

Notification of uncertain tax treatment by large businesses

Response to HMRC's second consultation document of 23 March 2021 by the Tax Law Review Committee of the Institute for Fiscal Studies¹

Introduction

This is the response of the Institute for Fiscal Studies' Tax Law Review Committee ("TLRC") to the invitation to comment on the proposal contained in the second Consultation Document ("Condoc 2") published by HMRC on 23 March 2021 to introduce an obligation for a large business to notify HMRC where it has adopted an uncertain tax treatment ("UTT").

We start by drawing attention to a number of points that lead us to respond to this consultation as we do:

1. Condoc 2 suffers from many of the flaws that were evident in HMRC's first consultation on this topic ("Condoc 1"). Condoc 2 has provided us with no evidence and with no reason to lead us to change our view of this proposal. The stated policy objectives are hopelessly confused.
2. Condoc 2 exhibits a number of contradictions, for example:
 - a. The proposal is supposed to be designed in a way that spares the majority of large businesses with a Customer Compliance Manager ("CCM") the additional compliance costs of notification (paragraph 2.7). However, paragraph 2.30 recognises the difficulty of legislating by reference to a non-statutory BRR+ process. It is unexplained as to how non-statutory discussion with a CCM can be relied upon to satisfy a statutory obligation to notify.
 - b. It is proposed that those large businesses without a CCM will be provided with some alternative means (which we understand is yet to be identified or developed) for discussing uncertainties as an alternative to notification. Again, it is unexplained how some alternative non-statutory system can substitute for a statutory notification obligation.
 - c. Taxpayers are frequently told that they *cannot* rely on HMRC guidance (see, e.g., Case 1 in the Appendix) and yet it is proposed that the notification obligation should rely on HMRC guidance.
 - d. The proposal is presumably designed to *increase* the number of reported uncertainties into which HMRC must enquire (and therefore increase the potential occasions of dispute) and yet the proposal is supposed to *reduce* the time take to identify and settle disputes. How that outcome is achieved is merely asserted, without examination or explanation.
3. As Condoc 2 recognises (see point 2.a above), addressing uncertain tax positions is a fundamental part of the role of CCMs, who should be having regular meetings with large

¹ The TLRC was set up by the IFS in 1994 to consider whether the tax system was working as intended, efficiently and without imposing unnecessary burdens. Its role is to keep under review the state and operation of tax law in the UK, which it does by selecting particular topics for study. It does not seek to question Government policy as such but looks at whether existing or proposed arrangements achieve the stated policy in a satisfactory and efficient way.

business, to the mutual benefit of both parties. If the compliance issue underlying this proposal involves businesses without a CCM, the resources that HMRC will have to invest to running the proposal properly may be better used in expanding the system of CCMs instead.

4. If the problem is that the BBR+ and CCM systems are not working sufficiently well, and if some large companies (whether within those systems or outside them) are thought to be “*pushing the boundaries*”, a better use of resources would be to target that group, perhaps with enhanced supervision via CCMs, rather than imposing new obligations on all large companies. The basis of responsive regulation that lies behind co-operative compliance requires a graded approach to taxpayers with different compliance levels. That strategy is undermined by the current proposal.
5. Fundamentally, the problem with Condoc 2 (as with Condoc 1) is that it is devoid of any proper illustration, examination or explanation of the underlying compliance issue that the proposal is designed to address. To work properly, a notification system must involve additional administrative costs and resources for HMRC, which might be better deployed in other ways, but essentially the proposal just appears to impose significant additional costs on largely compliant business for insignificant benefits.
6. Our final point in opening is to observe that a number of serious issues remain with the proposed notification triggers for an “uncertain tax treatment”. We think that they will raise significant legislative difficulties and may result in a whole new layer of uncertainty, not least the uncertainty involved in correctly identifying a “known HMRC position” or a “novel” situation.

From Condoc 1 to Condoc 2: *c'est la même chose*

In our response to Condoc 1, we said that we were unclear why the Government had chosen to consult at Stage 2 (Determining the best option and developing a framework for implementation including detailed policy design) of the Tax Consultation Framework rather than starting at Stage 1 (Setting out objectives and identifying options). For all the reasons we identified in our response, we considered that the proposal in Condoc 1 should be withdrawn.

The Condoc 1 proposal lacked a clear policy objective or rationale and, in our view, plainly needed to return to Stage 1 to be re-thought rather than being taken forward from Stage 2. We recommended that if the Government believed that additional measures were needed to address the tax gap or to improve large business compliance, further consultation starting at Stage 1 and taking account of the responses to the Condoc 1 consultation was the appropriate way forward. The TLRC was not alone in its criticism of the Condoc 1 proposals. Many respondents were highly critical of the proposals.

Condoc 2 continues down the same path from Stage 2 and, unsurprisingly, suffers from many of the defects of Condoc 1. The failure to set out adequate and clear policy objectives for the proposals and to identify a variety of options for achieving clear objectives means that Condoc 2 merely builds upon the sandy foundations of Condoc 1 and suffers from many of the flaws that respondents to Condoc 1, including the TLRC, have already pointed out.

There is therefore nothing in Condoc 2 that persuades us that this proposal merits legislation in its proposed form. We remain of the view that:

- the proposal should be withdrawn,

- if the Government believes that additional measures are needed to address the tax gap or to improve large business compliance, the Government should engage in proper consultation starting at Stage 1 and aimed at identifying the issues properly and setting out for consultation a variety of options for addressing those issues.

The Policy Objective

The stated policy objectives underlying the current proposals appear hopelessly confused:

- Most people will think it a good idea for government to consider measures to reduce the legal interpretation tax gap (Condoc 2, Question 1).
- Similarly, most people will think it is good idea to improve taxpayer compliance, where HMRC have identified specific deficiencies in taxpayer compliance.
- It may be that improved compliance measures will affect what is estimated as the “legal interpretation tax gap”, depending upon the particular methodology used to arrive at an estimate of the “legal interpretation tax gap”.
- Any reduction in the legal interpretation tax gap, however, is no more than an effect of improved taxpayer compliance. That does not mean that what has been estimated as the “legal interpretation tax gap” is an appropriate or relevant measure for devising proposals to improve taxpayer compliance.
- Put another way, the justification for a new compliance measures should properly be assessed by reference to the particular issue or problem with current compliance that has been identified and which the proposal is designed to address, rather than by reference to its impact on the tax gap.
- Only once that has been done – i.e., the compliance issue identified and the various options for dealing with it examined – can a proper assessment be made of whether the additional compliance and administrative costs involved for both taxpayers and HMRC are worthwhile. Indeed, that is a central aspect of an evaluation of any proposals that are designed to improve taxpayer compliance, not a justification in itself.

Condoc 2, as Condoc 1 before it, fails to explain the compliance issue that it is designed to address. It is therefore impossible to assess the sense or relevance of the proposal that it seeks to advance. At its worst, the proposal appears to impose significant additional costs on largely compliant business for insignificant benefits.

“Uncertainty” as a feature of any tax system

It should be recalled that the current proposal is not concerned with cases that involve tax avoidance. The proposal is concerned with the general operation of the tax system. Nevertheless, as we pointed out in our response to Condoc 1, the relationship between this proposal and the multiplicity of current anti-avoidance provisions – themselves a significant (and, to some extent, intended) source of uncertainty is unclear. Condoc 2 does not address that issue.

Furthermore, there is (and should be) no assumption that HMRC’s view of the matter is correct. In other words, there may be no inaccuracy in the reported tax position, save in the mind of the HMRC,

which may have incorrectly interpreted the law or reached the wrong conclusion on the application of the law to the taxpayer's circumstances.

"Uncertainty" is inherent in every tax system because no tax system can sensibly legislate for every eventuality and every set of circumstances. Every substantive tax issue that has to be decided by the appeal tribunal reflects an uncertainty in the interpretation of the legislation or in the application of the legislation to the taxpayer's particular circumstances. As we noted in our response to Condoc 1, this is reflected in HMRC's own assessment criteria for deciding whether or not to litigate an issue.

Those appeals that do end up in the tribunal are just the tip of a very large iceberg resulting from situations in which taxpayers have had to reach some conclusion in reporting and paying tax as to how current legislation is correctly interpreted and how it applies to their particular circumstances. Tax advisers spend their lives advising on "uncertainties" in the tax system in an endeavour to ensure that taxpayers report and pay tax correctly.

We see no basis or justification for assuming that taxpayers (or a particular category of taxpayers, such as large business) and their advisers routinely seek to report and pay tax other than in accordance with the law. If there are circumstances in which the contrary is shown to be the case, then they may be appropriate circumstances to address specifically. The current proposals, however, neither explain any such circumstances nor are limited to that issue.

Between the initial process of reporting and paying tax and arriving in an appeal tribunal to resolve an unresolved uncertainty, countless "uncertainties" will have been the subject of enquiry, discussion and resolution, by agreement or compromise.

This is indicative of the potential scale (and therefore cost) involved for large business and HMRC alike in the current proposal.

Against that background, we think that the suggestion at paragraph 2.7 of Condoc 2 that the intention is not to impose significant additional compliance costs on open and compliant businesses is entirely optimistic. Such businesses are likely to be put to significant compliance costs precisely because they, more than others, will want to comply fully with any notification requirements. They will wish to avoid the stigma of a penalty for non-compliance and to avoid the risk that HMRC may threaten a penalty for something that, in a case where HMRC's view proves to be wrong, represents the correct and accurate reporting of their tax position.

HMRC resources to administer the proposal properly

Apart from paragraph 2.7 of Condoc 2, the Response document to Condoc 1 and Condoc 2 make a number of unexplained assertions. Paragraph 2.6 of the Response document to Condoc 1, for example, explains that, "*the aim of this measure is to enable discussions about uncertain tax treatments sooner and reduce the time taken to identify and settle disputes.*"

It is unclear how this follows from the proposal. It is now proposed that a notification should be made with the relevant return. Furthermore, it is unclear why an increase in the number of reported uncertainties (i.e., occasions on which a taxpayer (with or without advice) has had to make some assessment of how current tax rules should be interpreted or applied to its circumstances) into which HMRC must then enquire and to which it must respond, should reduce the time taken to identify and settle disputes.

So far as large business is concerned, this would at least suggest a necessary increase in HMRC resources given that a significant factor in dealing with current disputes involving a real issue of uncertainty, is frequently attributable to the time taken by HMRC not only to absorb the information it is given but to formulate its view of the matter and to progress an enquiry.

A real risk of this proposal is that HMRC resources are wasted (and the business' compliance costs increased even further) in understanding and responding to notifications where, in the end, HMRC conclude that the business has correctly assessed the position and reported and paid tax correctly, as was always its aim. Alternatively, yet more issues will remain unresolved and, ultimately, may end up in the appeal tribunal, which may then endorse the taxpayer's position rather than HMRC's view.

Indeed, if there is a serious difference of view as to the meaning or application of the current tax rules, there is no reason to suppose that it will be a matter that can be resolved by compromise or agreement rather than ending up before an appeal tribunal for adjudication.

None of these issues have been properly explored or explained in either Condoc 1 or Condoc 2.

Additional HMRC resources are also implicit in the 'assurance' that *"an equivalent means of discussing uncertain tax treatments will be established for those customers without a CCM so no party is at a disadvantage"* (see paragraphs 3.6 & 3.17 of the Response document and paragraph 2.28 of Condoc 2).

Condoc 2 provides no detail of how this will be dealt with or how some non-statutory "equivalent means" can substitute for a notification obligation. It also appears from discussions on Condoc 2 that no clear method for achieving this has yet been devised with whatever additional resources may (or may not) be available to HMRC to administer this notification proposal.

If the compliance issue giving rise to this proposal particularly involves those businesses without a CCM, consideration might better be given to devoting the additional HMRC resources that will be needed to administer a notification system properly to expanding the system of CCMs instead.

However, as the real issue that has stimulated this proposal and the policy objective it is designed to serve remain shrouded in mystery notwithstanding two attempts at consultation, this is impossible to assess.

The proposed triggers for notification

HMRC's "known" position (trigger (a))

Paragraph 3.62 of the Response document states that, *"The government accepts that the onus will be on it to confirm its interpretation of the law to ensure notification are only received in those situations where there is true uncertainty"*.

If that is the onus on government and if the uncertainty in current rules is apparent, it is unclear why the correct response is not to clarify the law: Revenue guidance does not clarify the law but, in the context of this proposal, merely adds to the number of notifications and potential disputes where HMRC's view of the law is debatable or just wrong. "Uncertainty" often derives from known inadequacies inherent in the legislation that may well have been drawn to the government's attention on enactment or subsequently, but left unattended.

Paragraph 3.62 is presumably intended to tie in with trigger (a) for notifying an uncertain tax treatment, namely that it, *"results from an interpretation that is different from HMRC's known position"*. What is "known" is said to be derived from *"HMRC's guidance or other material in the public*

domain, or a position that is inconsistent with HMRC's view, as established in dealings between the business and HMRC".

It is unclear how any such requirement could be legislated without in itself creating significant additional uncertainty. Essentially,

- Large business has to reach a view (with or without the benefit of professional advice) how particular legislative provisions should be interpreted and correctly applied to its circumstances. This is currently the position.
- In addition, however, and irrespective of whether or not a business considers that the legislation (or its application to its circumstances) gives rise to an uncertainty, the business will have to consider whether by reference to any publicly available information or its previous dealings with HMRC, HMRC's 'known' interpretation might involve a different result.
- On the basis that it concludes (or is advised) that there may be more than one correct interpretation of the law, or that the application of the law to its circumstances may be uncertain, it will have to consider whether that uncertainty gives rise to an obligation to notify (subject to a penalty for failure to do so). Each of the triggers poses its own issue of 'uncertainty' as to what falls within its scope for these purposes. The need to consider the triggers and the obligation to notify will arise irrespective of whether or not the taxpayer's reported filing and tax payment is correct.

This process assumes that there is no uncertainty about HMRC's 'known' interpretation: but what degree of 'known-ness' is involved in this process?

Much of HMRC's guidance is necessarily written in general terms and changes to existing guidance may be unexplained (see Case I in the Appendix). Will taxpayers be expected to identify changes in guidance and notify a situation when guidance changes? Are changes retrospective to previous periods or prospective only? How is this proposed to be legislated for?

In response to a taxpayer's claim that its case falls within the terms of existing guidance, HMRC are quick to point out that taxpayers cannot rely on HMRC's guidance and that, furthermore, the taxpayer's circumstances are not the type of situation envisaged by the guidance.

Against that approach by HMRC to their own guidance, significant uncertainty surrounds HMRC's 'known' position, and that is before a business has to consider other publicly available information (including cases in course of litigation).

Our Appendix illustrates 'uncertainty' as to HMRC's 'known' view of the law. Existing enquiries may involve a variety of assertions by HMRC officers as to the interpretation or application of existing legislation, which may or may not be correct as a matter of law but which may nevertheless be regarded by HMRC as part of the previous dealings between HMRC and the business (see for example Case 1 in the Appendix).

Industry practice (trigger (b)) and equivalent transactions (trigger (c))

It is difficult to understand the relevance of several of the other proposed triggers – such as triggers (b) and (c) – in the light of trigger (a).

Trigger (c) begs the critical question as whether a transaction is 'equivalent' to what has gone before and how any change in legislation, relevant case law or HMRC interpretation and guidance impacts the matter.

“Novel” situations (trigger (d))

Trigger (d) refers to a scenario that “*is in some way novel such that it cannot reasonably be regarded as certain*” and HMRC’s position is not ‘known’.

The novelty should, it seems, relate to a “*product, transaction or business structure*”. It is unclear whether these categories, in themselves, are intended limitations on the application of the notification trigger or are merely illustrative of occasions where there may be some novelty (‘novelty’ in fact being the only limitation on the trigger).

Again, we find it difficult to conceive how this concept can satisfactorily be legislated. ‘Novel’ to whom? To HMRC? To the taxpayer in question? To taxpayers in general? To a particular class of taxpayer e.g., large business?

What is a ‘known’ position for HMRC? Does a general statement of position in HMRC guidance apply to any circumstances that falls within that generality even though they involve a factor that is “in some way” novel?

‘Novelty’ substitutes for ‘uncertainty’ and coupled with the requirement for a ‘known’ position for HMRC essentially represents a regression to the original proposal in Condoc 1 that was widely regarded as unworkable for its in clarity.

Trigger (d) illustrates the wholesale uncertainty that this notification proposal creates, quite apart from any uncertainty as to the interpretation or application of the existing tax rules.

Other triggers

All the triggers raise potentially significant difficulties of legislative definition. It is unclear, for example, how trigger (f) would be legislated: would it adopt existing concepts to “amount incurred” or “income received” or impose some overriding ‘economic’ substance test separate from existing concepts and existing accounting conventions? Each of them creates the problem that we have previously identified, namely that of introducing a further element of uncertainty with which large business must necessarily deal.

Conclusions on Condoc 2

We repeat below the conclusions we reached on the proposals in Condoc 1, annotated in bold with our conclusions based on the proposals in Condoc 2:

1. In our response to Condoc 1, we observed that we had been unable to identify a clear rationale for the proposal.

That remains the case for Condoc 2.

2. In our response to Condoc 1, we also recommended that the proposal should be properly targeted with a clearly stated objective that addresses an issue arising from current compliance measures and that takes account of existing reporting and compliance obligations.

The proposals contained in Condoc 2 acknowledge this to some extent but, overall, remain inadequate in this respect.

3. In our response to Condoc 1, we noted that it made no attempt to relate the notification proposal to existing measures designed to secure co-operative compliance; it did not explain the gaps (if any) that HMRC have identified in those existing measures and whether those gaps

are of a general nature or relate to a particular subset of large companies which may, in some way, be non-compliant notwithstanding those other measures.

The proposals contained in Condoc 2 acknowledge this to some extent but remain inadequate in this respect, lacking any adequate explanation of identified gaps or how they might alternatively be addressed.

4. As a result, we concluded in relation to Condoc 1 that it was not possible to say that the proposals in Condoc 1 represented a sensible, proportionate or necessary additional compliance obligation to impose on large business. We thought it likely that the costs involved for large business in complying with the proposal in the form proposed in Condoc 1 would far exceed the forecast yield of the proposal. Put simply, Condoc 1 offered no proof that the proposed measure was 'worth it' when comparing yield with additional compliance costs.

In this respect, Condoc 2 has essentially 'tinkered' with the tests of 'uncertainty', in an endeavour to make them less subjective but otherwise does nothing to address this criticism of the proposals. There is a fundamental difficulty involved in the endeavour underlying the definition of what is 'uncertain': what is 'uncertain' depends significantly on a person's knowledge, appreciation and subjective appraisal of the matter.

5. Condoc 1 referred to the definition of 'legal interpretation' that is used for the purpose of the tax gap estimates. As we noted, however, this is not an appropriate definition for use in legislation. Moreover, Condoc 1 made no attempt to relate the proposal to those estimates or to explain its impact on those estimates.

The proposals in Condoc 2 continue to be justified by reference to the 'legal interpretation' tax gap notwithstanding the unsuitability of that measure as a basis for the introduction of what is essentially a further compliance measure for large business. As noted in point 2 above, the appropriate policy justification for a measure of this nature is one that addresses an issue arising from current compliance measures and that takes account of existing reporting and compliance obligations.

6. It is unacceptable that a large company should be at risk of a penalty just because it disagrees with HMRC's view of the law. Thus, the essential pre-requisites of an obligation to notify an uncertain tax treatment are:
 - a. the existence of clear public statements of HMRC's view of the law; and
 - b. a test of 'uncertainty' that is capable of judicial scrutiny and determination on an appeal against a penalty for failure to notify.

This remains our view. Although trigger (a) is express by reference to HMRC's 'known' view of the law, we have pointed out some of the uncertainties that this engenders. Trigger (a) is not equivalent to a "clear public statement" of HMRC's view of the law.

7. In our response to Condoc 1, we noted that an objection to the use of published Revenue practice as a determinant of the duty to disclose is that it effectively allows HMRC to determine the scope of the obligation, backed by a penalty that does not depend upon HMRC being able to show that their view is right.

The proposals in Condoc 2 continue to rely on the use of published Revenue practice and our criticism is the same for the proposals in Condoc 2.

8. In our response to Condoc 1, we noted that a test of ‘uncertainty’ that is not open to judicial scrutiny and determination on appeal is plainly unacceptable as effectively imposing an unappealable penalty for failure to notify.

This point remains true of the proposals in Condoc 2. We doubt whether the triggers in Condoc 2 can be adequately legislated in a way that provides the necessary appeal rights for taxpayers.

9. An obligation to notify would appear to arise for any substantive issue of tax liability that HMRC might litigate or does in fact litigate, unless the issue falls within a specific exclusion from notification. HMRC itself has an established matrix to assess its prospects of success in litigation, which seeks to evaluate the potential outcome in terms of the level of certainty or uncertainty that attaches to the position that HMRC is litigating.

This point remains true of the proposals in Condoc 2.

10. In that respect, the current proposal effectively requires a company to anticipate HMRC’s own assessment of the level of uncertainty involved. That is not an appropriate basis for a notification obligation coupled with a penalty for failure to notify.

This point remains true of the proposals in Condoc 2.

As a general matter, we would refer HMRC to the comments that we made in our response to Condoc 1, the majority of which remain equally relevant to the proposals in Condoc 2.

7th June 2021

Appendix

The following illustrations involve businesses within the scope of the Condoc 2 proposals. They are taken from two recent appeals that have been heard by the First-tier Tribunal in which HMRC's has advanced arguments of application to taxpayers more generally and which many would consider to be inconsistent with previously established views of the law.

These appeals are in the public domain and the arguments presented for HMRC in the cases in question must now be among HMRC's 'known' view of the law, whether or not those arguments are ultimately found to be correct on conclusion of the appeals in question.

Case 1: Deferred Revenue Expenditure

HMRC have recently argued in the First-tier Tribunal that what is known as "deferred revenue expenditure" or "DRE" (revenue expenditure on the maintenance and repair of business assets that accounting standards require to be capitalised and written off over time) is not deductible for tax purposes in computing the profits of a property business on the sale of the asset in question.

HMRC's published guidance on DRE originally stated that:

"As indicated above, there is no rule of law that enables a business to obtain relief for revenue expenditure at a time that it is not written off to the profit and loss. Under GAAP, the capitalised revenue expenditure will be charged to the profit and loss account either on the sale of the asset or when there is a reduction in the value of the asset which is expected to be permanent such that the value falls below the asset's original cost. Relief will only be available for tax purposes when the expenditure is charged to profit and loss account, even though this may be some time after the expenditure was incurred."

The underlined sentence was deleted in 2019, which (for those in the 'know') reflected the approach that HMRC was taking in the litigation in question. Prior to that amendment in HMRC's published guidance, HMRC's view of the law on DRE would be known to some taxpayers (and their advisers) but not to others.

At the hearing of the appeal, HMRC said that the taxpayer was not entitled to rely upon its guidance in seeking to deduct DRE in computing its profits. Furthermore, HMRC also pointed to previous correspondence with the taxpayer in question which HMRC said would have indicated to the taxpayer HMRC's view of the matter (notwithstanding the published guidance at the time).

As Counsel for the taxpayer pointed out at the hearing, the arguments advanced by HMRC were not limited to the particular transaction in question (the sale of a leased property) but were generally applicable to all property businesses and to all trades to which the accounting principles for DRE applied.

To the extent that HMRC's amendment to its published guidance did not make clear to taxpayers generally the change in its known position on the law for DRE, its 'known' position is now a matter of public record.

The First-tier Tribunal has concluded that HMRC's view of the law is wrong and has allowed the taxpayer's appeal. It is not known whether HMRC will appeal the FTT's decision.

Case 2: Limited Partnerships

In *BlueCrest Cayman Management Cayman LP v HMRC*, HMRC argued that the general partner of a limited partnership (Partnership A) was the only person who could be a partner in another partnership (Partnership B). The general partner was therefore the sole person chargeable to corporation tax on the Partnership A's share of Partnership B's profits.

As Counsel for the taxpayer pointed out to the First-tier Tribunal, it followed from HMRC's argument that the share of profits attributable to a tax-exempt charity or pension fund as a limited partner in Partnership A would no longer be exempt, because (as argued by HMRC) those profits were properly taxable solely in the hands of the general partner. This point was acknowledged by the FTT in its decision but the FTT nevertheless held that the general partner was the only partner in Partnership B and was therefore taxable on Partnership A's share of Partnership B's profits.

Such partnership structures are common structures adopted by tax exempt bodies investing, for example, in property developments but, in any event, the point must be one of general application to limited partnerships.

HMRC's view is now a matter of general public knowledge, even though it is unlikely that the majority of limited partnerships may have appreciated the point (or would agree with it). A limited partnership that reports and pays tax by reference to the position of its limited partners is now taking a position against a 'known' HMRC view, even if HMRC has routinely agreed to partnership computations on that basis in the past.

The FTT's decision is under appeal.

Case 3: Ignoring transactions between associated persons

The *BlueCrest Cayman* decision also illustrates another 'known' position by HMRC, namely that HMRC is entitled to disregard transactions between associated persons under the UK's transfer pricing rules even though there is no challenge to the pricing of the transaction.

The *BlueCrest Cayman* appeal involved the sale of a 19 per cent partnership interest at an undisputed arm's length consideration. HMRC contended that the sale should be ignored under the UK's transfer pricing rules, on the basis that the purchaser of the 19 per cent interest was an associated company and the transaction would only have occurred between associated persons.

This argument is being advanced by HMRC in other cases, to the effect that the transfer pricing rules are not concerned solely with the correct pricing of the transaction (the transfer price being undisputed in *BlueCrest Cayman*). In other words, a taxpayer cannot assume that it has satisfied the transfer pricing rules by transacting at an arm's length price but must also consider whether it would have entered into the same transaction with an independent third party.

In *BlueCrest Cayman*, the FTT concluded this issue in favour of the taxpayer but its decision is being appealed by HMRC.

Case 4: Interest relief for acquiring a partnership interest

The *BlueCrest Cayman* decision also illustrates another 'known' position by HMRC, namely that a corporate taxpayer is not entitled to a deduction for corporation tax purposes of the financing costs incurred in acquiring a partnership interest.

Partnership A financed its acquisition of a 19 per cent interest in Partnership B by borrowing. HMRC's view is that Partnership A is not entitled to any relief for corporation tax purposes for the interest cost incurred on that finance against Partnership A's share of Partnership B's profits.

This view must apply to any acquisition of a partnership interest by a company and must now be a 'known' HMRC position. A corporate taxpayer who acquired a partnership interest in the past and which now continues to claim a deduction for the financing cost is taking a position against a 'known' HMRC view, even if HMRC has routinely agreed to the deduction in the past.

The FTT concluded the issue in HMRC's favour. Its decision is under appeal.

It should be noted that the First-tier Tribunal concluded that the transactions in *BlueCrest Cayman* were commercial transactions. However, even if the Tribunal had agreed with HMRC's view that they were tainted by tax avoidance, the three issues highlighted above concern the application of the tax rules generally and are unrelated to any question of tax avoidance.