Cause for concern

Elizabeth Small examines a decision with potential implications for any transactions involving connected or interdependent steps where full SDLT has not been paid

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First-tier Tribunal decisions are not legally binding on other tribunals and courts and specific and complex facts of individual cases do not usually cause a whole industry to pause and take a deep breath. But that is precisely what the decision in *Hannover Leasing Wachstumswerte Europa Beteiligungsgesellschaft MbH v HMRC* [2019] has done.

The case revolved around the application of the anti-avoidance provision contained in s75A Finance Act 2003 (FA 2003). It has created uncertainty in the property industry, which given the recent changes to non-residential capital gains tax (NRCGT, contained in the Finance Bill 2019) and the move to corporation tax on rental income for non-residents from April 2020, is extra burdensome.

As a general proposition, s75A is engaged where various steps take place in connection with the transfer of property from vendor (V) to purchaser (P) and if the amount of stamp duty land tax (SDLT) actually paid is less than would have been paid on a notional straightforward transfer from V to P with no other steps involved.

In *Hannover* the tribunal deemed there to be a transfer of the property to Hannover for the largest amount of consideration that was paid pursuant to the various steps, ie SDLT of 4% of £138.85m (£5,554,000), which was the consideration paid at step 2 – the sale of the Guernsey property unit trust (GPUT) units. See Figure 1 on p3.

It has long been a perfectly acceptable business approach for a purchaser to buy the corporate owner of the property (either a purchase of shares or units in a Jersey property unit trust (JPUT) or GPUT, for example). Units in a GPUT were bought by Hannover.

Older readers may recall that when SDLT was first mooted, the government considered charging SDLT on the purchase of land-rich entities, but that legislation was not enacted. At the time defining a property-rich entity was considered quite simply too difficult. After all, the draftsman would have had to consider the difference between two broad scenarios: on the one hand, where all that is being sold is a corporate wrapper with no substantial business other than the ownership of the property, and on the other, where a supermarket chain is being sold (as a going concern that owner-occupies its stores). In the latter case, arguably the Inspector of Taxes on the 'Clapham Omnibus' would consider that SDLT should not be charged as what is being sold is a true trading business.

In *Hannover* (like numerous other transactions) the basic analysis that the parties to the transactions and their advisers were working on was that no SDLT would be payable on the purchase of the units and none when the property was moved around the buyer's group of companies. That has

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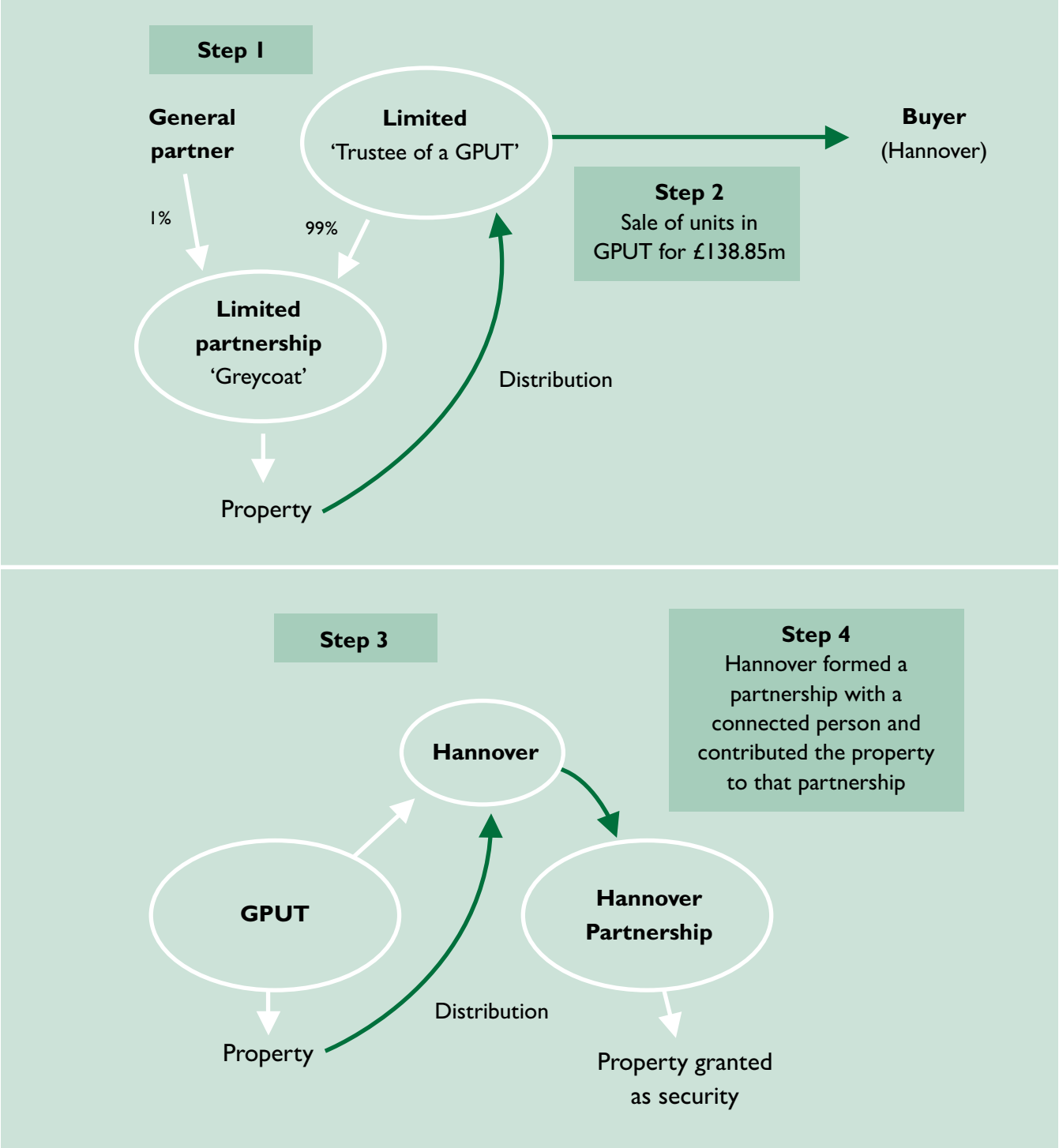
Hannover Leasing Wachstumswerte Europa Beteiligungsgesellschaft MbH & anor v HMRC
[2019] UKFTT 0262 (TC)

Project Blue Ltd v The Commissioners of HM Revenue & Customs
[2013] UKFTT 378 (TC)

Prudential Assurance Co Ltd v Inland Revenue Commissioners
[1993] 1 WLR 211

Figure 1: Hannover's purchase



been a tried and tested strategy. HMRC considered the point in 2013 following a flurry of enquiries into SDLT group relief claims in these circumstances. These enquiries often came with extensive information requests, which included copies of the seller's marketing brochures, copies of all turns of the contractual documentation etc. Enquires then stopped. HMRC went back to its accepted practice that there was nothing abusive per se in deciding to choose to buy the shares in the special purpose vehicle (SPV) or units in the GPUT that owns the property, rather than the property itself, and that group relief/distribution treatment on any subsequent movement of the property within the purchaser's group would not automatically be denied.

Typically advisers would not (before *Hannover*) have considered that s75A FA 2003 could have any application in this simple scenario. Partly because it would not be seen as being an unreasonable course of action. By analogy, the main safeguard from the application of the general anti-abuse rule (GAAR) is the so-called 'double reasonableness' test. This requires HMRC to be able to show that the arrangements entered into 'cannot reasonably be regarded as a reasonable course of action'. People in business frequently buy the corporate wrapper rather than the underlying business for sound commercial reasons, not just SDLT planning. The business continues

with less disruption and there is typically no need to novate every contract that the business has entered into. Also, buying the SPV is usually outside the risk of s75A because of a helpful limitation on the breadth of its application that is contained in s75C.

The real concern is the wider application of Hannover's principles, ie that HMRC is encouraged to take a mechanistic approach and that discretion is not acceptable.

Section 75A and s75C

But first let's recall that *s75A* is triggered where all of the following apply:

- One person (V) disposes of a chargeable interest and another person (P) acquires either it or an interest deriving from it (s75A(1)(a)).
- A number of transactions are involved in connection with the disposal and acquisition (scheme transactions) (s75A(1)(b)).
- The sum of the SDLT payable is less than would be payable on a notional land transaction effecting the disposal of the chargeable interest and the acquisition (s75A(1)(c)).

However, there is one key exclusion from the breadth of s75A. This would typically protect a taxpayer when buying the corporate wrapper rather than the business. Section 75C clearly states that in interpreting the core phrase in s75A regarding the transactions that are involved in connection with the disposal and acquisition (ie the scheme transactions), the transfer of shares shall be ignored if it was the first step.

Some conclusions

The judge in *Hannover* took a very mechanistic approach to s75A including that the order of the steps to be taken had to be carefully considered, and that because the first step was not the unit purchase it would not be ignored. The judge stated that if the order had been different the SDLT outcome may also have been different. In essence the judge concluded that:

- s75A does not include words like 'avoidance' and 'mitigation' – so it is not helpful to try to introduce a tax avoidance motive test into s75A, ie just look at the strict language;
- HMRC cannot narrow the breadth of s75A by guidance – this was not surprising given the decision in *Project Blue Ltd v The Commissioners of HM Revenue & Customs* [2013];
- HMRC has no discretion over the application of s75A; and
- the steps (collapse of a partnership, sale of the units, etc) were a pre-ordained series of transaction that was in connection with the transfer of the property and was commercially interdependent and formed an essential part of the overall deal, ie the steps were 'scheme transactions'.

The lack of a tax avoidance motive is not surprising given that HMRC in its SDLT Manual quotes enthusiastically from the decision of the First-tier Tribunal (Tax) in the appeal of *Project Blue*:

> Whilst it is clear that the purpose of s75A is to counteract the avoidance of SDLT, the provision contains no requirement that the taxpayer should have a tax avoidance motive or purpose as a precondition or defence to the application of the provision... Parliament obviously intended that the provision should apply regardless of motive.

So, as s75A was found to apply to Hannover's purchase of the units in the GPUT and there was no need for a tax avoidance motive, the judge in *Hannover* found for HMRC and charged SDLT on the consideration of £138.85m, which related to the scheme transactions.

I consider that it was unhelpful for Hannover's case that the price for the units in the GPUT was increased to reflect the anticipated SDLT saving, although this will often be the case in transactions.

The precise order of the steps was also unhelpful because no reliance could be placed on s75C, as the sale of the units in the GPUT was not the first step. In practice, there are often commercial constraints as to the order in which events take place, although the decision in *Hannover* suggest that great care should be taken about this in future.

Hindsight is a wonderful thing. So, while it is important to note that it is possible that the result in *Hannover* could have been different if the events had been re-ordered, the real concern is the wider application of its principles, ie that HMRC is encouraged to take a mechanistic approach and that discretion is not acceptable.

Wide-ranging impact of mechanistic approach to s75A

Rewrite *Prudential*?

Many transactions rely on tried and tested principles. Take the pension fund that enters into a development agreement with the developer; reliance is placed on the principles in *Prudential Assurance Co Ltd v Inland Revenue Commissioners* [1993] which means that SDLT is only paid on the land price for the undeveloped site. This analysis applies where in essence there are two 'bargains' as between seller and buyer and the usual parameters set out in the interpretation in *Prudential* are adhered to (ie the economic substance of the documents and not merely their form shows that the performance and completion of the two aspects are not interdependent upon one another). Could one apply s75A to this?

- **One person (V) disposes of a chargeable interest and another person (P) acquires either it or an interest deriving from it (s75A(1)(a)):** Yes.
- **A number of transactions are involved in connection with the disposal and acquisition (scheme transactions) (s75A(1)(b)):** Yes, depending on the interpretation of the phrase 'in connection'.

- **The sum of the SDLT payable is less than would be payable on a notional land transaction effecting the disposal of the chargeable interest and the acquisition (s75A(1)(c)):** Yes, because SDLT is not paid on the full amount of the consideration paid by the pension fund across the two contracts.

Absent any unusual steps, it is hoped that such an analysis would not be taken by HMRC; but can one be sure of this?

More worrying are the situations where HMRC has previously said it would not take an anti-avoidance point, as this may suggest that were it not for its lenient view an anti-avoidance point could be taken.

Sale and leasebacks

See Figure 2 below for examples of structuring a sale and leaseback.

HMRC in respect of the GAAR guidance specifically stated that structuring a sale and leaseback so as to 'avoid a "bear trap" insofar as s57A does not permit the leaseback to be granted to any other person than the vendor', and where '[t]hey are merely seeking to combine two reliefs', on the facts, is 'not such [an arrangement] that HMRC would seek to apply the GAAR'. While we might remain confident that if a client adopted the strategy outlined in the section 57A diagrams in Figure 2 that the GAAR won't be invoked, what of s75A if there is no discretion?

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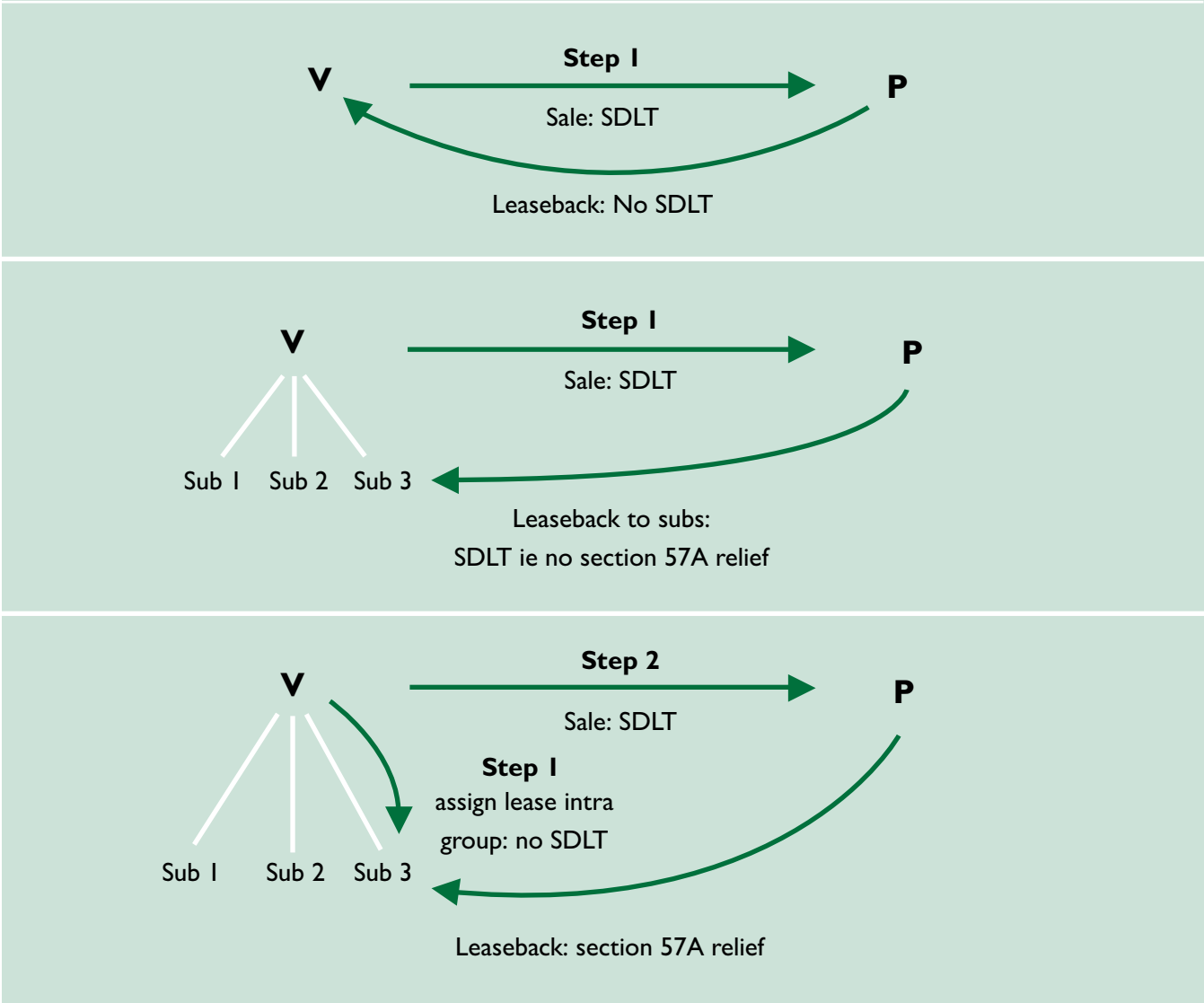
De-enveloping?

Yet more worrying is the vexed question of de-enveloping. In *Hannover* the property was de-enveloped in the hands of the buyer's group when it came out of the GPUT.

Figure 2: s57A – sale and leaseback relief



For a variety of sound commercial and tax related reasons much residential property used to be owned by SPVs. SPVs often had one shareholder/director – let's call him Mr Smith. Owning residential property that will be used by Mr Smith or his family may no longer be so efficient and many properties have been and continue to be de-enveloped. Calls for a de-enveloping relief fell on deaf ears.

If the SPV has no debt then on a distribution by it to Mr Smith there is no SDLT charge. That much is clear.

However, many companies were funded by debt.

Where the debt was purely shareholder debt the HMRC SDLT Manual confirmed that it would continue to apply its August 2007 SDLT Technical Notice Issue 5, and there would be no SDLT charge. Can one rely on that still? Or do you capitalise the debt first? Arguably (assuming no HMRC discretion is permitted) there must now post-*Hannover* be a section 75A risk if the transactions (ie debt capitalised and property transfer) are connected with one another. If there is no connection then that is a different analysis.

Section 75A was (at least in HMRC's guidance) always a potential risk in the context of third-party debt, where that debt had been eliminated before the property transaction occurred. The key determinant was: is there a connection between the two transactions?

There is a distinction to be drawn between transactions that are connected because of set-up, ie background/scenery, and transactions that have (as in the case of *Hannover*) to happen in a specific chronological order. That point as to the precise interpretation of connectivity/interdependence on a specific transaction could be drawn out in a clearance application.

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Clearance applications

Currently the HMRC manual says that the guidance on s75A is under review and:

> ... if you are unclear about whether s75A might apply please contact the SDLT technical team for further advice about how to proceed.

This is an informal clearance process.

I am aware that there is only a small dedicated HMRC team which is dealing with this and that it is taking at least six weeks to process clearance applications. HMRC has informally said that it is not a general clearance whether s75A will apply or not (ie in that regard it is not like s138 Taxation of Chargeable Gains Act 1992 share-for-share exchange clearances with respect to bona fide commercial reasons for the transaction). Instead, HMRC will consider only narrow points:

- whether something is a scheme transaction;
- the identity of the purchaser;
- the amount of the consideration; and
- whether something is classed as an incidental transaction.

Is this clearance going to be of long-term application by HMRC or is it merely going to inform HMRC as to how it will draft its revised guidance?

In any event, is guidance sufficient for a taxpayer to rely upon these days or should HMRC's views on the interpretation of s75A now be encapsulated in legislation or a statutory instrument?

The key takeaway point is that HMRC may see *Hannover* as empowering it to use s75A wherever:

- steps are commercially connected/interdependent; and
- the maximum SDLT has not been paid.

The crushing conclusion is that if there is anything other than a straightforward V to P sale of land, the transaction is potentially at risk. I recommend that all transactions that involve a number of commercial/interdependent steps are considered carefully because another important point which this case teaches us is that, when adopting a mechanistic approach, the order of steps and whether there is a set or pre-ordained ordered steps is now of more importance than their motivation. ■

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Extracts from the judgment in *Hannover*, per Judge Aleksander

183. It is not in contention that a purposive construction needs to be adopted when considering the application of s75A. What is very much in contention is how to approach such a purposive construction.

184. I do not agree with Hannover's argument that s75A only applies if the transactions, viewed collectively, been not taxed appropriately when you look at the scheme of SDLT.

185. Hannover say, in essence, that you look at the SDLT payable on the basis that s75A had not been enacted, and determine whether that is an appropriate amount of SDLT. Only if it is not (and how one should determine what is an appropriate amount of SDLT they do not address in any detail), can s75A be engaged. The issue I have with this approach is the meaning of 'scheme of SDLT'. Hannover's argument can only make sense if s75A is not treated as part of the 'scheme of SDLT' – but treated as sitting outside it. As soon as s75A is treated as forming part of the scheme of SDLT, Hannover's argument becomes circular and paradoxical. And I can find no reason for treating s75A as somehow special, sitting outside the 'scheme of SDLT'.

[...]

188. Nor am I in any way persuaded that the concept of 'objective tax avoidance' is in any way relevant to an analysis of s75A, or that the decision of the Supreme Court in the *Project Blue* case requires me to identify a 'tax avoidance scheme' or 'unintended tax loss' which 'exploits a loophole in the statutory provisions'. Although it is clear that s75A is intended to act as an anti-avoidance provision, in my view (and I find that) it self-defines the kind of tax avoidance that is within its scope (in a similar way to the former transactions in land provisions in s488 Income and Taxes Act 1970 that were considered in *Page v Lowther*). Lord Hodge in *Project Blue* says that 'It is sufficient for the operation of the section that tax avoidance, in the sense of a reduced liability or no liability to SDLT, resulted from the series of transactions which the parties put in place, whatever their motive for transacting in that manner'. I find that this is exactly what happened in this case – the series of transactions that were effected by the parties resulted in a reduced liability to SDLT when compared with the notional land transaction.

195. Finally, I recognize that if the steps had been undertaken in a different order, there might well have been a different SDLT result – in particular if the Hannover Company had acquired the GPUT units as the first step, and only after that step was the property transferred out of the Greycoat Partnership. In these circumstances, s75C(1) would have applied to disregard the acquisition of the GPUT units. But the sequencing of the steps was of critical commercial importance to Hannover, and it was essential to them that the property be extracted from the Greycoat Partnership before they acquired the GPUT units. The parties made a deliberate and considered decision as to the order of the steps, and have to live with the consequences that follow.