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JUDICIAL UNALLOWABLE PURPOSES

By Nikhil V Mehta

The Past

In the early 1990s, in the heady days of tax-based structured finance, a number of us were involved in the design and implementation of interesting (excuse the pun) debt instruments for companies. The tax ingredient in the recipes for these instruments was simple: to use the arbitrage which then existed between capital and income for corporate investors or between revenue and capital expenditure for corporate debtors.

One of my favourite instruments was the DIMBO. Any resemblance to a flying Disney pachyderm is entirely coincidental, except that the terms of some DIMBOs were so ambitious that the financial magicians who concocted them may well have believed elephants could fly.

A DIMBO stands for a "Deep-in-the-Money Bond Option". In its purest form, it is an option granted by a company over its own bonds to a corporate investor. The investor pays a hefty premium on the grant of the DIMBO in the knowledge that, at maturity of the underlying bond, there will almost certainly be a profit. So, an investor pays 70 for a DIMBO and a further 10 on exercise for a bond which will yield 100 at maturity (which may be soon after exercise of the DIMBO). The net profit (ignoring discounted cashflows) is 100-80=20. If that 20 is tax-free, that is a great result all-round since the investor gets that benefit and the borrower gets a pricing advantage.

Now, you may say that this looks awfully like a discount which should be taxable as income. But the trick was in arriving at terms which respected the integrity of the instrument as an option, not debt, including being careful that there was some element of optionality about exercise. Where things

started getting out of hand was when both those ingredients became flaky and exercise was deemed to occur at the exercise date without the option holder having to do anything.

But assuming "good" ingredients, how was the tax-free objective achieved? This was done simply by ensuring that the underlying bond was a sterling-denominated bond which, for the purposes of corporation tax on chargeable gains ("CGT"), was a qualifying corporate bond, or "QCB". Alternatively, the underlying debt instrument could have been a gilt, although the challenge with that is that the pricing of the debt instrument was outside the parties' control. Gains on QCBs and gilts are exempt, and were in those days for companies.

The interplay between the tax treatment of exercised options and QCBs meant that the whole of the gain of 20 was made at maturity of the bond, and that was a disposal of a QCB for CGT purposes.

One could even turbo-charge the tax benefit for the investor if it borrowed the option premium and exercise price amounts to invest in the DIMBO. Interest on the borrowing would be tax deductible, while the profit on the DIMBO would be tax-free.

Along came 1996 and the introduction of the "loan relationships" legislation. The eradication of the capital/income divide for corporate debt made the DIMBO as extinct as the mammoth (this really is my last elephantic allusion!) at least as far as tax-based motivations were concerned.

Buried in the loan relationships package was a quite sinister provision which attacked the borrowing side of the DIMBO investment on anti-avoidance grounds and, had the tax-free nature of the DIMBO remained, would, in all likelihood, have killed off the deduction for interest.

I. The Introduction of Para. 13

That provision was contained in Schedule 9, paragraph 13, Finance Act 1996. It is commonly known just as "para. 13". If

you are in the know, you know what it means – say no more. Just as people talk about the "Furniss" issue, they talked about the para. 13 issue. In fact, I still do even though para. 13 was done away with in the tax rewrite of the Corporation Tax Acts. I will continue to call it that in this article, even though the current measure is in Sections 441 and 442 of the Corporation Tax Act 2009. Somehow, the "Sections 441 and 442 issue" does not quite have the same ring about it.

So, what do these sections say?

They are worth setting out in full:

"*441 Loan relationships for unallowable purposes*

(1) This section applies if in any accounting period a loan relationship of a company has an unallowable purpose.

(2) The company may not bring into account for that period for the purposes of this Part so much of any credit in respect of exchange gains from that relationship as on a just and reasonable apportionment is attributable to the unallowable purpose.

(3) The company may not bring into account for that period for the purposes of this Part so much of any debit in respect of that relationship as on a just and reasonable apportionment is attributable to the unallowable purpose.

(3A) If—

(a) a credit brought into account for that period for the purposes of this Part by the company would (in the absence of this section) be reduced, and

(b) the reduction represents an amount which, if it did not reduce a credit, would be brought into account as a debit in respect of that relationship,

subsection (3) applies to the amount of the reduction as if it were an amount that would (in the absence of this section) be brought into account as a debit.

(4) An amount which would be brought into account for the purposes of this Part as respects any matter apart from this section is treated for the purposes of section 464(1) (amounts brought into account under this Part excluded from being otherwise brought into account) as if it were so brought into account.

(5) Accordingly, that amount is not to be brought into account for corporation tax purposes as respects that matter either under this Part or otherwise.

(6) For the meaning of "has an unallowable purpose" and "the unallowable purpose" in this section, see section 442.

442 Meaning of "unallowable purpose"

(1) For the purposes of section 441 a loan relationship of a company has an unallowable purpose in an accounting period if, at times during that period, the purposes for which the company

(a) is a party to the relationship, or

(b) enters into transactions which are related transactions by reference to it;

include a purpose ("the unallowable purpose") which is not amongst the business or other commercial purposes of the company.

(1A) In subsection (1)(b) "related transaction", in relation to a loan relationship, includes anything which equates in substance to a disposal or acquisition of the kind mentioned in section 304(1) (as read with section 304(2)).

(2) If a company is not within the charge to corporation tax in respect of a part of its activities, for the purposes of this section the business and other commercial purposes of the company do not include the purposes of that part.

(3) Subsection (4) applies if a tax avoidance purpose is 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 a loan relationship of the company.

(4) For the purposes of subsection (1) the tax avoidance purpose is only regarded as a business or other commercial purpose of the company if it is not-

(a) the main purpose for which the company is a party to the loan relationship or, as the case may be, enters into the related transaction, or

(b) one of the main purposes for which it is or does so.

(5) The references in subsections (3) and (4) to a tax avoidance purpose are references to any purpose which consists of securing a tax advantage for the company or any other person."

"Tax advantage" incorporates the general definition in Section 1139 of the Corporation Tax Act 2010. It includes:

"(a) relief from tax or increased relief from tax,

(b) a repayment of tax or increased repayment of tax,

(c) the avoidance or reduction of a charge to tax or an assessment to tax,

(d) the avoidance of a possible assessment to tax."

Para 13 (which has not changed much since its original enactment) caused a lot of consternation when it was first unveiled. Today, it is described as a targeted anti-avoidance provision or "TAAR", but I am pretty certain it was not called that in 1996-in fact, I think the acronym TAAR came in a little later to distinguish a TAAR from the general anti-avoidance rule, which then of course became the GAAR we have today in the shape of a general anti-abuse rule.

Like a number of other TAARs, there was nothing particularly "targeted" about the language of para. 13, and this is what created great uncertainty. Of course, it was clear that it applied to tax relief for corporate funding costs, but

its parameters were ill-defined. The biggest concern was that seemingly innocent commercial borrowings might be caught. It did not help that it was part of the extensive new code for loan relationships introduced in 1996, which permitted tax relief for items which were recognised as debits for accounting purposes i.e. the relief was not just restricted to interest costs, and neither was the restriction in para. 13.

The uncertainty was exacerbated by the fact that twenty years before para. 13, what was Section 787 of the Income and Corporation Taxes Act 1988 had been enacted to deal with interest deductions and tax avoidance. That section said:

> *"Restriction of relief for payments of interest*
>
> (1) Relief shall not be given to any person under any provision of the Tax Acts in respect of any payment of interest if a scheme has been effected or arrangements have been made (whether before or after the time when the payment is made) such that the sole or main benefit that might be expected to accrue to that person from the transaction under which the interest is paid was the obtaining of a reduction in tax liability by means of any such relief.
>
> (2) In this section "relief" means relief by way of deduction in computing profits or gains or deduction or set off against income or total profits.
>
> (3) Where the relief is claimed by virtue of section 403(7) any question under this section as to what benefit might be expected to accrue from the transaction in question shall be determined by reference to the claimant company and the surrendering company taken together".

The simple question was what was the interaction between Section 787, which had been introduced to attack highly aggressive tax avoidance schemes and the new para.13. Section

787 applied to all taxpayers, but that meant that companies were now exposed to both Section 787 and para.13.

Para 13 was intended to be broader than Section 787, and most importantly, was based on the subjective motivation of the taxpayer. Section 787, in using the words "sole or main benefit that might be expected to accrue" followed an objective approach. Incidentally, any overlap no longer exists because the latest version of Section 787, which was Section 443 of the CTA 2009, has been repealed.

The unclear matters in para. 13 related to the definition of "unallowable purposes", what amounted to a "main" purpose, and how one operated the "just and reasonable" basis. Further, it was a new notion that a tax avoidance purpose could be a business or other commercial purpose and therefore an allowable purpose, if it was not a main purpose. And, in determining whether there was a business or other commercial purpose, what exactly did not being within the charge to corporation tax in respect of activities actually mean?

The breadth and uncertainty of the "unallowable purposes" language, caused the then Economic Secretary to the Treasury to make the following statement to Parliament:

> *'The Government are aware of concerns that have been raised by my hon. Friends and by others regarding the particular anti-avoidance provisions in paragraph 13. This paragraph was amended significantly in Standing Committee but, because of the concerns that my hon. Friends and others have raised, I take the opportunity to allay some of the fears that have been expressed about the anti-avoidance rules.*
>
> *Paragraph 13 of the schedule disallows tax deductions to the extent that tax avoidance is the main motive behind a loan relationship. We have been told of concerns that this could be interpreted as preventing companies from getting tax relief for legitimate financing arrangements. I am happy to offer a reassurance that this is not the intention of the legislation. The paragraph*

denies tax deductions on loans that are for the purpose of activities outside the charge to corporation tax. Among other things, this will ensure that United Kingdom branches of overseas companies do not get tax relief for borrowings that are for overseas activities outside the United Kingdom tax net.

We have been asked whether financing - which, for example, is to acquire shares in companies, whether in the United Kingdom or overseas, or is to pay dividends - would be affected by the paragraph. In general terms, the answer is no, but the paragraph might bite if the financing were structured in an artificial way.

It has been suggested that structuring a company's legitimate activities to attract a tax relief could bring financing within this paragraph - some have gone so far as to suggest that the paragraph might deny any tax deduction for borrowing costs. These suggestions are clearly a nonsense. A large part of what the new rules are about is ensuring that companies get tax relief for the cost of their borrowing.

One specific point has been put to me by my hon. Friend the Member for Gloucester - that is, borrowing by a finance leasing company to acquire assets where this is more tax efficient than the lessee investing in the asset direct. Again, I am happy to offer a reassurance. Where a company is choosing between different ways of arranging its commercial affairs, it is acceptable for it to choose the course that gives a favourable tax outcome. Where paragraph 13 will come into play is where tax avoidance is the object, or one of the main objects, of the exercise.

Companies that enter into schemes with the primary aim of avoiding tax will inevitably be aware of that. The transactions we are aiming at are not ones which companies stumble into inadvertently. As one top tax adviser said recently, companies will know when they are into serious tax avoidance; apart from anything else, they are likely to be paying fat fees for clever tax advice and there will commonly be wads of documentation.

The last thing I want to do, however, is set out a list of so-

called acceptable or unacceptable activities. Borrowing for commercial purposes can be structured in a highly artificial way in order to avoid tax. If we said that borrowing for certain types of activity would always be okay, tax advisers would quickly take advantage and devise artificial financial arrangements simply to avoid tax. Provided that companies are funding commercial activities or investments in a commercial way, they should have nothing to fear. If they opt for artificial, tax-driven arrangements, they may find themselves caught.

It is clear that a balance must be struck between meeting the concerns that have been raised and weakening the provision in those instances where it needs to apply, but I can assure my hon. Friends that we shall keep the matter under review.' (Hansard 28 March 1996 Finance Bill Report Stage, Columns 1192-1193).

This extract still appears in the HMRC Manuals, so it is clear HMRC continue to consider it of relevance today: see the Corporate Finance Manual at 38170. The simple transaction which the Economic Secretary specifically mentioned was borrowing to acquire equity, the concern being that to earn tax-free dividends would not be within the business or other commercial purposes of the company as an activity not within the corporation tax charge. Did that automatically show an unallowable purpose? This concern was assuaged in part by the Economic Secretary saying that in general terms para. 13 would not apply to such a transaction. But then she qualified this by excluding financings structured in an artificial way and then later on also giving a warning about "artificial, tax-driven arrangements".

II. Para. 13 Goes to the Courts

It was clear that there would be areas in different shades of grey, particularly in complicated financings, where the application of para. 13 could not be ruled out. It would only be a matter of time before para. 13 came before the courts.

In fact, it took well over a decade for the first decision to be published. There have also been a handful of further cases since. What I propose to do is to look at some of these and see how the courts have applied unallowable purposes and to see what lessons there are to be learnt for future financings.

There are four outcomes possible in relation to para. 13:

(i) The tax avoidance purpose is either the only purpose of the company in doing the financing, or that purpose so dominates other purposes that it is an unallowable purpose and para 13 should result in a 100% prohibition of tax relief;

(ii) The tax avoidance purpose, not being a main purpose, is one of the business or commercial purposes of the company. In this case, even though there is a tax avoidance purpose, it is not an unallowable purpose so there should be no restriction on the tax relief;

(iii) The tax avoidance purpose is an unallowable purpose because it is a main purpose. But there are other main purposes too to which the deduction is attributable. In this situation, a just and reasonable apportionment would be appropriate so that only part of the funding costs should be denied;

(iv) There is no tax avoidance purpose at all, and all the purposes are business or commercial purposes. There is, however, a beneficial tax effect or consequence of doing the borrowing. Here, there is no unallowable purpose at all, so the tax relief should not be in doubt.

All of these different outcomes have been recognised by the courts. But only the first outcome i.e. denial of relief in full, has so far been upheld.

The first Para. 13 case was *A.H. Field Holdings Limited v HMRC [2012] UK FTT 104*. This got as far as the First Tier Tribunal ("FTT") and no further. One rather got the impression that HMRC had decided to fight one of their strongest cases

on para. 13 as the first case. The facts involved a property rich/cash poor property investment company entering into a financing to pay dividends to its shareholder. But the financing involved the company raising bank funds for a matter of days, paying the dividends, getting the dividend proceeds back from the shareholder in exchange for a short-term zero coupon note, repaying the bank from the subscription proceeds and, in the following year, raising bank funds again to repay the zero coupon note and repeating the circular transactions. This happened for a number of years. The tax purpose in the transactions was to get a tax deduction for the discount on the zero-coupon notes. It was clear from the evidence that the structure of the financing was heavily tax-driven.

HMRC did not have too much difficulty in attacking the transactions under para. 13 and denying the deductions. The FTT found that the tax deduction was a main purpose based on the evidence including the documentation. The flow of funds was circular, but nevertheless purportedly attracted tax relief.

In coming to their decision, the FTT stated that the onus was on the taxpayer to show that there was no unallowable purpose. This had clearly not been discharged. In considering what the purpose was, the FTT thought it was legitimate to look at the intentions not just of the taxpayer, but also that of its shareholders and other stakeholders like tax advisers. This was a surprisingly wide net for catching an unallowable purpose, and has since been narrowed to the purpose only of the taxpayer-see below.

The FTT clearly did not think much of the facts before them. They said that a tax benefit was not a main purpose if it was merely icing on the cake. What they were confronted with "produced a preponderance of icing and very little cake."

The weakness of the facts in *Field Holdings* provided a strong forensic start for HMRC in para. 13 challenges.

Three other cases were *Versteegh Limited [2013] UKFTT 642*,

Fidex Holdings Limited [*2014] UKUT 0454* and *Travel Document Service [2018] EWCA Civ 549*. The first case went as far as the Upper Tribunal. The other two went to the Court of Appeal. The facts in all three were rather different from those in *Field Holdings,* inasmuch as they all involved large financing transactions with a rather clearer business rationale. In *Field Holdings*, the deduction claimed was some £150,000 whereas the amounts in these cases ran into many millions. But the common theme in all three was the existence of a tax avoidance scheme in the structuring, as the courts found. *Versteegh* was a fairly straightforward tax arbitrage in a group whereby the borrower company sought a deduction for financing costs whereas the lender got no corresponding taxable income. *Fidex Holdings* was an old-fashioned tax-based structured finance transaction involving one financial institution proposing a scheme to another – in this case to generate tax losses available for surrender within the borrower's group. *Travel Document Service ("TDS")* involved a scheme devised by tax advisers. This was probably the most complicated of the three and the key to some intricate transactions within a large group involved devaluing shares which were treated as debt so as to be able to claim relief for a debit under the loan relationship rules generated by the diminution in value.

The taxpayer lost in *Fidex Holdings* and in *TDS* on the para. 13 point. *Versteegh* was a little more curious in terms of outcome. Although the final appeal went to the Upper Tribunal, the para. 13 point was one of a number of points of issue and was only taken at FTT level. It was argued in a strange way. There was no evidence adduced as to what the purpose of the financing was, but HMRC invited the FTT to come to the inevitable conclusion that para. 13 should apply where:

- The only reasons for the borrowing were to enable other group members to get a tax-free benefit in their hands whereas the borrower would get a tax deduction;
- All the participating group companies were aware of

the tax benefits at the time of entering into the borrowing;

- The borrower had a commercial need for the borrowing.

The FTT refused to follow this approach and said that the issue had to be decided on all the evidence. There was no shortcut of inevitability. So, HMRC lost on this approach.

In *Fidex Holdings*, the scheme turned on obtaining derecognition of existing bonds so that a debit could be claimed for the effect of derecognition. The holding of the bonds went from an unobjectionable purpose pre-scheme to an unallowable purpose (and other commercial purposes) once the scheme was implemented. So, the case is a good example of how the purpose of having a loan relationship can change. Further, the "all or nothing" approach to attribution meant there was no scope for a just and reasonable apportionment providing some relief as a result of mixed purposes.

The *TDS* case is notable for the fact that the loan relationships in question were in fact deemed loan relationships: the actual instruments were shares which, because of linked hedging arrangements including a total return swap, were deemed to be loan relationships. The judges had no difficulty in applying para. 13 to deemed loan relationships; one simply looked at the purposes attributable to the actual instruments even though they were not actual loan relationships. There was some discussion of apportionment on a just and reasonable basis, but the court found that there had been insufficient evidence available to determine whether any apportionment should be made.

It would be easy to conclude that any set of facts incorporating a "tax avoidance scheme" is, even after full production of evidence, bound to fail. But I do not think that is correct. What is still important is whether the scheme constituted a main purpose or not. What is clear is that HMRC were quite strategic in permitting cases to go to court where either there was

extremely aggressive avoidance as in *Field Holdings*, or at least the existence of "schemy" characteristics in situations where the amounts at stake were huge. So, the fact that the three cases I have mentioned above involved tax avoidance schemes shows the attitude of HMRC in case selection rather than inevitable judicial conclusions against the taxpayer.

III. Oxford Instruments

The most recent case on para. 13 is *Oxford Instruments UK 2013 Limited v HMRC [2019] UK FTT 0254*. The transaction involved a complex refinancing within a UK multinational group which had a US subgroup. The structure put in place for the refinancing was a "tower" structure, consisting of a number of companies held vertically including the taxpayer ("UK Newco"), which was a new hybrid entity treated as transparent in the US and opaque in the UK. The new structure involved eight steps. UK Newco only participated in the last step, which consisted of it subscribing for 1.4m preference shares issued by a US affiliate in exchange for a US$140m promissory note. None of the steps in the refinancing involved any movement of cash, and the previous seven steps did not have any UK tax-motivated features. The tax benefit to UK Newco lay in the fact that dividends on the preference shares were tax-free, but interest on the promissory note would be tax deductible. Taken in isolation, this was precisely the benefit on which the Economic Secretary gave comfort back in 1996.

However, HMRC challenged UK Newco on the basis that para. 13 applied to the promissory note. Interestingly, the top UK company had applied for a clearance in relation to the proposed structure under the arbitrage tax provisions. The facts disclosed in the clearance application included an increased UK benefit overall by comparison to the existing group financing arrangements. To nullify this, the applicant offered that UK Newco should forgo a specified percentage

of its tax deductions on accrued interest on the promissory note so that the overall position would be flat when compared to the previous financing structure. HMRC granted clearance on that basis, but made it clear that it related to the arbitrage legislation, and not to any other anti-avoidance provisions.

In the clearance application, the purpose of the refinancing was described as follows:

- To refinance existing loans which were due to mature in the near future;
- To introduce additional intra-group debt to achieve a suitable debt:equity ratio for the US sub-group, which had grown considerably;
- To simplify and consolidate existing intra-group debt; and
- To allow a flexible structure for funding future acquisitions in the US.

In a very careful and meticulous decision, the FTT held, with some reservation, that UK Newco was caught by para. 13, and further, that it should be denied relief for interest on the promissory note in full. A number of important general points come out of the decision, which I understand has become final:

(1) In looking at purpose, it was important to determine whose purpose. The purpose is only that of the taxpayer company claiming the tax relief and no-one else-in this case, it was only UK Newco or, more accurately, its directors;
(2) The intentions of other stakeholders such as tax advisers was irrelevant unless such parties had effectively exercised *de facto* control of the taxpayer company (there was no evidence of that before the FTT). What the FTT said in *Field Holdings* was rejected on this point;
(3) The initial burden of proof is on the taxpayer to show there is no unallowable purpose;
(4) The interest deductions generated the tax advantage in the form of relief capable of surrender by the taxpayer within

the UK group. The tax advantage has to be measured by reference to the taxpayer only and HMRC. Is the HMRC losing out as a result of the relief generated by the taxpayer? The net overall position of the group is irrelevant to this question, although it may be relevant to the question of identifying the taxpayer's main purpose;

(5) So far as UK Newco's main purpose was concerned, the FTT found that its sole purpose was to get the tax deductions for interest accruing on the promissory note so that it could surrender the relief. None of the broader purposes listed in the tax arbitrage clearance application could be attributed to it. Indeed, it did not even exist when those purposes were formed. The fact that it made a commercial spread between dividends earned and interest accrued was not a self-standing separate business or other commercial purpose. The evidence showed that the directors of UK Newco would not have carried out Step 8 if the tax advantage had been unavailable. The spread was simply a consequence of that step, not a self-standing purpose. Unlike earlier authorities where the tax avoidance purpose was held to be ***a*** main purpose, in this case the FTT found that the tax avoidance purpose was ***the*** main purpose. In the absence of any apportionment, nothing turns on this although I find it somewhat strange that UK Newco had a sole purpose of tax avoidance whereas in *Field Holdings*, which seemed to me to be a much more aggressive exercise, the tax avoidance purpose was only one main purpose.

(6) In a postscript to the judgment, the FTT expressed sympathy for the taxpayer because of the existence of the arbitrage clearance. The judge commented that had HMRC given the clearance with the intention of making a para. 13 challenge, that would have been misleading even with the express qualification in the clearance that it did not extend to other anti-avoidance provisions. There was no evidence to suggest

that, so UK Newco was just unfortunate to be attacked in this way by a subsequent decision by HMRC to raise para. 13.

IV. What About Just and Reasonable Apportionment?

No court to date has permitted just and reasonable apportionment so as to allow the deduction in part. To repeat the statutory wording, "The company may not bring into account …so much of any debit in respect of that [loan] relationship as on a just and reasonable basis is attributable to the unallowable purpose." This presupposes that there are other purposes to which at least part of the deduction is attributable.

But what does this mean? If a company has one (non-commercial) tax avoidance purpose and two commercial purposes, should that not automatically mean some apportionment merely by the existence of three purposes? Simplistically, if all the purposes carry equal weight, then the deduction should only be disallowed as to one-third. But it would be unusual to find such a scenario, and the question of weighting is extremely difficult.

In the early case of Iliffe *News and Media Limited v HMRC [2012] UK FTT 696,* the para. 13 issue was one of eight disputed issues. The taxpayer argued that it had both tax avoidance and commercial purposes in entering into the financing. It contended that the legislative purpose of para. 13 was to strike down a debit only to the extent that it is greater than it would be but for the tax avoidance purpose. If the debit would have remained the same based just on the commercial purpose, the fact that the tax avoidance purpose was a main purpose should not affect the deduction. On the evidence before it, the FTT accepted this argument and found in favour of the taxpayer. So, the existence of a tax avoidance main purpose did not affect the relief.

Not surprisingly, HMRC are not happy with this approach and challenged it in the *Oxford Instruments* case. They said that the correct approach is simply whether the statutory

language, read plainly, requires an apportionment to be made between the tax avoidance purpose and the other self-standing purposes. Since the FTT found the taxpayer to have only one purpose i.e. of tax avoidance, the point became irrelevant, but the judge made some observations on the question of apportionment on the hypothesis that the taxpayer had both tax avoidance and self-standing commercial purposes, being the achievement of the US objectives for the group and getting a spread on the financing.

He looked at the authorities and, in particular, the Court of Appeal authorities in *Fidex Holdings* and *TDS*. He derived no help from the former case since it again required attribution of the whole deduction to the tax avoidance purpose. In the latter, he found support in the judgment of Newey LJ for the *Iliffe* approach in relation to one of the participants to the scheme in question. He noted that relief was denied because there was insufficient evidence to support the application of the *Iliffe* approach, not because that approach was incorrect. He concluded that, if there had been mixed main purposes for the taxpayer in *Oxford Instruments*, the taxpayer would not have suffered any denial of tax relief as the relief would not have been increased by the tax avoidance purpose.

So, we still do not have any real guidance on the circumstances in which a debit will be allowed in part on the basis of just and reasonable apportionment. The *Iliffe* approach involves high stakes since it produces an "all or nothing" result. Realistically, if a company is considering entering into a new financing transaction or a refinancing, its purposes will all arise concurrently at that time. In a new transaction, the debit will be whatever it is, and if it is attributable to the commercial purposes, relief cannot be denied. In a refinancing, it may be that the debit is increased, but even that increase would be attributable to the concurrent purposes and not any historical reason for the original financing. The mere fact that the

deduction is greater than what it was earlier is not fatal if there are new commercial purposes to which the debit can be attributed.

The "all or nothing" approach means that apportionment could never result in a deduction being allowed in part. This is a startling result. It is perhaps worth noting, although it has no binding effect, the cautionary words of the FTT in *Versteegh* on the *Iliffe* approach. At para. 166 of the Decision, they thought that this approach involved putting a gloss on the para.13 language. The approach may be appropriate in some cases, but should not be regarded as a substitute for the statutory test itself.

HMRC clearly endorse this view, as they made clear in argument in *Oxford Instruments*. One cannot, therefore, assume that the *Iliffe* approach is the last word on just and reasonable apportionment. It does not in any event carry the force of precedent.

V. Some Concluding Remarks

I draw together the following strands on para. 13, based on the case-law:

(1) The existence of a "tax avoidance scheme", while optically unhelpful, is not fatal to the availability of tax relief. It is all a question of marshalling the different purposes for the transaction of which the scheme forms part;

(2) The purpose is that of the taxpayer company and no-one else. It is, therefore, extremely important to ensure that it, through its directors, exercises its decision-making functions and records all the proper purposes for implementing the relevant financing. The cases on corporate residence, particularly those involving special purpose companies, are helpful in showing what proper corporate governance should be;

(3) Benefiting other members of a group is a legitimate purpose. In the case of a new company, it obviously cannot backdate the purposes to those of other members of the group which

were formulated prior to its incorporation. But, with appropriate care, it can adopt those purposes for itself later;

(4) The need for purposes to be found in individual companies can be particularly challenging in practice where groups tend to make many common decisions at a higher level. So, there may be an education process for some multinationals in adhering to this;

(5) The burden of proof to show no unallowable purpose is on the taxpayer, which is why it is even more important than otherwise to have strong evidence, both documentary and oral, of the lack of an unallowable purpose. I distinguish this from "paying fat fees for clever tax advice" and "wads of documentation" linked to that, as per the Economic Secretary's Statement;

(6) There is a difference between purpose and effect/consequence. If a financing produces a beneficial tax effect, that is not the same as a tax avoidance purpose. The Economic Secretary's Statement in this area remain valid today;

(7) Other tax avoidance clearances on the structure are irrelevant and cannot be relied upon unless there is some suggestion of misleading conduct by HMRC;

(8) Just and reasonable apportionment remains an unknown quantity.

There is a tendency to assume that, given the pattern of HMRC victories before the courts on para. 13, any para. 13 challenge is bound to succeed. But that is not what the cases say. A well-structured financing with robust evidence of purpose (including a tax avoidance purpose), implemented with care and monitored for its duration (particularly to ensure that "good" purposes do not become "bad" purposes or new bad purposes do not arise), should still withstand a para. 13 challenge. Indeed, in all likelihood, such a transaction would go nowhere near the courts on the basis that HMRC would have granted the taxpayer relief in full.