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# Final, unnecessary step in refinancing had a unallowable purpose

A loan entered into as a final step in a debt restructuring was for an "unallowable purpose" where its main purpose was to obtain UK tax deductions and it was an unnecessary step in relation to the broader purposes of the general restructuring.


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The FTT has held that a loan used by a UK sub to subscribe preference shares in its direct US parent company was for an "unallowable purpose" such that deductions for the interest were denied by CTA 2009 s.441: Oxford Instruments UK 2013 Ltd v HMRC [2019] UKFTT 254. The loan was made as part of an additional and unnecessary final step in the arrangements, demonstrating that it was not protected by the broader business purpose of the debt restructuring.

## Background

The case concerned the increased refinancing of the US sub-group of Oxford Instruments PLC. In 2013, it was decided that for US objectives the existing intra-group funding for the US sub-group should be increased. These included introducing a more appropriate capital structure for the US sub-group which had increased in value, allowing for further acquisitions. As a result, existing intra-group financing from the UK group of a combined $94m was increased to $140m. In addition, the debt was also consolidated into one UK lender.

Deloitte's provided advice on the refinancing and suggested a "tower structure". One of the objectives was to increase the US funding but without giving rise to taxable receipts in the UK. Up to this point, the Oxford Instruments group had losses which could be used to set against the interest receipts, but these losses were due to be used up by 2015. As a result, as a final step in the arrangements, Deloitte suggested and the group implemented a loan of $140m from the US holding company to the appellant, which was set up as a UK subsidiary of that US holding company (under check the box arrangements). The appellant used the $140m to subscribe for preference shares in its US parent. However, the effect of the loan was to provide matching interest payments to offset the interest payments received by the remainder of the UK group.

HMRC sought to deny deductions for the interest on the loan to the appellant on the basis that the loan had been made for an "unallowable purpose". In essence, HMRC argued that the main or one of the main purposes for that loan was the obtaining of a tax advantage.

## Decision of the FTT

Firstly, the FTT suggested that (although it made no difference on the facts) the burden of proof was on the appellant to show that the closure notice issued by HMRC was incorrect. There was no reason to depart from the normal application of the rules on burden of proof in cases relating to “unallowable purpose”.

In relation to the tower arrangements, the FTT noted that the broader purposes of the US financing were met by the preceding elements of the debt restructuring. As such, the final step in the restructuring was solely designed for the obtaining of a UK tax advantage in matching the taxable interest receipts elsewhere in the group with tax deductions. In fact, the final step was unnecessary for the achievement of the US aims of the refinancing and the group would have carried out the refinancing even in the absence of the final step. Indeed, it was clear that the sole purpose of the final step was to ensure that the scheme as a whole did not result in any increased net taxable income in the UK.

As such, the FTT held that the debits claimed in relation to the loan to the appellant were not deductible as they were apportionable to the unallowable purpose.

However, the FTT did express some sympathy for the appellant. As part of the arrangements, Deloitte had sought clearance from HMRC that the anti-arbitrage rules would not apply to the refinancing arrangements. In that clearance application, it had been submitted that whilst it was not the main purpose to obtain a UK tax advantage, it had been admitted that one would arise (in the reduction of net UK taxable receipts). It was proposed to deal with that by way of a “voluntary disallowance” of 25% to eliminate any UK tax advantage. HMRC did provide clearance on this basis. However, both parties accepted that the clearance only applied to the anti-arbitrage rules and did not prevent HMRC taking a point on “unallowable purpose”, given the disclaimer in the clearance letter that it did not apply for any other anti-avoidance purpose. The FTT noted that, nevertheless, it would have been misleading for HMRC to have provided the clearance had they had, at the time, any intent to challenge the arrangements on a different basis.

## Comment

The decision highlights that an additional, unnecessary step added to a restructuring will not be protected by the general business purpose of the wider scheme. It was the purpose of the particular step that mattered.

Nevertheless, as the FTT accepted, the taxpayer was “unfortunate” to be subject to this approach by HMRC in circumstances where HMRC had accepted (in relation to other anti-avoidance provisions) that a voluntary disallowance would be sufficient to make the arrangements acceptable to HMRC.