[2015] UKFTT 0341 (TC)

TC04525

Appeal number: TC/2012/02613
TC/2012/02722

Corporation tax – loan relationship rules –debit relating to "tracker shares" linked to in the money swap receipts –derecognised for accounting purposes-whether deductible debit for loan relationship rules – legal and accounting concepts of loss – whether arising from derivative contract – whether transfer pricing rules at Schedule 28AA applied to tracker shares – whether shares are a provision for transfer pricing purposes – HELD –Debit did not reflect fair representation of loss from transactions –debit did not arise from derivative contract – transfer pricing rules broad ambit – share issue could amount to a provision - transfer pricing rules applied to issue price of tracker shares - appeal dismissed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

Abbey National Treasury Services Plc **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE Rachel Short
Nicholas Dee (Member)

Sitting in public at Royal Courts of Justice, the Strand on 29 – 30 January 2015

Mr Kevin Prosser QC and Ms Zizhen Yang of Pump Court Tax Chambers instructed by Slaughter and May for the Appellant

Mr Julian Ghosh QC and Ms Elizabeth Wilson of Pump Court Tax Chambers, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. The Tribunal has been asked to hear two related appeals one following on from the other. The appeals relate to a number of different transactions involving two different Appellants, Abbey National Treasury Services Plc and Cater Allen International Limited. The appeals have been listed and numbered according to the parties rather than the transactions considered.

2. This decision concerns appeals TC/2012/02613 and TC/2012/02722 which cover the transactions known as Umbriel I and II carried out by Abbey National Treasury Services PLC ("ANTS") in 2008 and 2009. It was accepted by the parties that a decision in principle by reference to facts and documents for the Umbriel I transaction undertaken in 2008 would be taken as determinative of the 2009 Umbriel II appeal also.

3. The related appeals, numbers TC/2012/02614, TC/2012/02613, TC/2012/02722 and TC/2012/02518 concern the Ariel I and II and Caliban transactions undertaken by ANTS and Cater Allen International Limited. They are dealt with in a separate decision notice.

4. This is an appeal by ANTS against HMRC's decision of 16 September 2011 to disallow a debit of £161,024,915 in ANTS' tax return for the year ended December 2008 relating to payments made on tracker shares issued by ANTS.

Preliminary issues.

5. Mr Prosser confirmed that he had received HMRC's amended version of Mr Drummond's expert witness report on 21 January 2015. He did not object to it being admitted late, but did reserve the right to object to specific issues raised by HMRC arising from Mr Drummond's evidence which were new issues.

6. Mr Prosser clarified that the 2008 appeal which the Tribunal was being asked to consider related to a deduction of just over £160 million claimed in ANTS' tax return for the year ended December 2008. The appeal was intended to concentrate on points of principle; the actual numbers, the size of the debit claimed, were not critical.

Facts.

7. At all material times ANTS was a 100% subsidiary of Abbey National Plc ("Abbey"). Both ANTS and Abbey were UK incorporated and resident companies. ANTS prepared its financial statements in accordance with International Financial Reporting Standards ("IFRS").

8. In December 2008 ANTS was a party to 26 "in the money" interest rate swaps with a total fair value of about £160 million, ("the Swaps"). The Swaps were entered into by ANTS for commercial purposes and were accounted for on a fair value basis of accounting.

9. The counterparty for 23 of the 26 Swaps was Banco Santander SA ("Santander") a non UK tax resident bank, the counterparties to the other three Swaps were Morgan Stanley, Dresdner Kleinwort and UBS Warburg.

10. On 5 December 2008 ANTS entered into an agreement with Santander to change the terms of the Swaps to which Santander was counterparty from being "net" paying to "gross" paying, i.e. there was to be no set-off of payments due from and to the two parties under the Swaps. The other Swaps were already gross paying.

11. On 9 December 2008 ANTS amended its memorandum and articles of association to increase its share capital by £1,000 comprising 1,000 £1 tracker shares ("the Tracker Shares"). On the same day ANTS issued 1,000 Tracker Shares to Abbey under a share subscription agreement.

12. The Tracker Shares entitled Abbey to receive a non-cumulative dividend in respect of each of a number of swap cash flows relating to the £160 million swaps ("the Swap Cash Flows") receivable, and actually received, by ANTS. The details of those cash flows were set out in the "Tracker Shareholders' Report". The rights and restrictions attached to the Tracker Shares were set out at paragraph 8.2 of ANTS' amended articles of association.

13. Paragraph 8.2(A)(ii) of the articles provided that the dividends on the Tracker Shares would:

> (a) *be of an amount equal to the lesser of the amount of the relevant Swap Cashflow actually received by the Company [ANTS] and the amount of Relevant Distributable Reserves;*
>
> *(b) be paid in the same currency as the relevant Swap Cashflow actually received by the Company;*
>
> *(c) become due only on the relevant Swap Cashflow Receipt Date, the date the Company actually received the cashflow when the Swap Cashflow is actually received by the Company and be paid by the Company as soon as possible and, in any event, by the date falling 2 (two) Business Days following such Swap Cashflow Receipt Date;*
>
> *(d) be increased by daily interest if not paid on the Swap Cashflow Receipt Date.*

14. Paragraphs 8.2(A)(iii) and (iv) of the Articles provided:

> (iii) *Any Swap Cashflow actually received by the Company [ANTS], to the extent that, and for so long as, the Company has not paid an equal amount to the holders of the Tracker Shares by way of a Tracker Share Dividend (or otherwise), shall be invested only in cash or cash equivalent liquid investments.*
>
> *(iv) For so long as there are any Swap Cashflows outstanding, the Company shall not create, or permit to subsist, any Encumbrance over, or with respect to, or sell, or otherwise transfer (or agree to do any of the foregoing in respect of), such Swap Cashflows or their related Swaps.*

15. The articles also provided (at paragraph 8.2(B)) that on a return of capital on a winding up or otherwise (other than a conversion, redemption or purchase of shares), the assets of ANTS available for distribution among its members were to be applied, in priority of payment to the holders of ordinary shares, in paying to the tracker shareholders an amount equal to the amount paid up on the Tracker Shares.

16. Also on 9th December 2008, ANTS and Abbey entered into a Tracker Share compensation agreement ("the Compensation Agreement"). The Compensation Agreement set out arrangements in the event that ANTS' relevant distributable reserves were insufficient to allow payment of the dividends on the Tracker Shares. The main terms of the Compensation Agreement were as follows:

(1) ANTS was obliged, to the extent that it was legally able, to make a payment ("the Compensation Payment") to Abbey of an amount equal to the excess of the swap cash flow actually received by ANTS over the amount of distributable reserves;

(2) Should the Compensation Payment be payable but not paid, interest would accrue daily on the unpaid amount; and

(3) Abbey was obliged to take all necessary steps to allow ANTS to make a lawful compensation payment provided that: (a) Abbey would not be obliged to make a cash payment to ANTS; and (b) an unconditional pound-for-pound matching reduction of any liability owed by ANTS to Abbey would be sufficient to allow ANTS to make a particular payment.

17. An initial Tracker Shareholder Report appended to the Compensation Agreement detailed the specific cash flows to be passed to Abbey as a dividend. Whilst the maturity dates for most of the swaps extended beyond 2010, only specific cash flows in 2009 and 2010 were to be passed on to Abbey as dividends. The fair value of these cash flows as at 9th December 2008 was £159,976,300, which was approximately equal to the fair value of the Swaps to which the specific cash flows related.

18. The Swap Cash Flows to which the Tracker Share dividend rights were linked were, in ANTS's accounts for the 2008 accounting period, derecognised as assets under the derecognition rules set out in IAS 39 paragraphs 16 to 28, giving rise to a corresponding debit. This debit was taken to equity and recognised as a dividend in ANTS' statement of changes in equity. ANTS accounting entries were:

DR Equity (balance sheet) - £159,976,300

CR Financial Asset(balance sheet) -£159,976,300.

19. ANTS' financial statements for the year ended 31 December 2008 disclosed a dividend payment of £161 million debited to retained earnings. Although the derecognition of the Swap Cash Flows fell to be accounted for as a dividend in the 2008 accounting period, as a matter of fact and law ANTS did not pay, or declare, any dividend on the Tracker Shares to Abbey in the period ending 31 December 2008.

20. ANTS retained legal ownership of the Swaps but was obliged to pass on an amount equivalent to the Swap Cash Flows, when received, in the form of a dividend to Abbey subject to ANTS' articles and the terms of the Compensation Agreement.

21. ANTS' corporation tax computation for the year ended 31st December 2008, submitted to HMRC on 4th January 2010, claimed a deduction from profits of £161,024,915 described as "swap derecognition taken to equity".

22. ANTS accepts that the £161,024,915 includes an adjustment of £1,048,615 reflecting forex movement on the Swaps between 9th December and 31st December 2008 which should not be taken into account in computing the correct amount to be deducted.

23. ANTS notified HMRC of the Umbriel transactions under the Disclosure of Tax Avoidance Scheme Regulations (DOTAS).

Agreed Issues.

24. The Umbriel I transaction was intended to create a deductible debit for ANTS but no *Ramsay* points or any question of whether the transaction gave rise to a tax advantage were in issue for this appeal. The Swaps were entered into for commercial purposes. The Swaps were converted to "gross payment" swaps on 5 December 2008 so that the payments received under them could be matched to the payments on the Tracker Shares.

25. For accounting purposes and in compliance with generally accepted accounting practice, the part of the Swaps represented by the Swap Cash Flows were derecognised as assets in ANTS 2008 accounts in accordance with IAS 39 giving rise to a debit. That debit was taken to equity and reflected as a dividend in ANTS' statement of changes in equity. For accounting purposes ANTS was treated as making a dividend payment equal to the Swap Cash Flows which it was obliged to pay to Abbey. HMRC's expert accounting evidence was not in dispute.

26. The right to payment under the Tracker Shares was transferred to Abbey at the fair market value of the Swap Cash Flows as at 9 December 2008. No payments were made as a result of that contract until March 2009, but for accounting purposes the asset was derecognised at the time when the Tracker Shares were issued on 9 December.

Issues in dispute.

27. The issues in dispute between the parties are whether the £160 million debit claimed in ANTS' tax return for the year ended December 2008 is deductible as a debit arising from ANTS' derivative contracts under Schedule 26 of the Finance Act 2002 and whether the transfer pricing rules at Schedule 28AA of the Income and Corporation Taxes Act 1988 apply to the Tracker Shares and if so, the extent to which they reduce the debit claimed by ANTS.

Law.

Schedule 26 Finance Act 2002 – Paragraphs 15 and 17A.

28. These provisions deal with the tax treatment of profits arising from derivative contracts. There is no dispute that the Swaps were derivative contracts for the purposes of Schedule 26. Paragraph 1 sets out the general parameters of the rules*:*

> *(1) For the purposes of corporation tax all profits arising to a company from its derivative contracts shall be chargeable to tax as income in accordance with this Schedule.*
>
> *(2) Except where otherwise indicated, the amounts to be brought into account in accordance with this Schedule in respect of any matter are the only amounts to be brought into account for the purposes of corporation tax in respect of that matter.*

29. Paragraph 15 sets out in more detail the amounts which are to be brought into account as taxable debits or credits:

> *(1) The credits and debits to be brought into account in the case of any company in respect of its derivative contracts shall be the sums which, when taken together, fairly represent, for the accounting period in question –*
>
> > *(a) all profits and losses of the company which (disregarding any charges or expenses) arise to the company from its derivative contracts and related transactions; and*
> >
> > (b) *all charges and expenses incurred by the company under or for the purposes of its derivative contracts and related transactions*"

30. Paragraph 17A provides further details of how amounts brought into account under paragraph 15 are to be computed:

> (1) *"Subject to the provisions of this Schedule (including in particular paragraph 15(1), the amounts to be brought into account by a company for any period for the purposes of this Schedule are those that, in accordance with generally accepted accounting practice, are recognised in determining the company's profit or loss for the period".*

31. Paragraph 17B gives details of what it means for an amount to be recognised for accounting purposes:

> *(1) Any reference in this Schedule to an amount being recognised in determining a company's profit or loss for a period is to an amount being recognised for accounting purposes –*
>
> > *(a) in the company's profit and loss account or income statement*
> >
> > *(b) in the company's statement of recognised gains and losses or statement of changes in equity or*

(c) *in any other statement of items brought into account in computing the company's profits and losses for the period.*

32. Paragraph 25A contains specific rules for debits and credit which are recognised in equity or shareholders funds:

Where in accordance with generally accepted accounting practice a debit or credit for a period in respect of a derivative contract of a company –

(a) is recognised in equity or shareholders' funds, and

(b) is not recognised in any of the statements mentioned in paragraph 17B(1)

the debit or credit shall be brought into account for that period for the purposes of this Chapter in the same way as a debit or credit that, in accordance with generally accepted accounting practice, is brought into account in determining the company's profit or loss for that period.

33. Paragraph 31A sets out how amounts which arise under the transfer pricing rules at Schedule 28AA are to be treated within the derivatives legislation:

(1) This paragraph applies where, in pursuance of Schedule 28AA to the Taxes Act 1988 (provision not at arm's length), an amount falls to be treated as any of the following-

(a) an amount of profits or losses (disregarding any charges or expenses) arising to a company from any of its derivative contracts or related transactions;

(b) charges or expenses incurred by a company under or for the purposes of any of its derivative contracts or related transactions

(2) That Schedule shall have effect so as to require credits or debits relating to the amount so treated to be brought into account for the purposes of this Chapter to the same extent as they would be in the case of an actual amount of-

(a) profits or losses (disregarding any charges or expenses) arising to the company from the derivative contract or related transaction, or

(b) charges or expenses incurred under or for the purposes of the derivative contract or related transaction, as the case may be.

34. Schedule 28AA Income and Corporation Taxes Act 1988 ("Taxes Act 1988") contains the UK's transfer pricing rules dealing with the tax treatment of transactions between related parties.

35. Paragraph 1 of Schedule 28AA sets out the basic rules;

(1) This Schedule applies where –

(a) any provision, ("the actual provision") has been made or imposed as between any two persons ("the affected persons") by means of a transaction or series of transactions, and

(b) at the time of the making or imposition of the actual provision-

(i) one of the effected persons was directly or indirectly participating in the management, control or capital of the other; or

(ii) the same person or persons was or were directly or indirectly participating in the management, control or capital of each of the affected persons.

(2) Subject to paragraphs 5A, 5B, 8, 10 and 13 below, if the actual provision –

(a) differs from the provision ("the arm's length provision") which would have been made as between independent enterprises, and

(b) confers a potential advantage in relation to United Kingdom taxation on one of the affected persons, or (whether or not the same advantage) on each of them

the profits and losses of the potentially advantaged person or, as the case may be, of each of the potentially advantaged persons shall be computed for tax purposes as if the arm's length provision had been made or imposed instead of the actual provision.

36. Paragraph 1(3) provides further details to determine when provisions made between related parties can be treated as differing from an arm's length provision:

(3) For the purposes of this Schedule the cases in which provision made or imposed as between any two persons is to be taken to differ from the provision that would have been made as between independent enterprises shall include the case in which provision is made or imposed as between any two persons but no provision would have been made as between independent enterprises; and references in this Schedule to the arm's length provision shall be construed accordingly.

37. The meaning of a potential advantage is set out in paragraph 5 of Schedule 28AA

(1) For the purposes of this Schedule the actual provision confers a potential advantage on a person in relation to United Kingdom taxation wherever, disregarding this Schedule, the effect of making or imposing the actual provision, instead of the arm's length provision, would be one or both of the following, that is to say

(a) that a smaller amount (which may be nil) would be taken for tax purposes to be the amount of that person's profits for any chargeable period; or

(b) *that a larger amount (or, if there would not otherwise have been any losses, any amount more than nil) would be taken for tax purposes to be the amount for any chargeable period of any losses of that person.*

OECD Article 9 Model Treaty and Guidelines.

38. Paragraph 2 of Schedule 28AA provides that the Schedule should be construed in such a manner as best secures consistency between the effect given to paragraph 1 and the rules, in accordance with the OECD Guidelines, contained in Article 9 of the OECD Model Tax Convention on Income and Capital. Article 9 deals with the tax treatment of transactions between associated enterprises.

Evidence.

39. The Tribunal was provided with the written witness statement of Mr Peter John Vaughan Drummond chartered accountant and expert witness on behalf of HMRC dated 18 November 2013 which was taken as read and his supplemental statement dated 21 January 2015. Mr Drummond also gave oral evidence before the Tribunal and was cross examined. His expert evidence was not disputed by ANTS.

40. Mr Drummond's witness statements considered (i) how gains and losses on changes in the fair value of the Swaps should have been recognised in ANTS' accounts and (ii) Whether the requirements for derecognition of the Swaps had been met and if so how that derecognition should be shown in ANTS' 2008 financial statements.

41. Mr Drummond's response to question (i) was that the requirements of IAS 39 in respect of the measurement of ANTS' trading Swaps are clear; gains and losses arising from changes in their fair value must be recognised in ANTS' profit and loss account.

42. In response to question (ii) Mr Drummond stated that three steps had to be considered in order for the Swaps to be derecognised (a) the derecognition had to apply to either the whole or part of an asset, here the derecognition applied to an identifiable part of the Swaps (the Swap Cash Flows) (b) the part assets identified had to have been the subject of a transfer; here there had been a transfer because ANTS has assumed the contractual obligation to pay the cash flows of the financial assets, the Swap Cash Flows, on to another party (c) the risks and rewards of ownership of the part assets need to have been transferred; they have been because ANTS' exposure to the variability in value of the part assets was no longer significant. Finally, derecognition reflected the economic effect of the transactions in an appropriate manner. Therefore the all the requirements for derecognition had been met.

43. As a result of the derecognition of the part assets they have to be removed from ANTS' balance sheet. As a starting point ANTS' financial statements for 2008 would show as a credit entry the difference between the remaining value of the Swap asset and the value of the derecognised part of that asset. The corresponding debit entry

would not however go to ANTS' income statement as a loss because the nature of the transaction was to distribute profits from ANTS to its parent, Abbey. The debit entry would therefore be presented either in the statement of changes in equity or in the notes to the financial statements in accordance with IAS1, as a transaction with equity holders acting as such. IAS1 overrides IAS 39 in this particular respect to ensure a fair presentation of profits and losses. ANTS' treatment of the transfer of part of the Swap asset to Abbey as a distribution, taken direct to equity, is in accordance with IFRS.

44. In response to Mr Prosser Mr Drummond confirmed that the terms which he had used in his report "profits, losses, gains" were used as accounting terms. He also confirmed, in response to Mr Ghosh that if the dividends in question here had been paid on ordinary shares rather than the Tracker Shares the accounting treatment would have been to debit distribution and credit cash.

45. He explained that his accounting advice was based on the premise that the Swap Cash Flows paid away under the Tracker Shares were part of an asset (the Swap to which they related) and so the derecognition was of part of an asset. He confirmed that his advice was based on the reduction in ANTS' assets (the Swaps) which had arisen because, for accounting purposes part of the Swap had been treated as transferred. He stressed that if the change in the Swap terms was between a parent acting as such and a subsidiary that would be treated by the subsidiary as part of a subscription for shares. Equally, Mr Drummond accepted that any increase in the value of these assets would be recognised as share premium if they arose from transactions entered into by shareholders acting as such.

46. He explained that if there was a real change in the value of a company's assets, that would generally give rise to a gain or a loss but that would not be recognised in the company's profit and loss account if it arose from a transaction with shareholders acting as such.

47. If the same transaction had been done by a charity, or another non-shareholding entity, the accounting entries would have been; credit carry value in balance sheet, debit to profit and loss account. The difference where the transaction was with shareholders was that no loss was recognised in the profit and loss account, the credit side of the transaction would be the same. In his view the accounting looked at the economic substance of the transaction and treated it as a distribution to equity. If the transaction had been with a charity its economic substance would have been a donation to the charity and the transfer would have been treated as an expense for accounting purposes. Specifically Mr Drummond said that;

> *"Speaking as an accountant, I would say in the one scenario [with a shareholder] there is no loss, whereas in the other it would be represented as an expense".*

48. He accepted that despite the obligation to pay on, or transfer, in accounting terms, all of the Swap Cash Flows, that did not mean that ANTS should be left with no residual obligations, the transaction would be treated as a transfer as long as substantially all of the risks and rewards had been transferred (or paid away). ANTS could not retain the benefit of a payment which it was obliged to pay straight out to

another entity; "*the accounting requires it to have divested itself of substantially all the rights and risks and rewards of ownership*".

49. He confirmed his statement in paragraph 4.36 of his witness statement that because of its back to back payment obligation, ANTS had no exposure to the variability in the cash flows which it continued to receive under the swaps.

50. He explained his view that each Swap Cash Flow transferred was a separate asset (coming from a separate swap), but when Abbey recognised its rights under the Tracker Shares that would be treated as a single asset.

51. Documents seen:

(1) Memorandum and Articles of Association of ANTS as amended up to 9 December 2009

(2) Letter from Abbey to ANTS subscribing for Tracker Shares dated 9 December 2008.

(3) Compensation Payment Agreement in respect of Tracker Share Dividends dated 9 December 2008.

(4) Tracker Shareholders' Report of 9 December as defined in ANTS' Articles of Association, setting out the details of the Swaps referenced in the Tracker Shares.

(5) Fax swap confirmations relating to each of the 26 Swaps to which the Swap Cashflows relate.

ANTS' Arguments.

52. ANTS needs to demonstrate that the £160 million debit fairly represents a loss which has arisen from its derivative contracts in accordance with part 1, Schedule 26 Finance Act 2002 in order to succeed in its appeal and that there is nothing in the UK transfer pricing rules at Schedule 28AA Taxes Act 1988 which could reduce that debit.

Schedule 26 Interpretation.

Accounting and legal concepts of profit and loss.

53. There is no dispute that the Swaps are derivative contracts for Schedule 26 purposes and Mr Prosser argued that Schedule 26 is what he described as a "*presumptively exclusive code*" for dealing with derivative contracts.

54. However, according to Mr Prosser, Schedule 26 is not dependant on the accounting characterisation of the contract between the parties. For accounting purposes no "loss" was recognised in ANTS profit and loss account, but Schedule 26 does not follow this treatment; it is looking at a legal definition of a loss which is wider than the accounting definition. Schedule 26 imposes an obligation to look at the

debits and credits arising (paragraph 14) being those which fairly represent the company's profits and losses for the accounting period in question (paragraph 15). Equally, Schedule 26 does not treat the Tracker Share subscription agreement as a disposal of any rights relating to the Swaps for legal purposes, despite their derecognition for accounting purposes, again demonstrating that Schedule 26 is not merely following accounting terms and concepts.

55. Paragraphs 14 and 15 of Schedule 26 contain concepts of loss which are legal not accounting concepts. In addition Schedule 26 contains particular rules at paragraph 17 to bring within the ambit of that legal definition of a loss or profit income and costs which would not be recognised as such for accounting purposes, including amounts recognised in the company's statement of changes in equity. Mr Prosser argued that the debit in question here fell within paragraph 17B(1)(b) being recognised in changes in equity and should therefore be recognised in determining ANTS' profits and losses for the period in question. The fact that the same type of payment, if made to a non-shareholder entity, such as a charity, would give rise to a debit in the entity's profit and loss account (as stated by Mr Drummond) supports the fact that a debit should be recognised in this case.

56. Paragraph 17A of Schedule 26 uses the term "profit or loss" and paragraph 15 cannot be treated as overriding this by imposing a different concept of profit or loss. Paragraph 15(1)(a) is intended to echo paragraph 17A; if a loss is recognised in determining a profit or loss under paragraph 17A, then it is a loss for paragraph 15 purposes. Paragraph 15 is coloured by paragraph 17A. Paragraph 17A is an example of a particular rule and this can be overridden by specific provisions, but there is nothing in paragraph 15(1)(a) which overrides the basic rule about recognition of losses, despite HMRC's suggestion that paragraph 15 is limited by the need to take account only of losses which fairly represent the loss from ANTS' derivative contracts. As a point of interpretation paragraph 25A (which deals with debits or credits recognised in equity which do not appear in any of the company's accounting statements) also suggests that 15(1)(a) cannot merely be an accounting definition. HMRC's interpretation of paragraph 17A would mean that it could never produce a deductible debit.

57. Mr Prosser referred to the case of *First Nationwide v Revenue & Customs Commissioners ([2012] EWCA Civ 278)* and the comments of Moses J at paragraph 11 that share premium is treated as distributable profits to demonstrate that the UK courts have recognised that there is a general legal concept of profits over and above an accounting definition of the same. Applied to these facts, there is a loss here for legal purposes because the agreement with Abbey has led to a reduction in the value of ANTS' assets since it no longer has a right to retain the interest payments made under the Swaps. Mr Prosser also referred to the *Re Spanish Prospecting Co Ltd* case to illustrate the same point; a reduction in value is a loss for legal purposes, whatever the accounting treatment says and despite the fact that it arises from a contract with ANTS' shareholders. (*Re Spanish Prospecting Co Ltd* [1911] 1 Ch 92).

58. Mr Prosser took issue with HMRC's suggestion that the terms of the Tracker Shares amounted to a contractual obligation by ANTS to pay on profits. The Tracker

Shares were merely a contractual obligation to pay on particular amounts, it was a misrepresentation to say that this was a distribution of profits which should be treated as a dividend. Mr Prosser also referred to s 337A Taxes Act 1988 to demonstrate that while there is specific legislation which deals with payments which are legally treated as dividends and their non-deductibility for tax purposes, there is no reference in Schedule 26 to treating payments which are dividends for accounting purposes in the same way.

Debits arising from derivative contracts.

59. Mr Prosser accepted that Paragraph 15 can in some circumstances override paragraph 17 to remove debits from consideration if they do not arise from derivative contracts, but said that it did not apply in this particular case. Here the losses arise from the Swaps because the obligation to pay on the Swap Cash Flows under the Tracker Shares gives rise to a debit which reflects a loss in value to ANTS of the Swap assets. The fact that this comes from an agreement with ANTS' shareholders is not relevant. HMRC's argument that the payment cannot derive from the Swaps because nothing has changed in their terms is not correct; ANTS' economic interest in the Swaps has changed. The loss arises from the Swaps because the loss is a debit representing a reduction in the value of these Swaps as assets of ANTS.

60. Mr Prosser pointed out that it would anomalous if an actual assignment of the payment flows under the Swaps gave rise to a deductible debit (which Mr Ghosh accepted they would) but the economically equivalent transaction of entering into a contractual obligation to pay on the sums did not.

Transfer Pricing.

61. Mr Prosser's view was that the transfer pricing rules at Schedule 28AA Taxes Act 1988 did not apply to these transactions for three reasons: (i) the issue of the tracker shares was not a "provision", (ii) if the issue of the shares was a provision, it did not differ from provision which would have been made between third parties (iii) even if both of those were wrong, nothing in Schedule 26 provided for these transfer pricing adjustments to be taken account of.

The Tracker Shares as a provision.

62. Mr Prosser's first point was that the issuing of the Tracker Shares was not the making of a "*provision*" to which Schedule 28AA could apply. He referred to the interpretive OECD Guidelines (1995 version) and OECD Model Treaty Article 9 which referred to "*conditions made or imposed between two enterprises in their commercial or financial relations"* and the Guidelines which referred to "*business transactions*". Schedule 28AA had to be construed in accordance with these OECD principles.

63. The issuing of shares does not amount to a business transaction because the issuing of shares to an existing 100% shareholder has no impact on that person's commercial interest in the company, ANTS's existing equity holding had merely been re-packaged. All that Abbey had done in terms of its financial relations was to transfer

value from one pocket to another. Mr Prosser said that there was nothing in the OECD Guidelines about how transfer pricing should be applied to share issuances. He accepted, as referred to in the OECD Guidelines, that a loan could be a provision, but said that unlike a share issue, a loan did have an impact on the rights of the holder over the company, conferring contractual obligations to pay amounts plus interest and giving the parent company creditor rights. Finally Mr Prosser said that it had never been suggested for transfer pricing purposes that transfer pricing could turn an equity interest into a loan instrument and that was because shares were outside the remit of Schedule 28 AA.

64. The OECD Guidelines suggested that Schedule 28AA should only apply when both of the relevant parties were "enterprises" i.e. carried on a business and therefore the rules only applied to transactions between the parties which were in the nature of business transactions, which the issuing of share capital was not. This was supported by the fact that the rules only applied to entities which were already connected by means of the holding of share capital, suggesting that this issuing of share capital itself should not be treated as a provision for these purposes.

The Tracker Shares as an arm's length transaction.

65. Mr Prosser's second argument was that, even if the Tracker Shares were a *provision*, they were no different than shares which could have been issued between independent enterprises, which regularly issue bonus or rights issue shares. He rejected HMRC's argument that the Tracker Shares changed Abbey's position because it gave them a more immediate right to profits of ANTS; as a 100% shareholder they already had all rights to ANTS' profits. Similarly a proportionate bonus or rights issue would not have any impact on the rights of either party. Mr Prosser said that it was possible to postulate that two enterprises who had a shareholder relationship could nevertheless deal on arm's length terms. Mr Prosser's referred the Tribunal to the OECD Guidelines (paragraphs 1.36 to 1.37 of the 1995 version of the OECD Guidelines) and suggested that this was not one of unusual situations in which it was possible to argue that the true comparator was no transaction at all. The fact that the Tracker Shares gave rise to a tax advantage is not the kind of "impediment to the tax administration" intended by paragraph 1.37 to allow a transaction to be redrawn or ignored for transfer pricing purpose.

66. When asked about the Compensation Agreement and whether this did, even if the Tracker Shares did not, change the relationship between Abbey and ANTS, he said that this was theoretical not real because in fact ANTS always had distributable reserves and in any event the Compensation Agreement should be considered as a free standing provision, for which very little would have been paid.

67. Mr Prosser referred us to some specific provisions of the Compensation Agreement and stressed that its terms were intended to ensure that ANTS made payments under it only in accordance with UK company law. He also referred us to ANTS' accounts for the 2008 period which demonstrated that even excluding the share reserve created by the "dividend" treated as payable due to the Swap transactions, ANTS had a further £288 million of retained earnings. On that basis the

value of the Compensation Agreement in practice was very small, since the chance of ANTS not having sufficient distributable reserves to make payments on the Tracker Shares was small. The only reason for the Compensation Agreement was to ensure that there was derecognition for accounting purposes.

The interaction of Schedule 28AA with Schedule 26.

68. In Mr Prosser's view Schedule 26 Finance Act 2002 always took precedence over other provisions unless specifically stated otherwise therefore the adjustments suggested by HMRC under Schedule 28AA Taxes Act 1988 could not be imported into Schedule 26. Schedule 28AA does not break the "presumed exclusivity" of Schedule 26, which is intended to make clear what amounts are to be brought into account and what amounts should be left out. There is nothing specific in Schedule 28AA which applies to the derivative code or overrides Schedule 26. To suggest otherwise would make paragraph 31A of Schedule 26, which applies specifically to transfer pricing adjustments within the derivatives contract code, otiose, which cannot be correct. Paragraph 31A does override the exclusivity of Schedule 26 but only with very limited effect; only if there is a loss which needs to be brought into account, it cannot remove debits or deal with debits which are nil or not there are all, as HMRC argue. The critical words of paragraph 31A(2) are: " *That Schedule [28AA] shall have effect so as to require credits or debits.... to be brought into account*". Its purposes is to bring in credits or debits which a taxpayer would not otherwise have, not to leave out of account debits or credits which have already been taken account of under Schedule 26. It cannot operate to bring in an imputed loss of nil.

HMRC's Arguments.

Schedule 26 Finance Act 2002 Interpretation.

Meaning of loss.

69. Mr Ghosh started by taking us to the specific terms of the Tracker Shares and stressing that under their terms ANTS was obliged to pay on profits which it had already received, i.e. the profits had to be recognised by ANTS before they were paid on. He asked us to consider how receiving a profit from a derivative and paying that on could ever realistically be said to give rise to a relievable loss for tax purposes. The thing which had led to the derecognition of profits here was the contractual obligation to pay realised profits from ANTS to Abbey; that was not an expense incurred in making profits, it was an application of profits which had been received.

70. He considered the meaning of a loss for paragraph 15 purposes in the context of the *Re Spanish Prospecting* decision and its formulation that "*the fundamental meaning is the amount of gain made by the business during the year*", a loss being the converse of that. The fact that ANTS was obliged to pay away amounts received under the Swaps did not alter the gains which it made from those Swaps. ANTS was receiving profits and paying them away once realised. From this perspective it was not relevant who the payment was going to; a shareholder, charity, or some other third

party. The payment being made by ANTS to Abbey was akin to a dividend of realised profits for which no deduction should be available.

71. Mr Ghosh referred to Mr Prosser's interpretation of the interaction of paragraph 15, 17 and 25A of Schedule 26; in his view the primary provision was paragraph 15, the other sections were subordinate to that; paragraph 17 was only relevant if amounts already fell within paragraph 15 while paragraph 25A, which referred to amounts recognised in equity or shareholders' funds, merely relaxed the recognition condition.

Debits arising from derivative contracts.

72. In Mr Ghosh's view the derecognised debit did not arise *from* the derivative contracts (the Swaps) as required by paragraph 15(1)(a) of Schedule 26. Mr Ghosh referred us to the dictionary definition of "from" and said on that basis the debit is not from the derivative, but the Tracker Shares and the Compensation Agreement; the payments are only made on the Tracker Shares once the payment has already been received under the Swaps. There has been no assignment of anything, including any cash flow, under the Swaps.

73. At the very least, the reference in paragraph 15 to the profits which "fairly represent" ANT'S' profits on its derivatives contracts is an attribution provision and it is not correct to attribute this deduction to the Swaps. This is a sensible construction of paragraph 15 and questions about deductions for dividends under s 337A Taxes Act 1988 are not relevant.

74. Mr Ghosh's conclusion on this point was that ANTS' arguments derived from what he referred to as "1970's style tax planning", being the attempt to produce a derecognition debit from a derivative for something which could not realistically be viewed as a loss.

Transfer Pricing.

75. In Mr Ghosh's view it was clear that the issue of the Tracker Shares was a provision for Schedule 28AA purposes.

The Tracker Shares as a provision.

76. There is no dispute that ANTS and Abbey are related for the purposes of Schedule 28AA. The terminology used by Schedule 28AA when dealing with "provisions" is "persons" not enterprises as suggested by Mr Prosser. The concept of an "enterprise" on which Mr Prosser relied to suggest that provisions were limited to financial and commercial relations is relevant only for comparing the actual provision to the provision which would have been made between "independent enterprises".

77. Mr Ghosh agreed that Article 9 of the OECD Model should inform the interpretation of Schedule 28AA. In his view no interpretation of Article 9 could take the Tracker Shares outside the scope of Schedule 28AA. The question was whether

the Tracker Shares affected persons who were related enterprises, which he said they did. He spent some time going through the basis on which ANTS and Abbey should be treated as associated enterprises for Schedule 28 AA purposes. It was clear that Article 9 made a contrast between associated and independent enterprises and ANTS fell into the former category. The distinction between controlled and independent enterprises was relevant for the comparator exercise to establish what an arm's length provision should be, not for determining whether a provision existed. The Tracker Shares did amount to *commercial and financial relations* for the purpose of Article 9; and also Schedule 28AA. His response to Mr Prosser's point about the lack of transfer pricing decisions concerning shares was that shares tend not to give rise to tax advantages.

The Tracker Shares as an arm's length transaction.

78. Mr Ghosh said that there was no basis on which a payment of £1000 to receive cash flows with a net present value of £161 million could be seen as an arm's length transaction. In considering the transfer pricing comparator the actual terms of the Tracker Shares are the starting point. Either the Tracker Shares would have been issued for greater consideration or they would not have existed at all between non-connected parties, because this is a transaction which could only be done between connected entities. The concept of an arm's length transactions is one which would have been carried out by independent enterprises. This transaction is quite different to a bonus issue because ANTS is giving up business profits from particular assets.

79. Considering the OECD Guidelines Mr Ghosh said that the Tracker Shares fell within the second category of transactions set out at paragraph 1.37 of the Guidelines so that it is possible to posit a nil transaction as the correct comparator. The terms of the Tracker Shares did, in his view, "*impede[s] the tax administration*". ANTS and Abbey had done something which commercially independent enterprises would not have done and which had forced HMRC to rely on the transfer pricing rules to determine the correct price.

80. Mr Ghosh also referred us to the decision in *Mansworth v Jelley*, in which he said the obiter comments were consistent with his interpretation of Article 9 and Schedule 28AA. The terms of the Tracker Shares could not be treated as made at arm's length. *(Mansworth (Inspector of Taxes) v Jelley* [2002] EWHC 442 (Ch)).

The Interaction of Schedule 28AA with Schedule 26.

81. As far as paragraph 31A of Schedule 26 is concerned, Mr Ghosh's view was that if an amount given by Schedule 28AA Taxes Act 1988 is nil, that paragraph is intended to allow you to substitute that amount for the purposes of the derivative contracts regime. This is a substitution not an addition provision and there is no other sensible interpretation of it. This is a case where in pursuance of Schedule 28AA an amount falls to be treated as a loss (in this case nil) arising from a company's derivative contracts and therefore paragraph 31A(2) requires that amount, nil, to be brought into account

Decision

82. *Findings of Fact*

(1) The Compensation Agreement was a critical element of the Tracker Share issuance because it was the basis on which derecognition was achieved for accounting purposes.

(2) The Swap Cash Flows were derecognised in ANTS' accounts at the time when the Tracker Shares were issued, not at the later time when payments were made on the Tracker Shares.

(3) The issuance of the Tracker Shares had no legal impact on ANTS' rights or obligations as a counterparty under the Swaps.

(4) The debit in question was recognised in equity because the transaction to which it related was a transaction with shareholders. Had the transaction been with a non-shareholding third party, such as a charity, the deduction would have gone to profit and loss account.

Interpretation of Schedule 26 Finance Act 2002.

83. Both parties argued, despite the architecture of Schedule 26 and the ostensible intention of the legislation to align accounting and tax profits, that the meaning of loss for the purposes of paragraph 15 of that Schedule was not an accounting, or at least not purely an accounting concept. Both referred to it as a legal concept, but with a different ambit; Mr Prosser said that a loss had to be recognised for paragraph 15 purposes because the result of the issue of the Tracker Shares was to diminish the value of ANTS' assets (its interest in the Swap cash flows) and this should pertain despite the fact that the accounting treatment of the transaction was to derecognise the asset and reflect the loss in statements of equity. Mr Ghosh said that the term loss in paragraph 15 bore a broad legal meaning but on no basis could the loss in value of assets arising from an agreement to pay on realised profits be treated as a loss for Schedule 26 purposes.

84. The issue is answered in part by paragraph 17B of Schedule 26 which does on its face enable the derivatives legislation to take account of debits which are taken to equity. Specifically amounts taken to equity are treated as recognised for accounting purposes and therefore fall within the scope of paragraph 17A as amounts which can be brought into account as deductible debits. However, on this question of statutory interpretation we agree with Mr Ghosh that paragraph 17B and A are specific provisions which can be overridden by the general principles of paragraph 15 to which paragraph 17A is made explicitly subject. It is not all debits which are recognised in equity which can be treated as deductible debits, but only those which fulfil the other conditions of paragraph 15 in particular that they fairly represent all profits and losses of the company for the accounting period in question

85. Our starting point is that the derecognition debit which both parties accepted was the correct accounting treatment under IAS 39 cannot be accepted on its face as

producing a fair representation of the company's losses arising from its derivative contracts without further analysis.

86. We agree with the approach of both parties that the reference to a loss in Schedule 26 should not be limited to a purely accounting concept and that the reference in paragraph 15 to reflecting only such losses and profits which fairly represent the company's position for that year is a means of ensuring that accounting treatment which is, for whatever reason, too far divorced from commercial reality should not be allowed to apply for tax purposes. (This is supported by the comments in the DCC *Holdings Ltd* decisions culminating in the Supreme Court decision (*DCC Holdings (UK) Ltd v Revenue and Customs Commissioners* [2010] UKSC 58) and reflected in later iterations of the legislation.) In this particular situation, as made clear by Mr Drummond, the accounting treatment is reflecting the economic substance of the transaction, that ANTS is obliged to pass on the payments which it receives under the Swaps which is out of line with ANTS' legal position, that it remains the counterparty to the Swaps and the recipient of the positive Swap Cash Flows.

87. Mr Prosser attempted to persuade us that there was a real loss because ANTS had passed on the cash flows under the Swaps and this had an impact on the value of the assets (the Swap cash flows) held by ANTS; Mr Ghosh took a different view of what had actually happened, that ANTS had merely entered into an agreement to pay on profits which it had received in the form of a dividend. On this point we agree with Mr Ghosh, for legal purposes ANTS was in exactly the same position as it always had been as far as the Swaps were concerned, it simply had an equal and opposite obligation to pay on receipts from those Swaps.

88. Mr Prosser argued that it was anomalous that two economically equivalent transactions (the assignment of the Swap Cash Flows and an agreement to pay them on on a back to back basis) should give rise to different tax results. We do not agree that this is an anomalous result in a tax code which does not operate on the basis of economic equivalence; the UK tax legislation does not generally elevate economic substance over legal form in circumstances where back to back arrangements are in place, which is what we consider Mr Prosser's argument is suggesting that we do.

89. Mr Drummond told us that if the Swap Cash Flows had been transferred to a non-shareholding third party, that element of the Swaps would still have been derecognised under IAS 39, but the derecognition debit would have been taken to profit and loss account. In these circumstances it might have been more straightforward to accept that this represented a fair view of the company's profits as Mr Prosser suggested, arguing that the fact that the derecognition debit was taken to equity should make no difference to our analysis. We do not agree with this approach. IAS1 overrides IAS39 here for a reason; that there is no real loss in these circumstances, as Mr Drummond said "*speaking as an accountant, I would say that in one scenario, there is no loss, whereas in the other it would be represented as an expense*".

90. We come to this conclusion accepting that in some circumstances paragraph 17B of Schedule 26 provides for the possibility of recognising amounts taken to a

company's statement of changes in equity as a deductible debit. We do not consider that these are circumstances in which paragraph 17B applies because neither the legal nor the accounting analysis suggests that a loss has been generated; for legal purposes ANTS has not disposed of any rights and for accounting purposes the disposal is treated as giving rise to a dividend.

91. We think that in substance and in form that should properly be treated as a distribution of profits, or a dividend, (as in fact was the result that IAS came to) and that this cannot be treated, on a fair view, as a loss giving rise to a debit under paragraph 15 of Schedule 26.

Arising from a derivative contract.

92. In order to succeed ANTS needs to demonstrate not just that there is a debit which can be recognised under paragraph 15 but also that this arises from a derivative contract; the only derivative contracts which were identified to us were the Swaps. As stated above, from ANTS' perspective (and also the Swap counterparties') nothing had changed as far as the terms of the Swaps were concerned; ANTS had just entered into a back to back agreement to make equivalent payments on to its parent entity.

93. For accounting purposes it was agreed that the derecognition deduction arose at the time when ANTS entered into the Tracker Share agreement, not at the time when payments were actually made on the Tracker Shares in 2009. ANTS claimed a deduction in 2008 not 2009 for the £160 million debit.

94. It is clear, at least for accounting purposes then, that what triggered the debit was not any actual payment made by ANTS in respect of the Swap Cash Flows, which were not made until 2009, but the issuing of the Tracker Shares. This is an agreement which is legally separate from the Swap contracts, although it derives its economic value from those Swap contracts. It is also worth nothing that according to Mr Drummond not only were the Swap Cash Flows transferred under the Tracker Shares, but as a result they changed from being a number of assets (the 26 Swaps) to a single asset, underlining their separation from the Swaps themselves.

95. While we accept that the Tracker Shares are connected to the Swaps, we do not think that this means that the source of the debit is the Swaps; the source of the debit, the thing which gave rise to a diminution in the value of ANTS' assets is the issue of the Tracker Shares and it was not suggested that this was a derivative contract. If it had not been for the Tracker Share terms, there would have been no impact on the value of the Swaps. (If for example ANTS simply happened to have, as many financial institutions would, matching swaps on its book and paid equal and opposite amounts out to a third party, while a debit would have been available for those third party payments, no debit would be treated as having arisen from the swaps which generated the positive cash flows).

96. The issue here is not that there is no loss, but that Schedule 26 is only intended to apply to losses derived directly from derivative contracts, which this is not. Schedule 26 applies to a defined set of transactions including "related transactions"

(paragraph 15(7)) which extends to the assignment of rights under derivative contracts and a defined set of expenses, being expenses directly arising from derivative contracts (paragraph 15(4)). In our view this suggests that in order to be a debit arising from a derivative contract there has to be a direct nexus between the debit and the derivative contract, rather than the more remote causal link via the Tracker Share terms which exists here.

97. In this case, no income was assigned from the Swaps, no rights under the Swaps were transferred. The debit arose, as made clear by Mr Drummond, because of the contractual obligation to pay on the Swap Cash Flows under the Tracker Shares, which had no legal impact on the Swaps at all. This debit might be economically connected to, or related to, the derivative contracts, but it does not arise from those contracts as required by paragraph 15.

98. Our conclusion is that ANTS does not have a debit which can properly be recognised under Schedule 26; the "loss" generated by the derecognition debit is not a loss to which Schedule 26 applies and even if it were to such a loss, it does not arise from a derivative contract.

Transfer Pricing.

We are considering the application of the transfer pricing rules to this transaction as a discrete point, in view of our conclusions above that no deductible debit arises under the derivatives code at Schedule 26 Finance Act 2002

The issue of the Tracker Shares is a "provision".

99. Mr Prosser's main contention was that the UK transfer pricing rules at Schedule 28AA as interpreted by reference to the OECD model treaty and Guidelines simply did not apply to the transaction. A "provision" was something which impacted the business or financial affairs of the relevant entities; here the Tracker Shares made no difference to the relationship between ANTS and Abbey because ANTS was already, and remained a 100% subsidiary of Abbey, its profits had merely moved from one pocket to another. There was nothing to which the transfer pricing rules could attach.

100. Mr Ghosh disagreed with this, stating that the only reasons that shares were not usually brought within the remit of Schedule 28AA was because they were not often used for tax planning purposes.

101. We agree with Mr Ghosh that there is nothing in Schedule 28AA itself or indeed Article 9 of the OECD model convention and its Guidance Notes which specifically takes the issue of shares outside the transfer pricing rules. We do not agree with Mr Prosser's rather narrow interpretation of "commercial and financial relations" in this context which we think is wide enough to include a share issue which could, in circumstances other than those under consideration here, influence the relationship between a holder and issuer of shares.

102. We consider that Mr Prosser's approach to be an overly restrictive and incorrect application of the Schedule 28AA rules. We think that the reason that share issuances

have not been the subject of Schedule 28AA in the UK is because there is a plethora of other legislation on the UK statute book which controls the manner in which equity capital can be used to manipulate profits between related companies. Our conclusion is that the issue of the Tracker Shares can be treated as a provision to which Schedule 28AA applies and that the UK transfer pricing rules are in point.

103. Mr Prosser did accept that if the Tracker Shares were not themselves a provision, the Compensation Agreement might be a separate provision but said that it would have little value as a free standing agreement particularly taking account of the very low risk of ANTS not having sufficient distributable reserves. We do not think it is correct to view the Compensation Agreement as a separate provision; it is very clear that it owed its existence to the conditions in IAS 39 and the need to ensure that the Tracker Shares fulfilled the conditions for derecognition (as was accepted by Mr Prosser). For that reason alone we think its value is more than covering the risk of ANTS not having sufficient reserves; it is the key which unlocks the ability to derecognise the Swap cash flows from ANTS accounting (and potentially tax) accounts. The Compensation Agreement is at least a separate provision, if not part of the provision made between the parties represented by the Tracker Shares. Our conclusion is that the Compensation Agreement has to be taken account of in considering the provision made between the parties in applying the transfer pricing rules at Schedule 28AA.

The arm's length provision.

104. Mr Prosser attempted to suggest that shares with terms similar to the Tracker Shares could have been issued between independent enterprises, citing a proportionate issue of bonus shares of a particular class as similar to the Tracker Shares. We do not think that this is an apt analogy for the issue of shares such as the Tracker Shares whose market value was £161 million but which were issued at £1,000. Bonus shares of the type described by Mr Prosser would not be paid for at all and would not comprise a defined and valued set of cash flows as the Tracker Shares did. It is very difficult to imagine a comparable commercial situation in which a company would be willing to give away £160 million of value in exchange for £1,000 to a third party. To use the terms of the OECD Guidelines, it does not represent "*commercially rational*" behaviour.

105. Mr Prosser stressed that the OECD Guidelines placed clear restrictions on tax authorities either disregarding or substituting another transaction for the actual transaction carried out between the parties other than in the specific circumstances set out at paragraph 1.37. Our view is that the Tracker Shares do fall within one of those exceptions, namely that "*the arrangements in relation to the transactions viewed in their totality, differ from those that would have been adopted by independent enterprises acting in a commercially rational manner and the structure impedes the tax administration from determining the appropriate transfer price*". The example given in the guidelines of a transaction falling within this exception is of an agreement whose legal terms (the length of the contract), rather than merely its price, has to be taken account of. On this analysis we think that the Tracker Shares (including the Compensation Agreement), by reason of their legal character, not being the type of

shares which would be issued between independent parties, fall within this exceptional category. We also think that the fact that the Tracker Shares were issued as part of a transaction which was notified to HMRC under the DOTAS rules supports this conclusion.

106. Our conclusion on these points is that the Tracker Shares are a provision for Schedule 28AA purposes and that the comparator transaction is that they would not have been issued at all between independent enterprises with the result that any debit arising should be reduced to nil.

The adjustment under Paragraph 31A Schedule 26 Finance Act 2002.

107. Mr Prosser also suggested that even if shares could come within the ambit of Schedule 28AA, any adjustments arising from Schedule 28AA, in particular an adjustment which led to a "nil" debit or to ignoring the existence of the shares was outside the scope of paragraph 31A which was intended to bring in positive adjustments made by Schedule 28AA, not remove debits from the scope of Schedule 26.

108. Mr Ghosh said that this was an incorrect interpretation of what paragraph 31A was intended to do; it was there to fit any adjustments made by Schedule 28AA into the scope of Schedule 26 and that included a situation in which debits were decreased or disappeared altogether.

109. We can see some logic in Mr Prosser's interpretation of the drafting of paragraph 31A which does not readily lend itself to this situation, however the transfer pricing legislation is intended to both increase profits or decrease losses (paragraph 5 of Schedule 28AA) and Mr Prosser's interpretation of paragraph 31A would limit its capacity to decrease losses and its scope in the context of derivative transactions. Our view of paragraph 31A is that its purpose is to ensure that any Schedule 28AA adjustments conform to the mechanics of Schedule 26 and so can properly be treated as debits or credits within the terms of that code. On that basis we do not accept that paragraph 31A can be relied on by ANTS to mitigate the effect of the transfer pricing adjustments made by Schedule 28AA in reducing the available debit to nil.

110. For these reasons we agree with HMRC that the Schedule 28AA transfer pricing rules can be applied to the provision made between the parties here; being the issue and payment for the Tracker Shares and plus the Compensation Agreement.

111. The parties suggested at the Tribunal that if Schedule 28AA was found to be in point they should be allowed to make further submissions about how the transfer pricing rules should be applied to the provision made between ANTS and Abbey. Having concluded in the first part of this decision that no debit arises, and here that the correct comparator transaction is no transaction at all with no debits arising, we have assumed that further submissions on this point would not serve any purpose.

112. For these reasons this appeal is dismissed.

113. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

RACHEL SHORT
TRIBUNAL JUDGE

RELEASE DATE: 14 JULY 2015