions were not limited to the conscious motives of the person whose intentions were under investigation. He referred to the decision in *Vodafone Cellular Ltd v Shaw* ([69] TC 376)*:*

> "some consequences are so inevitably and inextricably involved in the payment that unless merely incidental they must be taken to be a purpose for which the payment was made"

62. He argued that authorities such as *Vodafone* demonstrated "fluid use" of concepts of intent and purpose. Further, Mr Gibbon suggested that in this instance, as in the

Section 709 cases, there should be taken to be little distinction between an "object" and a "purpose".

Businesses Purpose of the loan

63. Mr Gibbon claimed that the main purpose for the loan structure being put in place and involving amounts to the order of £2million, was that the anticipated annual saving for the group was 28% of the discount payable by the Appellant on redeeming the previous year's loan note. The saving to the group could be reflected in increased payments to the beneficiaries of the Trust.

64. He suggested that the saving would come entirely from the reduction of the group's liability to UK corporation tax with little, if any, corresponding increase in corporation tax in Jersey. Once the initial payment had been paid and the first discounted loan note issued, the loan notes could be rolled over from one year to the next, generating tax deductions for an indefinite period.

65. Mr Gibbon submitted that the same effect could be achieved by paying interest on a long-term loan but interest paid to Jersey would be subject to withholding tax whereas the discount was not.

66. Mr Gibbon said that achieving a deduction for the Appellant under the loan relationship legislation would not assist the group fiscally insofar as the discount received by Holdings Jersey was taxed as income in Jersey. However since the relevant rate of tax in Jersey was 2% as opposed to 30% in the UK, the effect would be highly beneficial overall.

The circularity of the funds

67. Mr Gibbon submitted that the structure set in place was largely self-cancelling. The loan from Barclays would be repaid within days and the cash paid upwards by the Appellant to Jersey was almost entirely returned within days. He suggested that this was indicative that the transactions had a purpose that was not amongst the business or other commercial purposes of the Appellant.

68. He argued that the reason for most of the cash flow created by the transactions was either to facilitate or cancel another part of the transaction with the result that a net payment, much smaller than the cash flow of £2 million into, within and out of the group, could be made by the Appellant to Holdings Jersey. That payment could be made by way of paying a discount on the loan note and thus incurring a debt for the purposes of the loan relationship code, whereas before the structure was implemented such payments from the Appellant to Holdings Jersey would be by way of non deductible dividend distributions.

69. Mr Gibbon submitted that for the avoidance of doubt insofar as HMRC referred to the transactions being self-cancelling it was no part of HMRC's case that any of the transactions should be treated as a sham or a nullity. To this extent he agreed with Mr Southern's approach to the line of a cases culminating in *McNiven* and *BMBF*.

70. Mr Gibbon did argue however that the self-cancelling nature of the transactions was relevant to the issue of the "purpose" of the loans. He submitted that the purpose of the transactions could only be properly examined in the light of the structure as a whole including that it was meant to be repeated annually.

71. On that basis Mr Gibbon suggested that the discount and fees in respect of the 2003 and 2004 loan relationships arose in each case from a loan relationship to which the Appellant was party for a purpose which was not amongst the business and other commercial purposes of the Appellant and thus the debit should be disallowed by virtue of para 13(2).

72. The debits corresponding to the discounts in each case payable by the Appellant represented a "tax advantage" within the meaning of Section 709 of ICTA and for the purpose of para 13.

73. Mr Gibbon claimed that the burden of proof was on the Appellant to show that gaining a tax advantage was not a main purpose of the transaction. He referred to the judgement of Foster J in *Hasloch v CIR* ([47] TC 50) where the judge upheld a Special Commissioners' decision rejecting an appeal because the appellant had failed to discharge the onus placed upon him of proving that obtaining a tax advantage was not a main purpose of a transaction.

Whose Purposes are relevant?

74. Mr Gibbon made clear that he was not taking issue with Mr Southern's approach to the rules concerning the attribution of purpose in a corporate context, but that he did contest what purpose could be identified among the relevant players.

75. Mr Gibbon particularly stressed that in order to establish the Appellant's purpose it was necessary to go beyond Mr Roberts who was not part of the Appellant's "inner circle". Mr Roberts was not aware of the shareholders' intentions and the documents which Mr Roberts did not see, such as the KPMG report, filled this void.

Unallowable purposes for para 13

76. Mr Gibbon submitted that the correct approach to unallowable purpose was to refer to the questions as they were asked in by the High Court in *Prudential*, which was essentially a two stage approach – firstly to ask whether there is a tax advantage as defined by the legislation (in his view there was) and secondly to ask whether the loan has an unallowable purpose. It is only when a tax advantage has been established, that one moves on to ask whether there is an unallowable purpose.

77. Mr Gibbon also referred us to the recent Special Commissioners decision in *Snell v R & C Cmrs* ([2008]STC(SCD)1094) as authority for the proposition that identical loan transactions could be dealt with differently depending on purpose, in answer to Mr Southern's argument that his approach would mean that "all debentures in the land" were potentially subject to a para 13 attack.

78. In respect of the US cases referred to by Mr Southern, Mr Gibbon pointed out that these were rather old cases and if they were relevant at all, they were relevant to decisions considering a *Furniss v Dawson* approach to tax avoidance, which was not relevant in this instance.

79. In respect of the commercial purposes posited by the Appellant in respect of the ZCN, the main one being improved return on capital employed ("ROCE"), he contended that there was little or no evidence that ROCE was being considered by the Appellant. He challenged whether there had been any intention to put additional funds into hands of shareholders because in the event they received a similar dividend to that which they had received in previous years.

80. The main purpose of the Appellant being party to each of the loan relationships was a tax purpose, namely to secure the debits corresponding to the discount payable by the Appellant and as a result those debits should be disallowed by virtue of para 13(4).

81. In Mr Gibbon's view, there would not have been any debits absent the unallowable purpose under either para 13(2) or 13(4) therefore the full amount of the debits fell to be disallowed.

82. The ancillary fee costs should likewise be disallowed as incurred for an unallowable purpose.

83. In his submission these were loans with the main purpose of tax avoidance, or at least one of their main purposes was tax avoidance.

Evidence – Mike Townsend.

84. Mr Townsend was called as an expert witness on behalf of the Appellant. Mr Townsend explained that he was not a qualified accountant but was experienced in the analysis of companies, including by reference to ROE and ROCE. His evidence was directed at the significance of ROE/ROCE to the Taxpayer and was therefore relevant to one of the main commercial purposes of the ZCN as explained by Mr Southern.

85. Mr Townsend referred to a textbook, "*The Financial Times Guide to Using and Interpreting Company Accounts*" by Wendy Mackenzie, which included a description of the meaning of ROE and ROCE and discussed in general terms what those terms were intended to convey. He also said that these ratios would be used both by external analysts and investors in a company as a means of assessing its performance.

86. Mr Townsend said that he had not seen any documents produced by the Appellant which discussed these ratios and agreed that representatives of the Appellant, including Mr Roberts, would not necessarily have a technical understanding of these ratios. However Mr Townsend agreed that the concepts underlying these terms would be used pragmatically by businessmen such as Mr Roberts.

87. Mr Townsend confirmed that these ratios would not be impacted by changes in the debt equity ratio of a company and would not have been impacted by the change from equity to debt funding undertaken by this Appellant, on the assumption that the ZCN could be treated as long term debt.

88. Mr Townsend was referred to the 2003 year end accounts, which demonstrated that, post the issuance of the ZCN there had been an increase in the fixed assets of the company. However, he agreed that this increase was mainly as a result of an increase in the Appellant's re-valuation reserve increasing (i.e. properties held had been re-valued at a higher price) and not due to the ZCN.

Evidence – Mr Roberts

89. Mr Roberts is the **c**hairman and a director of the Appellant.

90. He stated that the aim of the scheme which gave rise to the ZCN was to achieve a regular flow of cash to shareholders. The discount payments on the loan were intended to replicate level of dividends paid in previous years.

91. In his witness statement Mr Roberts stated that the directors were attracted to the scheme as offering the best way of satisfying the requirements of the shareholders without compromising the needs of the business. It was ROCE to the shareholders by way of discount payments rather than dividends. When funds were not available in cash to meet dividend payments the Appellant's bankers were always reluctant to lend money for this purpose but were willing to oblige if it was a loan to meet existing commitments such as a discounted loan note.

92. He stated that the structure gave various advantages such as giving the shareholders an assured ROCE and this was seen as a good discipline by the directors to ensure that they were fulfilling their fiduciary duties to the shareholders.

93. On cross examination he further explained that he would not have used the concept of ROCE with reference to the Appellant's business in 2003. A particular return was not required, the shareholders just wanted as much as could be paid to them.

94. He stated that the saving of tax was not the main purpose because the main purpose was to secure regular payments to shareholders. He believed that the ZCN gave a more reliable return to shareholders than equity.

95. His main concern regarding the ZCN was to guarantee income to shareholders and to ensure that there was no risk that the ZCN could not be rolled over because the bank would not provide funding for year 2.

96. He stated that he had not seen details of the KMPG report and was not aware of the details of Trust deed. The only document he saw concerning the ZCN was the Accountants' tax report and he had not seen the full KPMG report.

97. He confirmed that regular meetings were held with the shareholders approximately every three months, but he only attended meetings in Birmingham. He was aware of other meetings which he did not attend in 2003.

98. He stated that he regarded himself as "employee" of the company. His only financial interest in the company was his salary. Mr Meek, of the Accountants and Mr M Hirschfield were the ones mainly involved with financial matters.

99. He confirmed that it was always possible for ZCN to be turned back into equity.

100. He agreed that as a result of the ZCN no more money had gone into the Appellant because the loan had been repaid to Barclays. The net result was that of funding for the shareholders but just in a different form. He stated that the debt/equity ratio had no impact on shareholders.

101. He confirmed that the Appellant was asset rich but cash poor. Rentals received from the Appellant's properties were used for maintenance and re-investment. The Appellant could have used its rental receipts to pay the dividend, but this did not make business sense.

Findings – of fact.

102. We found that when Mr Bailey of Barclay's Bank Plc attended by telephone with Mr Meek of the Accountants at the directors' meeting of 12 November 2003 it was his understanding that the purpose of the Appellant in respect of the ZCN structure was tax saving. We found that the specific quotation by Mr Bailey of an expected tax saving of £45,000 demonstrated that the scheme had been understood by him as a tax planning scheme.

103. We were referred to the email exchanges between Ms Guffog in Barclays group tax and her colleagues, including Mr Bailey of 24 November 2004, discussing the roll over of the 2003 loan in late 2004:

> "This is a straight loan repayment, not a dividend. The effect on cash is neutral when this is unwound. The loan is to be outstanding only for three days. By funding in this way, I understand that £45 thousand of tax will be saved"

104. We found that there was no discussion in the board minutes or any other disclosed documents of any pressure to improve the cash return to the Trust, or any specific reference to ROCE or ROE.

105. There was no documentary evidence that the Appellant had made actual comparisons between any third party lending that might have been available to the Appellant and the cost of borrowing from Jersey although the Appellant did look at comparable interest rates offered by other lenders.

106. We found that the structure set in place was largely self-cancelling. The loan from Barclays would be repaid within three days and the cash paid upwards by the Appellant to Jersey was almost entirely returned within days.

107. We found that the ultimate payment to the shareholders under the ZCN was an equivalent amount to the historic dividends which had been paid and therefore the beneficiaries did not receive a greater amount of cash than that which they had received in earlier years.

108. We found that had HMRC allowed the deductions for the ZCN discount payments the only beneficiary would have been the Appellant which would have reduced its corporation tax due.

109. According to Mr Townsend the difference between ROCE and ROE is that the first is a measure used to analyse a company's profitability and the second is a measure to an investor in a company of its return from the investment therein. We found that as the ZCN was treated as long term loan, there was no impact on either the ROCE or the ROE of the Appellant. It was agreed by Mr Townsend, Mr Southern and Mr Gibbon that the ZCN should be treated a long term debt (although its initial term was only 364 days, it was capable of, and was, rolled over for a second term.)

110. We found that the tax reports produced by KPMG were not shared with all directors, and in particular that Mr Roberts did not have sight of them. His main concern as a director was to protect the assets of company and the return to shareholders and he knew little of any tax planning.

111. Although Mr Roberts stated that the Appellant's bankers were reluctant to lend money for the payment of dividends but would oblige if it was a loan to meet existing commitments such as a discounted loan note, we found that all the bank was doing in reality was to lend money for 3 days for a fee.

112. We found that as confirmed by Mr Townsend on cross examination, while the ROCE/ROE of the Appellant had improved during the relevant period, that was due to an increase in the company's re-valuation reserve, and not as a result of swapping equity for debt funding.

113. We found that all the relevant documents relating to the ZCN were produced by Mr Meek of the Accountants, in his capacity as the Appellant's tax adviser.

Findings - of law.

Onus of Proof

114. It is clear, and was agreed between the parties that the onus of proof in this instance is on the taxpayer to demonstrate that the "unallowable purpose" test in para 13 does not apply to the discount and fee payments on this ZCN. (see *Lewis v IRC* [1999] STC (SCD) 349).

115. It is also clear that it is part of the role of this Tribunal, as a fact finding tribunal, to determine this purpose. This was made clear in *IRC v Trustees of Sema Group Pension Scheme* ([2002] STC 276),

> " the statutory criterion is that the tax advantage shall be more than relevant, or indeed an object; it must be the main object. The question whether it is so is a question of fact for the commissioners in every case"

Whose purposes are relevant ?

116. HMRC did not dwell on the question of whose purposes were relevant for the interpretation of para 13, and in fact Mr Gibbon stated before us that he had no issues with Mr Southern's approach to the attribution of purposes, but since Mr Southern spent some time considering the point in his submissions and we have dealt with it briefly here.

117. While the directors are clearly the "directing mind and will" of the Appellant, in carrying out their duties and exercising their executive function, they are obliged to, and in this case did, take account of the views of their shareholders as well as responding to advice given by external advisers such as Mr Meek of the Accountants.

118. While it is only the directors who can legally act on behalf of the company and embody its purposes, "embedded" within their purposes are the "purposes" of all the stakeholders in the company. The purposes of the directors cannot be divorced from and treated as discrete from the purposes of all the members of and advisers to the company.

119. On this basis we consider that it is legitimate to consider the wishes of the shareholders as well as the directors themselves in order to divine the purposes of the Appellant.

Is it relevant that the loan is being made by a shareholder?

120. Mr Southern suggested that this loan was being treated differently by HMRC because it was a loan which was made to the Appellant by shareholders rather than through a third party lender. Indeed Mr Southern argued that had the loan been made by a third party bank, there would have been no basis on which paragraph 13 could have been argued.

121.Mr Southern cited *Salomon v Salomon* as support for the fact the debentures made by a shareholder should not be treated any differently than those of a third party lender and HMRC did not contest this point. While the Tribunal accepts Mr Southern's point in respect of *Salomon v Salomon* (although this is in the context of an insolvency and therefore not precisely analogous to this case), the Tribunal does not accept that the para 13 arguments would disappear were the loan to have been made by a third party lender. It was no part of HMRC's argument that the ZCN had an unallowable purpose only because it was made by a shareholder.

If the loan is not a sham must it have a non fiscal purpose?

122. The ZCN was not a "sham", but its legal, commercial, and economic consequences were limited.

123. Neither HMRC nor the Appellant suggested that this loan was a sham, but the Appellant argued that if it was not a sham, it necessarily followed that it must have a commercial purpose.

124. The Tribunal does not agree that all loans which are not "shams" do not have a fiscal purpose. One of the reasons for this is that it would give paragraph 13 a very limited impact. If the loan in question was a sham, then arguably there would be no "money debt" to fall within loan relationship code in the first place, and paragraph 13 could not be in point.

125. Secondly, the test of a "sham" transaction is essentially a legal test, does the transaction answer to the documents which support it? In our view, it is perfectly possible for a transaction to have a legal identity but not necessarily have a commercial purpose.

126. Our view is that para 13 is more sophisticated and less binary than Mr Southern suggests; the test applied by para 13 is not distinguishing simply between transactions which are solely motivated by tax and transactions which are carried out for business purposes. It is directed at transactions which have some business purpose, but which nevertheless are so influenced by their tax effect, that it is reasonable to assume that the tax effect must have been one of the main purposes for entering into the transaction.

127. We consider that it is transactions of this type at which para 13(4) is directed – contrary to Mr Southern's approach, our conclusion is that para 13(4) applies to ensure that where tax purposes are the "main or one of the main purposes" for entering into a transaction, they trump any other commercial or business purpose.

128. We would add that we agree with Mr Gibbon's conclusions on behalf of HMRC that the US line of cases including *Helvering v Gregory*, to the extent that they can be treated as part of UK law, are not relevant in the context of para 13 and are overridden by the specific terms of para 13(4).

The circularity of the funds

129. What is the significance of the fact that there had been a circular movement of funds? – Mr Southern says that this is not relevant, because there has been a change of position of the Appellant. However HMRC took the view that this was indicative of the fact that the transactions had a purpose other than the business and other commercial purposes of the Appellant.

130. In this regard we would refer to two recent decisions which have, taking the *BMBF* decision at their starting point, stressed that mere circularity is not sufficient grounds for ignoring transactions which are otherwise legally effective – *Mayes v R & C Cmrs (*[2011] EWCA civ 407) and the FTT decision in *Explainaway Ltd v R & C Cmrs*([2011] SFTD 1105)

131. The court in *Mayes* explained, in the light of *BMBF*, that the proper approach of the courts involved a two step approach (i) a purposive construction of the statute to see, on a close analysis, what transaction would answer to the statutory provision and (ii) a realistic analysis of the transaction to see if it answers that description.

132.The Tribunal accepts that there was a real loan and that in this instance the circularity of funds not is not per se sufficient to confer on the loan an unallowable purpose. However, we think that the fact that funds were lent from Barclays Bank, immediately paid back from Holdings Jersey and lent internally is one of factors to be considered in considering the overall context and commerciality of the lending transaction.

The meaning of purpose and consequence for para 13

133. Mr Southern refers to HMRC's own (limited) guidance on the application of para 13 (CFM 6216), which states that para 13 will not apply if a company borrows to pay dividends, as long as that borrowing is not done in an artificial way.

134. Mr Southern attempted to provide his own example of the difference between a purpose, a motive and an intention, but in this regard we agree with Mr Gibbon that these are essentially fluid and not particularly helpful concepts.

135. Mr Southern warned us against "inferring purpose from consequences" but we consider that it is legitimate to consider the consequences of the taxpayer's actions in order to determine his purpose. Consequences are the result of purposes which have been acted on. Consequence can, and will usually be, related to purpose, though we take on board the fact that purposes can be frustrated and consequences can be unexpected.

136. Mr Southern attempted to distinguish between intentional purposes as compared to the "inevitable" consequences of a taxpayer's actions. Mr Southern asked whether the purpose was to obtain a tax deduction for the discount on the loan and said that this cannot be a purpose because it was a "natural concomitant" of the loan (as per Woodhouse P in *Challenge Corporation*.) On that basis tax saving is not a separate object of the loan.

137. We do not think that this is a helpful distinction: A purpose can include an inevitable consequence. We take the decision in *Sema Pensions* as authority for the fact that just because a tax result is a "natural concomitant" of a transaction (in that case, the tax credits which were available as the result of a share buy back), it does not necessarily mean that it cannot be a main purpose for entering into that transaction.

138. The Tribunal considers that Mr Southern is not directing himself to the correct question–which is not what was the purpose of obtaining the discount on the loan, but what was the purpose of entering into the loan itself, which is an anterior question. To take the facts in *Mallalieu* as an analogy, para 13 is asking why Ms Mallalieu chose to wear clothes, not why she chose to wear clothes which were black.

139. In order to divine the Appellant's purposes for entering into this loan, we think that a Tribunal can do no more than look at the components of this particular decision by reference to these particular facts and circumstances, taking account of both the alleged purposes by reference to the available evidence and actual consequences of the Appellant's actions; this is the approach taken in *Prudential*, *Sema* and *Brebner*.

Are the Transactions in Securities definitions of a tax advantage relevant?

140.There are a number of reasons why we disagree with Mr Southern's approach to this question. Whilst we accept that the loan relationship code is an exclusive taxing code, that is not the same as saying that other sources cannot be used to interpret it.

141. Indeed, even Mr Southern took a rather contradictory approach to the large body of case law which has arisen around the transaction in securities legislation – on the one hand telling us that it had no place in the loan relationship code, because that code starts from a different premise, while also relying on a number of the Section 709 cases to support his interpretation of what a "commercial purpose" is in the context of this loan (particularly relying on *Brebner* and *Sema Pensions* for their statements about ancillary purposes).

142. The question of how the definition of a "tax advantage", which is derived from the transactions in securities legislation, should be applied in the context of para 13 has been recently considered by the FTT in the *Explainaway* decision. The judge in that instance suggested that the definition needed to be applied purposively, and within the context of para 13, and that it should not be restricted to its meaning in the context of Section 709, given that Section 709 is directed at different transactions, and has a different effect.

143. We agree with this approach and that the Section 709 cases authorities should not, as Mr Southern suggests, merely be jettisoned, but need to be considered in the context of the purpose and intent of para 13.

144. Mr Southern's main objection to their use was that the tax avoidance tests in para 13 are restricted to a consideration of what has actually occurred, without the ability to infer an alternative taxable transaction. We consider that the concept of a "tax advantage" referred to in para 13(5) implicitly includes a comparison with an alternative, less favourable tax result and it is not necessary to look to Section 709 and the case authorities which have considered its application, to come to this conclusion.

145.Mr Southern's real point, we think, was less about whether para 13 requires the court to consider an alternative, less advantageous transaction, and more about whether that comparison made sense when the transaction under consideration was a loan which would always give rise to deductible debits, by its very nature.

Conclusions.

146. Was one of the purposes for which the Appellant entered into the ZCN a tax avoidance purpose? We have concluded that it was.

147. If tax avoidance was a purpose for entering into the ZCN, was it something other than the main purpose? We have concluded that it was at least one of the main purposes for entering into the ZCN.

148. Mr Southern was anxious that in considering the application of para 13 we should provide certainty to taxpayers and avoid metaphysics. With respect, para 13 is not susceptible to easy analysis, and while metaphysics might not be helpful, what is required is a careful analysis of all the relevant facts and circumstances and a proper balancing of all the components of decisions made by this taxpayer in entering into this lending transaction.

149. Whilst it is true that tax considerations can form part of a commercial transaction without swamping its non tax elements, it is also true that tax driven transactions can be covered with a veneer of commerciality in an attempt to disguise their main purpose.

150. What were the purposes of entering into this loan relationship, the ZCN?– As set out above, we think it is both legitimate and reasonable to start to answer this question by looking at the stated purposes for entering into the ZCN, the evidence which supports those stated purposes and what the effects of entering into it were. Then to consider whether the purposes which gave rise to these effects were predominantly commercial or tax purposes.

151. Mr Southern accepted, and the evidence certainly supports the fact that tax was among the considerations for entering into the ZCN. By reference to the tax reports prepared by the Accountants and KPMG, the Tribunal has concluded that tax was among the purposes of the Appellant for entering into the ZCN.

152. What were the non tax, commercial purposes for entering in the ZCN? Mr Southern suggested that there were a number of commercial purposes for entering into the ZCN, over and above its tax effect;

(1) Increasing debt funding and improving “ROCE”.

(2)Conserving working capital for the business

(3) To ensure ROE to shareholders on an assured basis.

153. While we do not dispute that these were commercial considerations which were in the mind of the Appellant when it was considering entering into the ZCN, we think that the weight given to these commercial purposes should be measured both by the amount of attention afforded to them as part of the planning of the ZCN and by

reference to their expected and actual commercial results, which, on the evidence before us, was small.

154. We found no evidence that either ROCE or ROE was considered by the directors and there was a lack of evidence that certainty of cash flow was relevant to the shareholders. Mr Roberts's evidence has merely led us to conclude that while the shareholders were very interested in the quantum and certainty of the return which they received from the Appellant, they were uninterested in the impact which that had on the Appellant's ROCE or ROE.

155. There was very little either in Mr Robert's evidence or in any of the other evidence submitted to the Tribunal to support the fact that any of the directors, shareholders or beneficiaries were greatly concerned, or even understood the concepts of ROCE or ROE. As Mr Roberts said in his witness statement, the only issue which concerned the shareholders was how much cash they were going to receive from the Appellant. Equally, little or no evidence was produced to suggest that the Appellant was concerned with the conservation of working capital.

156. Conversely, we were provided with evidence that significant thought was given to the tax effects of the ZCN, both in the KPMG and the Accountants' advice. It is interesting that no equivalent document setting out the ROCE/ROE advantages of the ZCN was produced.

157. Mr Roberts seemed to know little about the tax planning which had been part of the decision to enter into the ZCN, but we conclude, as did HMRC, that this indicates not that tax planning was not a part of the Appellant's reasons for entering into the ZCN, but that it was not part of the decision making process to which Mr Roberts was party.

158. We were not given the opportunity to hear from any of the other directors of the Appellant, but our conclusion is that, Mr M Hirschfield in particular might well have been able to give a much more detailed view of the tax elements of the decision to enter into the ZCN.

159. We would add that we consider that is relevant in this regard that Barclays Bank, as part of providing the financing decided that the loan needed to be reviewed by their own in house tax risk committee and we refer to the email exchanges between Ms Guffog in Barclays group tax and her colleagues, including Mr Bailey of 24 November 2004, discussing the roll over of the 2003 loan in late 2004 as quoted at paragraph 103 above.

160. Presumably this is not something which is applied to "every debenture in the land" or even every loan made by Barclays. From Barclays' perspective, as a relatively neutral but well informed bystander, there were sufficient tax elements in this funding to prompt them to require scrutiny by their tax risk committee.

161. On the evidence produced before the Tribunal, the effects of the Appellant entering into the ZCN were:

(1) The shareholder's interest in the Appellant had changed in legal form from equity to debt.

(2) The income flow received from the Appellant by the shareholders had also changed in form from dividend payments to discount receipts, but the quantum of the income had not changed.

(3) The tax position of the Appellant had changed because it could claim deductions for the discount payments against its UK tax liabilities which it could not claim for the dividend payments.

(4) Fees had been paid to Mr Meek at the Accountants and to Barclays Bank, amounting to £4,112 and £5,500 respectively and which were claimed as deductions.

(5) On receipt of the discount payments there was only 2% tax payable by the recipient entity in Jersey.

162. The evidence of Mr Roberts and Mr Townsend has led us to conclude that neither an improvement in ROCE/ROE nor additional certainty for the shareholders were in fact achieved by the ZCN; Mr Roberts referred to the fact that he was continually concerned with the risk that the Barclay's loan would not be rolled over for another year, suggesting that the shareholders had swapped the uncertainty of whether dividends would be declared for the uncertainty of whether a loan facility would be rolled over.

163. On cross examination, Mr Townsend said that while the ROCE of the Taxpayer had improved during the relevant period, that was due to an increase in the company's re-valuation reserve, and not as a result of swapping equity for debt funding.

164. There was very little evidence before us to suggest that serious consideration was given to either of these aspects of the ZCN issuance by the directors of the Appellant at the time when the ZCN was entered into, and there is a corresponding lack of significance in the effect which the ZCN had in both of these aspects of the Appellant company's position.

165. We would categorise the effects set out above, as to (1) and (2) as legal effects, which, while supporting the fact that the ZCN was not a sham, have only a very limited, if any, economic or commercial impact on the position of both the company and the shareholders.

166. It is particularly significant in this regard that Mr Roberts stressed that it was always the intention of the company to ensure that the return which was paid on the ZCN, was the same in money terms as the return which would have been paid by way of dividend payments. Therefore, it is only effect (3), the changed tax position, which has any real economic or commercial impact for the Appellant.

167. Taking the approach of the courts in cases such as *Brebner,* to determining whether a tax advantage has been obtained, and by reference to the wording of para

13 itself, we think it is legitimate to ask "is there an alternative way in which the shareholders could have been given the same return?"

168. We consider that the answer to this is yes, – they could have done what they had done for all previous years and relied on dividend payments; Mr Roberts confirmed this when he said as part of his evidence that he was always aware that it would be possible to convert the ZCN back to an equity holding.

169. On that basis we have concluded that one of the purposes for entering into the ZCN was to significantly reduce the Appellant's UK corporation tax payments and that this amounts to a tax avoidance purpose as defined by para 13(4) and (5).

170. In determining whether this tax avoidance purpose was a main purpose, we do not agree with Mr Southern that a commercial purpose will always cancel out any fiscal purpose. Whether it does so depends on the weight given to the commercial purpose. Mr Southern suggests that commercial purposes have some greater intrinsic weight than tax purposes, because any commercial purpose will always trump a fiscal purpose. We do not find anything in the drafting of paragraph 13 or in any of the case authorities referred to, to suggest that this is the correct approach.

171. This point is made explicitly in *Sema Pensions:*

> "there is no inconsistency between holding that a taxpayer had carried out transactions for bona fide commercial reasons and……holding that a main object of the transaction was to obtain a tax advantage" (Lightman J at para 48).

172. We think that para 13 is more subtle than Mr Southern suggests and recognise that between cases which are clearly commercial and cases which are only tax driven, there are cases where tax, while not the only component, is a substantial component of the decision and therefore cannot be ignored.

173. In order to decide whether para 13 applies, it is not enough just to point to a commercial purpose of the taxpayer, it is necessary to weigh up all of the relevant factors which, on the basis of the evidence, the taxpayer took account of in coming to the decision to take this particular course of action, taking account of both commercial and tax considerations.

174. One of the main effects of the ZCN was certainly to significantly change the tax position of the paying entity. In fact, this is one of the only economic effects of the transaction, and the evidence suggests that this was an important component of the decision of the directors.

175. The approach of the Special Commissioners in *Prudential* was that if all commercial purposes were discounted, and only tax was left, the conclusion must be that tax is at least one of main purposes of a transaction. The Tribunal considers on this evidence that we are left very much in the same position.

176. There are a number of different ways of testing whether tax is one of the main purposes of this transaction. We also think it is legitimate to ask in this context

whether the transaction would have been undertaken if the tax impact had been neutral. In other words, would it have been worth the fees paid to Mr Meek and to Barclays Bank and the time and planning required of the directors, to ensure the commercial advantage of providing, in Mr Robert's words a more secure flow of income to the shareholders and an improved ROE or ROCE?

177. We think the answer to this must be no, given the relative worth of these advantages, to the extent that they were achieved at all, compared to the Appellant's tax saving.

178. On these facts the Tribunal has concluded that the non tax, commercial purposes of the ZCN are not sufficiently significant components to override any fiscal purposes. Applying the test as it was enunciated in *Sema pensions*:

> "Obviously if the tax advantage is mere icing on the cake, it will not constitute a main object"

Our view is that the tax planning in respect of this ZCN was more than mere icing and that in fact this transaction produced a preponderance of icing and very little cake. The ZCN had as one of its main purposes the obtaining of a tax advantage, namely the tax deductions available in the UK for the discount element of the ZCN.

Disallowance of debits

179. Debits are disallowed in accordance with para 13(1)(a) to the extent that "on a just and reasonable apportionment, they are attributable to the unallowable purpose" i.e. to extent that debits gave rise to non fiscal, commercial effects, they should be allowable. Neither party addressed this point in detail and both sides assumed that the debits, including the fees paid to Barclays Bank and the advisory fees paid to the Accountants, would either be allowable in full or disallowable in full.

180. Nevertheless we have considered whether there is any extent to which the ZCN discount payments gave rise to a non tax commercial effect. We have concluded above that their only significant effect was a reduction in the Appellant's tax charge. On this basis we do not think there is any extent to which the discount element of the ZCN should be allowable.

181.In respect of the fee payments to Barclays Bank and the Accountants, on the basis that these relate wholly to the Accountants' tax advice and to Barclay's lending fees for the years in question, we have concluded that these should also be disallowed in their entirety.

Decision

182. The Appellant's appeal is hereby dismissed and it is confirmed that all of relevant debits were correctly disallowed by HMRC.

183. 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 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.

RACHEL SHORT/SANDY RADFORD

TRIBUNAL JUDGES

RELEASE DATE: 7 February 2012