Quick losses—a perilous intra-group debt restructuring? (Kwik-Fit Group v HMRC)

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Tax analysis: The Upper Tribunal (UT) upheld the decision of the First-tier Tribunal (FTT) that: (1) an intragroup debt restructuring, which would have had the effect of accelerating the use of a non-trading loan relationship deficit, had an 'unallowable purpose' (within the meaning in sections 441–442 of the Corporation Tax Act 2009 (CTA 2009)); and (2) the original commercial purpose under which intra-group debtors had borrowed survived the assignment of loans as part of the restructuring so that, on the basis of a just and reasonable apportionment, debits calculated by reference to the pre-assignment rate of interest were allowable in respect of the post-assignment period. So the outcome for the taxpayer was a bit of a curate's egg—good in parts (although certainly in quantum terms, mostly not so good). Although the 2017 reforms to the group relief rules to permit the surrender of a non-trading deficit will have removed the original impetus for the Kwik-Fit scheme, the underlying message, that using a debt restructuring to accelerate access to tax losses is vulnerable to the unallowable purpose rule, and that transfer pricing does not offer an effective inoculation, is likely to have wider relevance. Written by Gerald Montagu, senior counsel at Gide Loyrette Nouel LLP.

Kwik-Fit Group Ltd and others v Revenue and Customs Commissioners [2022] UKUT 314 (TCC)

What are the practical implications of this case?

'Double, double, toil and trouble; Fire burn, and cauldron bubble'

Loan relationship unallowable purpose cases, like Macbeth's three witches, seem currently to be posing advisers and taxpayers a triple challenge. *Kwik-Fit* is far from alone—it is accompanied round the (thankfully not yet, at least in the UK, blacked-out) fire by *Black Rock HoldCo (No 5) LLC v HMRC* [2022] UKUT 199 (TCC) (which the UT directly referenced in *Kwik-Fit* and *JTI Acquisition Company (2011)* [2021] UKFTT 446 (TC)).

To the extent that these three cases appear to indicate, to a greater or lesser degree (perhaps, it may be said to a lesser extent in the case of *Kwik Fit*) a desire on HMRC's part to depart from the approach reflected in HMRC's Manuals and other policy statements over many years and to resist the use of loan relationship debits to 'monetize' losses, it would be would be helpful if that change of stance could be communicated rather more clearly (including by updating its Manuals) than seemingly relying on the tribunals to pick their way through particular fact patterns and leaving it up to everyone else to deduce their own conclusion as to what is acceptable planning and what is not.

In *Kwik-Fit*, the UT noted that the group's tax manager had 'sought' to discuss the restructuring with HMRC and also that the restructuring would not have gone ahead if HMRC had indicated that it would not give rise to the desired benefits. To that extent, *Kwik-Fit* is a cautionary tale of the dangers of having a half-conversation with HMRC. As a general matter, particularly in these resource strapped times, it is not always easy for a taxpayer to engage with HMRC, making it difficult or impossible to achieve proper certainty as to the position.

Stepping back a little, these debates about what purposes are allowable resonate with recent arguments, highlighted by Ross Birkbeck (see: Wholly and exclusively: does a tax motive prevent deductibility? (2022): Tax Journal, Issue 1597, 8) that the courts have been addressing as the extent to which seeking a tax benefit is incompatible with a payment being wholly and exclusively in the course of a trade. One might, to illustrate the point, substitute references to 'trade' with the term 'business or other commercial purposes' in the Court of Appeal's observation in *Hoey* [2022] EWCA Civ 656 at para [194]:

> ‘Once the existence of a trade is recognised, the mere fact that a transaction is entered into with a fiscal motive does not, in the normal way, denature it or mean that it is infected by a duality of purpose which makes expenditure on it non-deductible. At times, HMRC's arguments seemed to come close to suggesting that the courts should recognise a general principle that the existence of a tax avoidance motive which is more than purely incidental must give rise to a duality of purpose which means that the wholly and exclusively rule cannot be satisfied.’

If, on the threshold of 2023, we venture a glance backwards in time, this feels like a modern articulation of a debate that can be traced right back to the prohibition, introduced in Addington’s Duties on Income Act of 1803, on relief for interest payable ‘out of profits or gains’ of a trade and the linked restriction on deduction and retention to interest payable out of such profits or gains. The old case law may generally no longer be directly applicable, and modern legislation may use many more words—CTA 2009, ss 441–442 alone uses 585 words (!)—but the underlying question is really as old as the taxation of income.with

What was the background?

By means of a mixture of a pot-pouri of debt assignments, varying the terms of existing debts and entering into new debts, an intermediate holding company in the Kwik-Fit group (Speedy) sought to increase the interest income it received from fellow members of the group, from 0.74% to LIBOR + 5%, so as to allow Speedy to utilise a £48m brought forward non-trading deficit over three years, rather than (ie if the restructuring had not taken place) over 25 years.

What did the court decide?

The UT rejected the taxpayer’s argument that the use of the non-trading deficit could not amount to a tax advantage on the basis that the utilisation of existing losses was not a ‘relief’ from tax. On a ‘plain’ reading of the reference in CTA 2010, s 1139(2)(a) to a ‘relief or increased relief’, the UT was satisfied that an accelerated utilisation of a non-trading deficit was ‘readily’ encompassed—CTA 2010, s 1139(2)(a) posed a functional question (and so could be triggered without any demonstration that less tax is payable).

The UT disagreed with ‘any argument’ based on *CIR v Kleinwort Benson Ltd* [1969] 2 Ch 221 that as a matter of legal principle, a person cannot have a purpose to secure a tax advantage because what that person is doing follows inherently from the legislation.

The UT also gave short shrift to an argument based on *Burlington Loan Management DAC* [2022] UKFTT 29 (TC) that knowledge of a counterparty’s tax position was not synonymous with having a purpose of facilitating a tax advantage purpose for that counterparty—and, although the UT did not put it quite like this, it is suggested that there is an important distinction between an intra-group context (as in *Kwik-Fit*) and a third party context (as in *Burlington*).

Equally and perhaps unsurprisingly, the argument that, as three of the five debtors were already loss-making, the increase in those losses by virtue of the increased interest rate did not represent a ‘tax advantage’ was dispatched ‘briefly’ by the UT. More interestingly, and in what may distantly echo the FTT’s decision in *The Tower One St George Wharf Ltd* [2022] UKFTT 154 (TC), the UT agreed with HMRC that a company can have a purpose even if that purpose is ultimately unsuccessful. The FTT, having considered a considerable amount of evidence, had not in the UT’s view erred by inferring an unallowable purpose from ‘knowledge’ of the hoped-for tax advantage. In this context, the UT accepted that the ‘underlying motivation to the restructuring of achieving a group tax saving’ caused the debtors to share the unallowable purpose that had been conceived of at group level.

Finally, having followed HMRC up to this point, the UT rejected HMRC’s contention that the FTT’s finding that loans had been assigned with a view to accessing trapped losses precluded relief at the historic interest rate on a ‘just and equitable’ basis. Here the FTT’s finding, as a matter of fact, that if the reorganisation had not occurred the debtors would have continued paying interest at the 0.74% rate was not interfered with.

Case details

- Court: UK Upper Tribunal (Tax and Chancery Chamber)
- Judges: Upper Tribunal Judge Swami Raghavan and Upper Tribunal Judge Rupert Jones

- Date of judgment: 25 November 2022

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