Neutral Citation Number: [2024] EWCA Civ 330

Case No: CA-2022-001918

**IN THE COURT OF APPEAL (CIVIL DIVISION)**
**ON APPEAL FROM THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)**
**MR JUSTICE MICHAEL GREEN AND JUDGE RUPERT JONES**
**[2022] UKUT 199 (TCC)**

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 11/04/2024

**Before:**

**LORD JUSTICE PETER JACKSON**
**LORD JUSTICE NUGEE**
and
**LADY JUSTICE FALK**

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**Between:**

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| **BLACKROCK HOLDCO 5, LLC** | **Appellant** |
| **- and –** | |
| **THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS** | **Respondents** |

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**Kevin Prosser KC and David Yates KC** (instructed by **Simmons and Simmons LLP**) for the **Appellant**
**David Ewart KC and Sadiya Choudhury KC** (instructed by **HMRC Solicitors Office and Legal Service**) for the **Respondents**

Hearing dates: 5 and 6 March 2024

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# Approved Judgment

This judgment was handed down remotely at 10.00am on 11 April 2024 by circulation to the parties or their representatives by e-mail and by release to the National Archives.

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**Lady Justice Falk:**

## INTRODUCTION

1. In 2009 the BlackRock group acquired the worldwide business of Barclays Global Investors ("BGI") for approximately US $13.5 bn, comprising $6.6 bn in cash and the balance in shares in BlackRock, Inc. ("BRI"), the group's parent company. The parties agreed that, out of the total consideration due, the amount that would be paid for BGI's US business ("BGI US") would be $2,252,590,706 in cash and BRI shares worth $8.5 bn (the "BRI Shares").

2. This appeal concerns the structure that BlackRock used to acquire BGI US, and specifically the deductibility for UK tax purposes of interest payable on $4 bn of intra-group loans put in place for that purpose. HMRC challenged the claim to deduct on two grounds, namely (1) the transfer pricing rules in Part 4 of the Taxation (International and Other Provisions) Act 2010 ("TIOPA") (the "Transfer Pricing issue"), and (2) the unallowable purpose rule in s.441 of the Corporation Tax Act 2009 ("CTA 2009") (the "Unallowable Purpose issue"). In outline, HMRC's position on the Transfer Pricing issue is that the loans would not have been made at all between parties acting at arm's length, such that relief should be denied on that basis. On the Unallowable Purpose issue HMRC maintain that relief should alternatively be denied because securing a tax advantage was the only purpose of the relevant loans.

3. In a decision of Judge John Brooks dated 3 November 2020, the First-tier Tribunal ("FTT") decided that the interest was deductible ([2020] UKFTT 443 (TC)) (the "FTT Decision"). In a decision of Michael Green J and Judge Rupert Jones dated 19 July 2022, the Upper Tribunal ("UT") allowed HMRC's appeal on both issues and confirmed HMRC's amendments to the relevant tax returns that denied the deductions ([2022] UKUT 199 (TCC)) (the "UT Decision").

4. The appeals relate to returns for accounting periods ended 30 November 2010 to 31 December 2015 inclusive.

5. The court is grateful for the assistance provided by the submissions of Kevin Prosser KC and David Yates KC for the appellant, BlackRock HoldCo 5, LLC ("LLC5"), and David Ewart KC and Sadiya Choudhury KC for HMRC.

### The acquisition structure

6. The relevant acquisition structure is best viewed pictorially, and is included as an Appendix to this decision in a form reproduced from the UT Decision. BlackRock Financial Management, Inc. ("BFM"), shown as the parent company in the structure, was an existing Delaware corporation and an indirect wholly owned subsidiary of BRI. The acquisition structure involved the formation of three further entities which were incorporated in Delaware as limited liability companies ("LLCs"), namely BlackRock HoldCo 4, LLC ("LLC4"), LLC5 and BlackRock HoldCo 6, LLC ("LLC6"). In outline, BFM became the sole member of LLC4 and LLC4 became the sole member of LLC5. Both LLC4 and LLC5 became members of LLC6. It was LLC6 that acquired BGI US, by acquiring all of the outstanding shares in Delaware Holdings, Inc., the existing owner of BGI US, from the Barclays group.

7. The transaction consideration was passed down to LLC6 in the following manner:

   a) BFM contributed $2,252,590,706 in cash and the BRI Shares to LLC4.

   b) LLC4 contributed $2,144,788,229 in cash and the BRI Shares to LLC5 in return for 100 common (that is, ordinary) shares in LLC5 and the issue by LLC5 of loan notes in four tranches totalling $4 bn (the "Loans").

   c) LLC4 also contributed the balance of the cash, being $107,802,477, to LLC6 in return for the issue of 100,000 common shares in LLC6.

   d) LLC5 contributed $2,144,788,229 in cash and the BRI Shares to LLC6 in return for the issue of 2,400,000 preference shares in LLC6.

8. The holders of the common shares in LLC6 were entitled to 216 votes for each common share. The holders of the preference shares in LLC6 were entitled to one vote for each preference share. The effect was that LLC4 held 90% of the voting power in LLC6.

9. Section 6.1 of the Limited Liability Company agreement of LLC6 stated that its board would determine in its sole and absolute discretion the amount of Available Assets (as defined) that were available for distribution and the amount, if any, of such Available Assets to be distributed to members in accordance with the following order of priority:

   a) A total annual distribution of $300 per preference share (amounting to $720,000,000 on the basis of 2,400,000 shares).

   b) A total annual distribution of $20 per common share (amounting to $2,000,000 on LLC4's 100,000 common shares), but no such distribution to be made unless and until all preference dividends for such period had been paid.

   c) Any unpaid amounts of either preference or common dividends would be carried forward, with interest.

   (Section 6.1 also gave the board of LLC6 the power, once these entitlements had been satisfied, to make additional distributions simultaneously to the holders of both classes of share, but on the basis that the amount distributed per preference share was four times the amount distributed per common share.)

10. The effect of this was that, as preference shareholder, LLC5 would be entitled to the vast majority of the distributions from LLC6, and to priority over distributions paid to LLC4. However, LLC4 controlled LLC6, and therefore could control whether it made any distributions.

11. Under US tax rules LLCs, unlike regular corporations, may elect to be disregarded for tax purposes. Each of LLC4, LLC5 and LLC6 made such an election. The effect of those elections included that transactions between those entities, including the Loans, fell to be ignored for US tax purposes.

12. In contrast to other entities in the structure, LLC5 was resident for tax purposes in the UK by virtue of being managed and controlled here. Unlike the position for US tax purposes it did not fall to be disregarded for UK tax purposes, and was treated as an entity subject to UK corporation tax.

13. The dispute concerns the claims by LLC5 to deduct interest on the Loans made to it by LLC4 in its corporation tax returns. If those claims were properly made they would give rise to losses (strictly, non-trading deficits on loan relationships) which could be surrendered to UK members of the BlackRock group to set against their own taxable profits. LLC5 sought to make such surrenders, and in accordance with the usual policy of the BlackRock group did so for no consideration. (LLC5 had no taxable income because its receipt of dividends on the preference shares was exempt from tax.)

**Other relevant facts in outline**

14. As a preliminary observation, the scope of the FTT's findings is not immediately obvious. Large parts of the FTT Decision appear at first sight to summarise evidence without explicitly confirming that the evidence was accepted. However, while additional clarity would have assisted, it is tolerably clear that where evidence is summarised without qualification it was accepted and found as a fact. In the case of the evidence of the two witnesses of fact, Nigel Fleming and J. Richard Kushel, this is supported by the FTT's finding at para. 5 that they were both "credible, truthful witnesses who at all times sought to assist the Tribunal". Further, para. 9 expressly refers to making "the following additional findings of fact" to expand on those set out in a statement of agreed facts. The structure of the decision suggests that that comment covers the following sections up to para. 54.

15. I will deal with some of the factual findings in greater detail below, but it is convenient to refer to four points now. Cross-references are to paragraphs of the FTT Decision.

16. First, the FTT found that the split ownership structure of LLC6, with LLC4 rather than LLC5 having voting control of LLC6, was introduced because of concerns that the US financial regulator might have about a UK resident controlling a US bank, together with compliance-related concerns about the UK Treasury consent and UK controlled foreign company rules (para. 24). Those concerns had arisen in the context of an earlier proposal involving two rather than three LLCs, under which a UK tax resident LLC would itself acquire BGI US, and would be wholly owned by one further (non-UK resident) LLC owned by BFM (para. 21). It is not suggested that the UK related concerns themselves connote any tax avoidance purpose.

17. Secondly, having considered expert evidence adduced by both parties, the FTT found that an independent lender would not have been prepared to enter into the Loans on the same terms as the parties actually did, but that it would have done so if it had obtained certain covenants from, in particular, LLC6 and BGI US that were not there in the actual transaction (para. 103, reflecting an agreement of the experts recorded at para. 77 and a further finding at para. 89). The FTT also accepted the evidence of BlackRock's expert that such covenants would have been forthcoming (para. 102).

18. Thirdly, the board of LLC5 approved the proposal to take the steps relevant to that entity at a meeting held on 30 November 2009, one day before the acquisition of BGI US completed. While it is common ground that the structure outlined above was devised, and LLC5 was incorporated, in accordance with tax advice that anticipated that UK tax advantages could be obtained, BlackRock's position is that this is not relevant to the Unallowable Purpose issue because that is concerned solely with the subjective purpose of LLC5, determined by reference to the intentions of the board members. In that connection the FTT found that LLC5 "entered into the Loans in the furtherance of the

commercial purpose of its business of making and managing passive investments" (para. 121). Although the FTT also found that the securing of a tax advantage was "an inevitable and inextricable consequence" and on that basis was itself a main purpose, BlackRock say that was an error of law because the board had left the anticipated tax advantages out of account in deciding whether to approve the transaction.

19. Fourthly, it is uncontroversial that the relative amounts of debt and equity by which LLC5 was funded took account of the need to ensure that LLC5 was not "thinly capitalised", meaning having insufficient equity to justify the level of debt it took on.

## THE TRANSFER PRICING ISSUE

### The issues

20. The UT allowed HMRC's appeal on the Transfer Pricing issue on the basis of an argument that was not raised in the FTT, namely that in determining whether an independent lender would be prepared to lend, the transfer pricing provisions do not permit the existence of third-party covenants to be hypothesised where those covenants are not present in the actual transaction. LLC5 challenges that conclusion as Ground 1 of its appeal.

21. HMRC defend the UT Decision and also rely on an additional ground by way of Respondent's Notice, namely that the UT erred in holding that the FTT had been entitled to conclude on the basis of the expert evidence before it that an independent lender would have entered into the Loans subject to it being able to obtain the necessary covenants; and that the covenants would have been forthcoming (HMRC's Ground 1).

### Relevant legislation

22. The relevant legislation is contained in Part 4 of TIOPA.

23. Section 147 TIOPA relevantly provides:

> "**147 Tax calculations to be based on arm's length, not actual, provision**
> (1) For the purposes of this section "the basic pre-condition" is that—
> (a) 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,
> (b) the participation condition is met (see section 148),
> (c) …, and
> (d) the actual provision differs from the provision ("the arm's length provision") which would have been made as between independent enterprises.
> (2) Subsection (3) applies if—
> (a) the basic pre-condition is met, and
> (b) the actual provision confers a potential advantage in relation to United Kingdom taxation on one of the affected persons.
> (3) The profits and losses of the potentially advantaged person are to be calculated for tax purposes as if the arm's length provision had been made or imposed instead of the actual provision."

24. "Transaction" is broadly defined by s.150(1) TIOPA to include "arrangements, understandings and mutual practices (whether or not they are, or are intended to be, legally enforceable)". Section 150 also provides that "series of transactions" includes a number of transactions entered into in pursuance of the same arrangement, and expressly states that provision can be made between two persons by means of a series of transactions even if there is no direct transaction between them or the series includes transactions to which neither of them is a party. Section 148, read with ss.157 to 163, has the effect that the "participation condition" is met if, among other things, one of the persons controls the other. That is referred to as being a situation where one of the persons is "directly participating in the management, control or capital" of the other. The concept of "potential advantage" is defined in s.155 and includes the creation or increase in losses for tax purposes.

25. Section 151 elaborates on the concept of arm's length provision, as follows:

> "**151 "Arm's length provision"**
> (1) In this Part "the arm's length provision" has the meaning given by section 147(1).
> (2) For the purposes of this Part, 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 include the case in which provision is made or imposed as between two persons but no provision would have been made as between independent enterprises; and references in this Part to the arm's length provision are to be read accordingly."

26. It is common ground that the relevant "actual provision" referred to in s.147(1) is the Loans made by LLC4 to LLC5, that the "participation condition" is met by virtue of LLC4's control of LLC5 (in the terms of the legislation, LLC4 was "directly participating in the management, control or capital" of LLC5) and that the Loans did confer a "potential advantage" in relation to UK taxation.

27. Section 152 TIOPA deals specifically with debt financing between corporate entities, in the following terms:

> "**152 Arm's length provision where actual provision relates to securities**
> (1) This section applies where–
> (a) both of the affected persons are companies, and
> (b) the actual provision is provision in relation to a security issued by one of those companies ("the issuing company").
> (2) Section 147(1)(d) is to be read as requiring account to be taken of all factors, including–
> (a) the question whether the loan would have been made at all in the absence of the special relationship,
> (b) the amount which the loan would have been in the absence of the special relationship, and
> (c) the rate of interest and other terms which would have been agreed in the absence of the special relationship…
> (3) Subsection (2) has effect subject to subsections (4) and (5).
> (4) If—

> (a) a company ("L") makes a loan to another company with which it has a special relationship, and
> (b) it is not part of L's business to make loans generally,
>
> the fact that it is not part of L's business to make loans generally is to be disregarded in applying subsection (2).
>
> (5) Section 147(1)(d) is to be read as requiring that, in the determination of any of the matters mentioned in subsection (6), no account is to be taken of (or of any inference capable of being drawn from) any guarantee provided by a company with which the issuing company has a participatory relationship.
>
> (6) The matters are—
>
> (a) the appropriate level or extent of the issuing company's overall indebtedness,
>
> (b) whether it might be expected that the issuing company and a particular person would have become parties to a transaction involving—
>
> (i) the issue of a security by the issuing company, or
>
> (ii) the making of a loan, or a loan of a particular amount, to the issuing company, and
>
> (c) the rate of interest and other terms that might be expected to be applicable in any particular case to such a transaction."

28. Section 154 defines some of these terms, as follows:

> "**154 Interpretation of sections 152 and 153**
>
> …
>
> (3) "Special relationship" means any relationship by virtue of which the participation condition is met (see section 148) in the case of the affected persons concerned.
>
> (4) Any reference to a guarantee includes—
>
> (a) a reference to a surety, and
>
> (b) a reference to any other relationship, arrangements, connection or understanding (whether formal or informal) such that the person making the loan to the issuing company has a reasonable expectation that in the event of a default by the issuing company the person will be paid by, or out of the assets of, one or more companies.
>
> (5) One company ("A") has a "participatory relationship" with another ("B") if—
>
> (a) one of A and B is directly or indirectly participating in the management, control or capital of the other, or
>
> (b) the same person or persons is or are directly or indirectly participating in the management, control or capital of each of A and B.
>
> (6) "Security" includes securities not creating or evidencing a charge on assets.
>
> …"

29. It is uncontroversial that s.152 is in point and that the necessary special relationship existed between LLC4 and LLC5 through the former's control of the latter. It is also undisputed that the third party covenants that the FTT found would have been in place in an arm's length transaction would not be "guarantees" within s.154(4).

30. Finally, but importantly, s.164 provides that Part 4 of TIOPA is to be read "in such manner as best secures consistency" with the transfer pricing guidelines issued by the Organisation for Economic Co-operation and Development (the "OECD guidelines"):

> **"164 Part to be interpreted in accordance with OECD principles**
> (1) This Part is to be read in such manner as best secures consistency between—
> (a) the effect given to sections 147(1)(a), (b) and (d) and (2) to (6), 148 and 151(2), and
> (b) the effect which, in accordance with the transfer pricing guidelines, is to be given, in cases where double taxation arrangements incorporate the whole or any part of the OECD model, to so much of the arrangements as does so.
> ….
> (3) In this section "the OECD model" means—
> (a) the rules which, at the passing of [the Income and Corporation Taxes Act 1988] (which occurred on 9 February 1988), were contained in Article 9 of the Model Tax Convention on Income and on Capital published by the Organisation for Economic Co-operation and Development, or
> (b) any rules in the same or equivalent terms.
> …"

31. As discussed in oral argument, this is perhaps not drafted as clearly as it might be. We are not concerned with double taxation arrangements. The explanation is that the OECD guidelines are produced with reference to the OECD model double tax convention, and specifically Article 9 of the model, which deals with "associated enterprises". Article 9 allows a contracting state to make adjustments to profits for tax purposes where, broadly, the terms of the actual arrangements between enterprises in the two contracting states differ from what would have been agreed between independent enterprises, and requires corresponding adjustments to be made by the other contracting state.

32. Section 164(1)(b) refers to "transfer pricing guidelines". That term is defined in 164(4) by reference to guidelines published by the OECD. The definition changed over the relevant period. The effect in this case is that, for LLC5's accounting periods ended 30 November 2010, 31 December 2010 and 31 December 2011 the relevant version of the OECD guidelines is that published in 1995, and for the periods ended 31 December 2012 to 31 December 2015 inclusive, the version published in 2010.

33. Later versions of the guidelines were published in 2017 and 2022. Although those later guidelines are not strictly applicable there was no dispute between the parties that we can consider them on the basis that (so far as they are relevant to this case) they simply elucidate or expand on points made in earlier versions. Indeed, both parties relied on the 2022 version on that basis.

## The OECD guidelines

34. Paragraph 1.6 of both the 1995 and 2010 versions of the OECD guidelines explains that what Article 9 of the model convention seeks to do is to adjust profits by reference to "the conditions which would have obtained between independent enterprises in comparable transactions and comparable circumstances" (a comparable "uncontrolled transaction", as opposed to the actual "controlled transaction"). The 2010 version adds

that this comparability analysis is at the "heart of the application of the arm's length principle", while explaining at para. 1.9 that there are cases, for example involving specialised goods or services or unique intangibles, where a comparability analysis is difficult or complicated to apply.

35. In its discussion of comparability analysis, para. 1.15 of the 1995 version states:

> "Application of the arm's length principle is generally based on a comparison of the conditions in a controlled transaction with the conditions in transactions between independent enterprises. In order for such comparisons to be useful, the economically relevant characteristics of the situations being compared must be sufficiently comparable. To be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g. price or margin), or that reasonably accurate adjustments can be made to eliminate the effect of any such differences. In determining the degree of comparability, including what adjustments are necessary to establish it, an understanding of how unrelated companies evaluate potential transactions is required. Independent enterprises, when evaluating the terms of a potential transaction, will compare the transaction to the other options realistically available to them, and they will only enter into the transaction if they see no alternative that is clearly more attractive. For example, one enterprise is unlikely to accept a price offered for its product by an independent enterprise if it knows that other potential customers are willing to pay more under similar conditions. This point is relevant to the question of comparability, since independent enterprises would generally take into account any economically relevant differences between the options realistically available to them (such as differences in the level of risk or other comparability factors discussed below) when valuing those options. Therefore, when making the comparisons entailed by application of the arm's length principle, tax administrations should also take these differences into account when establishing whether there is comparability between the situations being compared and what adjustments may be necessary to achieve comparability."

Similar text appears at paras. 1.33 and 1.34 of the 2010 version.

36. As can be seen from this, it is essential that the "economically relevant characteristics" are "sufficiently comparable", in the sense of any differences either not having a material effect on the relevant condition (term) of the transaction, or being capable of being adjusted for with reasonable accuracy so as to eliminate their effect.

37. Paragraph 1.17 of the 1995 version expands on the concept of differences as follows:

> "… In order to establish the degree of actual comparability and then to make appropriate adjustments to establish arm's length conditions (or a range thereof), it is necessary to compare attributes of the transactions or enterprises that would affect conditions in arm's length dealings. Attributes that may be important include the characteristics of the property or services transferred, the functions performed by the parties (taking into account assets used and risks assumed), the contractual terms, the economic circumstances of the parties, and the business strategies pursued by the parties…"

Again, this is reflected in the 2010 version, at para. 1.36. For present purposes, the references to functions, risk and economic circumstances are noteworthy.

38. Under a sub-heading "Factors determining comparability", the guidelines discuss among other things the importance of a functional analysis, which "seeks to identify and to compare the economically significant activities and responsibilities undertaken or to be undertaken by the independent and associated enterprises" (para. 1.20 of the 1995 version). As part of this, the guidelines identify the relevance of risks assumed by the parties:

> "… Controlled and uncontrolled transactions and entities are not comparable if there are significant differences in the risks assumed for which appropriate adjustments cannot be made. Functional analysis is incomplete unless the material risks assumed by each party have been considered since the assumption or allocation of risks would influence the conditions of transactions between the associated enterprises." (Para. 1.23 of the 1995 version; para 1.45 of the 2010 version.)

39. The OECD guidelines make clear that, in general, tax administrations should not disregard actual transactions. Both the 1995 and 2010 versions give two examples of when, exceptionally, this might be done (paras. 1.36 to 1.38 of the 1995 version; paras. 1.64 to 1.66 of the 2010 version). The first is where the economic substance of a transaction differs from its form, the classic example being debt that in economic substance amounts to equity. The second is a situation where the arrangements differ from those that would be entered into by commercially rational independent parties and the effect is to impede the application of transfer pricing principles, an example being a transfer of unlimited rights to intellectual property relating to future research. It was not suggested that either of these exceptions is in point.

40. A further point clarified by the guidelines is that the presence of a tax motive or purpose does not justify non-recognition of the parties' characterisation or structuring of a transaction. Rather, the fact that a transaction has been entered into with tax savings in mind is not relevant for transfer pricing purposes: paras. 9.181 and 9.182 of the 2010 version.

41. Mr Prosser referred us to the 2022 version of the OECD guidelines in relation to two points. The first is the treatment of synergies available from membership of a group. The guidelines clarify that incidental benefits arising from group membership need not be adjusted for even if they are substantial. The example is given of an improved credit rating available to a borrower by virtue of membership of a group, as compared to what it would be on a standalone basis (paras. 1.177, 1.178 and 1.184 of the 2022 version). This point is also addressed in both the 1995 and 2010 versions at para. 7.13.

42. Secondly, in a section dealing with intra-group loans, para. 10.56 of the 2022 version notes that where a parent grants a loan to a subsidiary the grant of security is less relevant to its risk analysis because it already has control and ownership, such that the absence of contractual rights over the assets of the borrower "does not necessarily reflect the economic reality of the risk inherent in the loan". The same section also addresses covenants, pointing out (in effect) that the drivers leading to covenants being required at arm's length may not be present in an intra-group context and that it will be appropriate to consider whether there is in practice the "equivalent" of covenants (para. 10.86).

## The FTT Decision

43. The FTT considered the evidence of two experts, Timothy Ashley for BlackRock and Simon Gaysford for HMRC. Mr Ashley had had significant experience in treasury management and the debt capital markets. Mr Gaysford did not have debt capital market experience. His expertise was as an economist.

44. The experts were asked to consider whether the Loans differed from those which would have been made between independent enterprises, including whether they would have been entered into at all. The FTT found that there was broad agreement between them on most issues, including that "an independent lender would, on the strength of the [BGI US] business, be willing to lend $4 bn to LLC5 but would have required covenants from LLC5 to do so" (para. 69 of the FTT Decision). This was reiterated at para. 77 in the following terms, by reference to a joint statement and Mr Gaysford's report:

> "… the experts agree that it would have been possible for LLC5 to execute a $4 billion debt transaction in December 2009 with an independent enterprise at similar interest rates to the actual transaction that took place between LLC5 and LLC4, but subject to different terms and conditions that independent lenders would have required to manage the credit risks appropriately."

45. Mr Ashley's report listed various types of covenant, but he agreed in oral evidence that the "critical ones" were:

> "(1) Additional debt covenant restricting the amount of debt that could be raised at LLC6 or [BGI US] level to cap the amount of incremental debt that could subordinate or subvert LLC5 lenders; and/or
>
> (2) Provision of additional covenants (e.g. preference share payment covenant from LLC6)…" (Paras. 70 and 71 of the FTT Decision.)

Other covenants on Mr Ashley's list included negative pledges restricting LLC6's ability to makes loans to LLC4 or other group entities and the ability of LLC6 and BGI US to grant security to other lenders.

46. As to the "preference share payment covenant" referred to in (2) above, the FTT recorded at para. 72 that:

> "In evidence Mr Ashley also agreed that a covenant would be required to ensure that LLC6, if it was going to do so, would pay a dividend to LLC5 first to, "make sure that it is effectively honouring the preference shares which are preferred and pay that dividend flow first." However, he confirmed that there was "nothing more" to the covenants he would be suggesting than that although he believed that it was not possible to compel LLC6 to declare a dividend."

47. The covenants that Mr Gaysford stated were required are set out at para. 73 of the FTT Decision. No doubt reflecting his different expertise, they are somewhat less specific and described more by overall effect rather than content, in particular covenants to "remove the existing uncertainty" and prevent "actions that could reduce the value of LLC5".

48. The FTT went on to consider the experts' evidence in further detail. On the question of the additional terms and conditions that an independent lender would require, the FTT set out at para. 78 the following extract from section 14 of the joint statement:

> "f. The preference share structure was unusual but not necessarily problematic given BGI US was already a successfully performing business. The preference shares carried an expectation that [LLC5] should receive over USD700m annually in income which would have given it a sizeable debt capacity. The main issue was that the flow of value from BGI US to LLC6 and then to [LLC5] via the preference shares was paid at the discretion of LLC4. Whilst a lender would probably be unlikely to accept this position, it should have been possible for BGI US, and LLC6 – with the explicit consent of LLC4 – to effectively ratify the legal and financial position to which [LLC5] was entitled, that is via inter-company agreements and covenants which would have formed part of [LLC5's] borrowing transaction. Both experts agree that an independent lender would have required the protection described in this paragraph and that it probably could have been put in place. Mr Gaysford believes that it would have been costly and complex to do so. Mr Ashley believes it would have been straightforward and the associated 'cost' would have been an 'opportunity cost' (ie reduced flexibility to enter into further transactions rather than a cash cost).
>
> g. In addition to the protections discussed in f above, the purpose of which would have been to secure the flow of value from BGI US and preference share dividends from LLC6, the experts agree that an independent lender would likely also have required other structural enhancements to the terms of the loans, to ensure the cashflow generation of BGI US could not be diverted in any way. Possible additional clauses would include (1) a negative pledge on further indebtedness within BGI US, LLC6 or indeed [LLC5], (2) a change of control clause and (3) a restriction on BGI US or LLC6 being able to lend money to any other entity – whether inside the BlackRock Group or not. These are well known standard clauses required in almost every external debt transaction – though to emphasise, one would not expect to see them in an inter-company loan transaction within a group.
>
> h. The experts cannot say with certainty whether all of the possible additional clauses listed in paragraph g would have been required to support a USD4bn loan or bond transaction by [LLC5]. However, in view of the structural subordination of LLC5 (being 2 entities away from the generation of cashflows), the experts agree that an independent lender would have required at least some of the enhancements discussed in paragraph g.
>
> i. Again, both experts agree that the enhancements discussed in paragraph g would have been necessary, and probably could have been achieved. Mr Ashley believes it would have been straightforward to do so and that the associated 'cost' would have been an 'opportunity cost' (ie reduced flexibility to enter into further transactions) rather than a cash cost. In Mr Ashley's experience, such enhancements are very common terms in debt transactions, including the BlackRock's group own revolving credit facility.

> Mr Gaysford believes it would have been costly and complex to do so, and that any 'opportunity cost' would have been significant."

The extract went on to record a difference between the experts as to whether some form of parental support was also required, Mr Ashley's view being that it was not.

49. HMRC's case before the FTT was, essentially, that the transaction would simply not have taken place at all at arm's length. The FTT concluded that both HMRC's submissions, and Mr Gaysford, were wrongly focusing on the position of the BlackRock group as a whole. Their objection was that there was a much simpler commercial alternative for a commercial lender to the group which did not involve a loan to LLC5, whereas the required comparison was between the actual lending transaction and a hypothetical loan to the same borrower (para. 101). The FTT went on:

> "102. Both experts agreed that an independent lender would have entered into an arrangement subject to it being able to obtain the necessary covenants. On balance, given that Mr Gaysford accepted that his concerns in relation to cost and complexity did not amount to "deal breakers", I prefer the evidence of Mr Ashley that the covenants would have been forthcoming. Similarly I prefer the evidence of Mr Ashley regarding parental support especially as Mr Gaysford was unable to say with "certainty" that the transaction would not have proceeded in its absence.
>
> 103. Therefore, for the reasons above I find that although an independent enterprise would not have entered into the Loan on the same terms as the actual transaction it would, subject to the covenants described above, have entered into the Loans on the same terms as the parties in the actual transaction."

## The UT Decision

50. As already explained, HMRC raised a new argument in the UT, namely that in determining whether an independent lender would be prepared to lend, the transfer pricing provisions do not permit the existence of third-party covenants to be hypothesised where those covenants are not present in the actual transaction.

51. In essence, the UT accepted Mr Ewart's submission that s.147(1)(a) TIOPA imposes a "two party rule", because it requires focus on the "provision…made or imposed as between any two persons". That meant that in this case only the terms of the Loans could be considered. Third-party covenants not given as part of the actual transaction may not be taken into account because to do so "materially changes the surrounding circumstances and alters the economically relevant characteristics of the transactions in question" (para. 75 of the UT Decision).

52. In reaching that conclusion, the UT reasoned that the FTT had essentially compared a different transaction to the actual one, because importing third-party covenants changed the nature of the provision to be compared (para. 59). The UT also agreed with Mr Ewart's submissions that s.152(5) TIOPA did not assist BlackRock. That only applied where a guarantee was present in the actual transaction (para. 70). Further, its existence indicated that not only guarantees but other types of third-party covenant "affect the substance of the loan transaction". Those other sorts of covenant could only be taken into

account if they were present in the actual transaction, because the actual and arm's length transactions would otherwise not be the same (para. 72).

53. The UT recognised that the effect of this was that LLC5 would not have been challenged on transfer pricing grounds if it had gone through the "rather artificial exercise" of putting covenants in place with other group companies. However, this was unlikely to be a problem in practice because "it will be very obvious if groups have sought to manipulate the actual transaction in that way by including wholly unnecessary covenants that attempt to anticipate what an independent expert might later decide would be required by an independent lender" (paras. 72-74).

54. On the basis of the FTT's finding that an independent lender would not have advanced the Loans without third-party covenants, the FTT should therefore have concluded that no provision would have been made as between independent enterprises, within s.151(2) TIOPA (para.76). The UT accordingly re-made the decision to that effect (para. 100).

55. Given the UT's conclusion on this point it was unnecessary to deal with other challenges to the FTT's conclusions, but the UT went on to do so. Relevantly for our purposes, the UT concluded that the FTT did not mischaracterise the expert evidence or make unsupported findings in relation to it (paras. 79-88).

**Discussion**

56. I consider that the UT erred in accepting HMRC's argument that the transfer pricing provisions do not permit the existence of third-party covenants to be hypothesised where those covenants are not present in the actual transaction.

57. I agree that what the legislation requires is consideration of the "provision…made or imposed as between any two persons", which must be compared to the provision that would have been made between two independent enterprises. As the Special Commissioners said in *DSG Retail Ltd v HMRC* [2009] STC (SCD) 397 ("*DSG Retail*") at [65] (by reference to the predecessor legislation), two means just that, not "two or more". However, nothing in the legislation or the OECD guidelines requires the position of third parties to be ignored if it is otherwise relevant.

*Comparable transactions: "economically relevant characteristics"*

58. The critical starting point is that, as the OECD guidelines make clear, any comparison requires the "economically relevant characteristics of the situations being compared" either to be "sufficiently comparable", or that "reasonably accurate adjustments" can be made to eliminate the effect of any material differences.

59. In the real transaction, LLC4 had no need of any of the covenants considered by the experts because, quite independently of its ownership of LLC5, it had control of LLC6 and its subsidiaries, including BGI US (the "LLC6 sub-group"). LLC4 had no real world concern that members of the LLC6 sub-group might take on excessive additional debt or that they might grant unacceptable security to other lenders. It also had no real world concern that the preference share rights might be circumvented. As the UT recognised, for LLC4 to require covenants to guard against those (in practice unreal) risks would indeed be artificial. It was simply unnecessary. LLC4 was in a position to control those risks itself.

60. While I appreciate that this is not the way in which the case has been argued (at least on appeal), one way of approaching this is to remind oneself that, in hypothesising a comparable transaction and with the exception of their assumed independence, the actual characteristics of the parties are not adjusted. This was helpfully explained in *DSG Retail* at [78] in relation to the words "differs from the provision which would have been made as between independent enterprises" which now appear in s.147(1)(d) TIOPA. After stating that this might indicate enterprises not sharing the same attributes as the actual parties, the Special Commissioners said:

> "But it is clear to us that that interpretation is not consistent with the OECD model … and therefore that [the legislation] should be interpreted as requiring consideration of what provision independent enterprises sharing the characteristics of the actual enterprises would have made."

61. It is worth noting that this approach finds support in the domestic legislation, because it explains s.152(4) TIOPA, which requires the fact that it is not otherwise part of the lender's business to make loans to be disregarded (see [27] above).

62. If the only change to the actual transaction is to break the group relationship between LLC4 and LLC5, LLC4 would still have its direct interest in LLC6 and would therefore still control both LLC6 and its subsidiaries. On that approach covenants from the LLC6 sub-group would be unnecessary. LLC4 could ensure that the preference share dividends were paid by LLC6 as anticipated.

63. As I say, the appeal was not argued on that basis, but it does underscore the artificiality of considering how LLC4 needs to be protected. In reality, and even if the control relationship was broken between LLC4 and LLC5, LLC4 does not need further protection. (I appreciate that the question whether LLC4 needs further protection is not the only one to ask, because for transfer pricing purposes it is equally necessary to consider whether LLC5 would be prepared to enter into the Loans as an independent borrower, without assurances e.g. that its preference share rights would not be frustrated. But despite that perhaps being more pertinent, it was not the focus of the debate.)

64. If we do put to one side LLC4's actual control of the LLC6 sub-group, then there is a significant difference between the "economically relevant characteristics" in the actual and hypothetical transactions. The risks are quite different. In the actual transaction it is obvious that the only real risks to be assessed from LLC4's perspective related to the performance of the BGI US business. In contrast, the lender in the hypothetical transaction would be exposed to an additional risk that something might be done by LLC4 or entities controlled by it to divert or otherwise frustrate the expected dividend flows on the preference shares to LLC5.

65. Similarly in the actual transaction, consistently with the unchallenged evidence before the FTT and reflecting the fact that LLC4 could receive no dividends on its common shares unless dividends were paid on the preference shares (see [9] above), LLC5 was not exposed to any real risk that the expected dividend flows to it would not materialise, beyond risks related to the performance of the BGI US business. In contrast an independent borrower would have no practical assurance that nothing else would be done to switch off or reduce the anticipated dividends on the preference shares.

66. There was an issue before us about the fact that evidence relevant to the point just made concerning the lack of risk for LLC5 was not reflected in findings of fact by the FTT. This point was raised in HMRC's skeleton argument but was rightly not pursued by Mr Ewart in oral submissions. The evidence was unchallenged and it must also be borne in mind that the argument we are concerned with was raised for the first time in the UT. The absence of findings is therefore unsurprising. It would also be unfair for HMRC, having raised a new argument in the UT, then to rely in this court on a failure by BlackRock to secure relevant findings in the FTT.

67. As already explained, the OECD guidelines contemplate that adjustments may be made to ensure that material differences between "economically relevant characteristics" are eliminated. They also explain (see [37] and [38] above) that material risks must be identified and addressed.

68. That is precisely what the expert evidence sought to do. The evidence accepted by the FTT in effect adjusted the terms of the actual transaction to ensure that the "economically relevant characteristics" of the actual and hypothetical transactions – and in particular the risks assumed – were comparable. This was done by hypothesising the existence of certain covenants from other group members. In the real world those covenants were unnecessary: the risks did not exist. In the hypothetical world the existence of the covenants addressed the risks that might otherwise exist, so rendering a comparison possible on the basis that the "economically relevant characteristics" of the actual and hypothetical transactions were then sufficiently comparable. The reference in the joint statement to it being possible for BGI US and LLC6 "to effectively ratify the legal and financial position" (see [48] above, para. f.) reflects this.

69. Mr Ewart submitted that the parts of the OECD guidelines referred to above all concern comparability analyses, but in this case there was no comparable transaction because the FTT had found that an independent lender would not lend to LLC5. That finding reflected the expert evidence that there were no comparable transactions.

70. In my view that overlooks the FTT's findings of fact. The FTT found that an independent lender would have entered into the Loans on the same terms, subject to third-party covenants being entered into. I do not think it matters that a precise equivalent transaction between parties acting at arm's length is not identified. This is not a transaction involving specialised goods or services or unique intangibles of the kind referred to in para. 1.9 of the 2010 version of the guidelines, where a comparability analysis is problematic. It is a lending transaction.

71. What the OECD guidelines do require is that the "economically relevant characteristics" are "sufficiently comparable", and that to the extent that there would otherwise be material differences "reasonably accurate adjustments can be made to eliminate the effect of any such differences": see above. The economically relevant characteristics of the actual lender and borrower in this case include (a) LLC4's actual control of LLC6 and (indirectly) BGI US, such that in practice it had no need, when deciding to make the Loans, of any covenants from those entities (or, of course, from itself), and (b) LLC5's own position in the group, such that its board had no reason to be concerned about any possibility that the expected profit would not, if made, find its way up to it by way of preference share dividends, whether due to dividend flows being diverted or otherwise. The third-party covenants do just what the guidelines require, namely adjust for the

absence of these risks in the actual transaction, so rendering the economically relevant characteristics comparable.

72. Mr Ewart also submitted that there is no mention in the OECD guidelines of introducing third parties. This includes the section in the 2022 version that addresses covenants in loan transactions, which only considers covenants from a borrower (see [42] above). However, the guidelines do not rule out reference to the position of third parties, and in my view a proper application of them may, for the reasons already given, require it to be taken into account. It is also noteworthy that the consideration of covenants in the 2022 version clearly reflects the reality that intra-group loans generally do not require the sorts of protections that an independent lender would need, and recognises that it is appropriate to consider whether there is the "equivalent" of covenants in practice. This is consistent with the approach that I have described. The hypothesised covenants are designed to put the independent lender in an equivalent position to the actual lender.

73. Another example also helps to illustrate the problems with HMRC's position. As emphasised in the expert evidence, arm's length lenders will always consider the source of the cashflows that will service any loan that they may make. Where the proposed borrower is a holding company rather than the entity that directly generates the cashflows, lenders will be concerned about structural subordination. This relates to the fact that the holding company's own interest in the cashflows is limited to a direct or indirect interest in another entity, and the resultant risk that subsidiaries may take action, whether by additional borrowings, the grant of security or otherwise, that will have priority over the holding company's interest, with the effect that the cashflows do not find their way up the group to service the loan.

74. As the experts jointly explained (see [48] above, para. g), this is commonly addressed by "structural enhancements" that restrict the actions of subsidiary entities. However, an arm's length lender would not normally be satisfied by a commitment from the borrower to that effect. It would want direct commitments from the subsidiaries: indeed it would often seek security over their assets as well. As the experts indicate, the sorts of restrictions to which they refer are "well known standard clauses required in almost every external debt transaction", but would not be expected in an intra-group loan transaction. That is because they are not typically needed in that case.

75. There is no principled distinction between that scenario and this one. In both cases an arm's length lender will typically require some form of third party protection. Yet there is (rightly) no suggestion that a loan to a group entity which can properly be supported by the sub-group that it owns can be challenged under the transfer pricing rules because the borrower's subsidiaries have not given negative pledges or granted security.

76. I should add that, on the facts of this case, I also respectfully disagree with the UT's observations about manipulating transactions with artificial covenants ([53] above). While I agree that the covenants would have been unnecessary in the real transaction, and in that sense it would be artificial to include them, there would have been nothing wrong in doing so in fact.

*The domestic legislation and s.152(5)*

77. There is also support for the relevance of third parties in the domestic legislation.

78. The first point is that it is worth recalling that the legislation applies not only to a transaction directly between two parties (A and B) but to a series of transactions by means of which a "provision" is made or imposed between A and B. That series will clearly involve third parties, and indeed may be such that there is no direct transaction at all between A and B: see [24] above. Nevertheless, that (indirect) provision must be compared to the arm's length provision. While the "series of transactions" rule is not relevant on the facts of this case, there is an analogy because where it does apply the legislation must be contemplating that transfer pricing may involve considering the position of third parties in both the actual and hypothetical transactions. Similarly in the present case, third parties are both actually present and would be in the hypothetical transaction. The difference is that the practical comfort that they provide in the actual transaction in this case is not legally formalised, because it is unnecessary to do so.

79. Secondly and more significantly, I accept Mr Prosser's submission that the existence of s.152(5) TIOPA materially undermines Mr Ewart's main submission in oral argument on the transfer pricing rules, namely that the domestic legislation does not permit any reference to third parties because, as *DSG Retail* determined, "two means two".

80. Section 152(5) is set out at [27] above. To recap, it provides:

> "(5) Section 147(1)(d) is to be read as requiring that, in the determination of any of the matters mentioned in subsection (6), no account is to be taken of (or of any inference capable of being drawn from) any guarantee provided by a company with which the issuing company has a participatory relationship."

Sub-section (6) refers among other things to "the appropriate level or extent of the issuing company's overall indebtedness".

81. The rationale for this provision is best understood by an example. Assume a UK subsidiary that forms part of a larger non-UK based group. Assume further that the UK subsidiary has limited assets or that it is already funded by a significant amount of debt rather than equity. The UK subsidiary takes out a loan from a non-UK resident sister company with the benefit of a guarantee provided by the non-UK parent. An arm's length lender would also not have made the loan without the benefit of the guarantee, because it would view the subsidiary as thinly capitalised (see [19] above). Section 152(5) would have the effect that the guarantee is ignored in the hypothetical transaction, with the result that the financing costs under the loan would be disallowed.

82. HMRC's position is that s.152(5) concerns a situation where a guarantee exists in the real world, whereas what BlackRock seek to do is to hypothesise something that does not exist in the real world. The UT accepted that argument.

83. With respect, that misses the point. If third parties were irrelevant then there would be no role for s.152(5). It illustrates that the "two means two" mantra cannot be applied without further analysis. Further, the fact that s.152(5) applies to guarantees provided by related parties provides a clear indication that, in contrast, guarantees from third parties who are not related <u>can</u> be taken into account. The same must apply to arrangements involving a third party that do not fall within the definition of guarantee in s.154(4) TIOPA (set out at [28] above), irrespective of whether that third party is a related party or not.

84. As to non-existence in the actual transaction, that overlooks what does exist in the real world. The appropriate comparison is not between the non-existence of covenants in the actual transaction and the covenants that a third-party lender would require, but between the actual risks in the real world and the risks in the hypothetical transaction. In the hypothetical transaction there are risks that third parties (specifically, the LLC6 sub-group) may take actions that prejudice the performance of the Loans. Those risks do not exist for the parties to the actual transaction. The covenants in the hypothetical transaction effectively bring the risks into line with each other, so that the transactions are comparable.

85. Thirdly, and related to this point, it is worth reiterating just how broad the concept of "actual provision" is ("provision … by means of a transaction or series of transactions": s.147(1)(a) TIOPA). As noted at [24] above, "transaction" is very broadly defined to include "arrangements, understandings and mutual practices (whether or not they are, or are intended to be, legally enforceable)". The concept of the "actual provision" is then extended further by the inclusion of "series of transactions". The net is therefore intended to be cast very widely. Related parties are much more likely to be prepared to rely on informal understandings or non-binding arrangements than parties acting at arm's length. There is no indication in the legislation that the mere fact that an understanding or arrangement is non-binding should prevent a comparison with an arm's length arrangement that has a similar economic effect and which would, in practice, be legally binding.

*Term or condition as between the lender and borrower*

86. A final point on the interpretation of the transfer pricing rules is that what the transfer pricing rules require is a consideration of the terms that would have been agreed between the two "affected persons" if they had been independent enterprises (see s.147(1) TIOPA). As the OECD guidelines make clear, this requires a "comparison of the conditions in a controlled transaction with the conditions in transactions between independent enterprises" (see [35] above). Where s.152 TIOPA applies, this is also spelt out by reference to the terms that would be agreed at arm's length (s.152(2), see [27] above).

87. If a lender acting at arm's length requires a third party to provide support for a proposed loan, whether by covenant, guarantee, security or otherwise, that is properly described as a term or condition that would be stipulated <u>as between the lender and borrower</u>. Put simply, the lender would be saying to the borrower that it will lend only on the condition that the support in question is provided, and no doubt normally only on the basis that the support remains in place during the period for which the loan is outstanding.

88. It is self-evident in those circumstances that the existence of that support <u>will</u> be a term or condition of the loan as between the lender and borrower. It is nothing to the point that there may also be a (separate) "provision" as between the borrower and the third party that may itself be subject to the transfer pricing rules, such as a fee payable by the borrower for the provision of a guarantee.

89. Of course, this does not mean that any intra-group loan to a thinly capitalised borrower can be treated as being on arm's length terms by hypothesising some form of third party support that does not exist in the actual transaction. As already discussed, the

economically relevant characteristics of the actual and hypothetical transactions, and in particular the risks assumed, must be sufficiently comparable.

*The expert evidence: HMRC's Ground 1*

90. As already explained, HMRC's Ground 1 is that the UT erred in holding that the FTT had been entitled to conclude on the basis of the evidence before it that an independent lender would have entered into the Loans subject to it being able to obtain the necessary covenants, and that the covenants would have been forthcoming.

91. Despite the carefully put submissions of Ms Choudhury for HMRC on this point, I agree with the UT that the FTT was entitled to reach the conclusions that it did on this issue.

92. In summary, Ms Choudhury submitted that the FTT did not address the fact that the experts did not conceive of the covenants in the same terms, and also did not address the point that it became clear during oral evidence that Mr Ashley's conception of the critical covenant in respect of the preference share dividends went no further than the preference share rights, and so could add nothing. In contrast, Mr Gaysford's evidence made it clear that he considered that it would be necessary to go much further.

93. While it would have been clearer if the FTT had explicitly addressed differences between the experts about the content of the covenants and spelt out in more detail in its conclusions exactly what covenants it was referring to, it is clear that it preferred Mr Ashley's evidence to the extent that the experts' views differed. It was entitled to do so. Further, large parts of the experts' evidence was agreed: see above. That included, critically, that an arm's length lender would lend $4 bn to LLC5 subject to suitable covenants, and that those covenants could probably have been put in place. Mr Gaysford's concern about "cost and complexity" was, as he clarified in cross-examination, really a point about there being a better commercial alternative, but as the FTT correctly identified Mr Gaysford was wrongly focusing on the position of the BlackRock group as a whole: see [49] above.

94. Ms Choudhury's submission that the dividend related covenant proposed by Mr Ashley added nothing to the preference share rights ignores an important point, namely that it would provide the lender with direct contractual rights against LLC6 (and/or, potentially, LLC4) that it would do nothing to frustrate the payment of the preference share dividends. From a lender's perspective that is different to the share rights held by LLC5. Further, Mr Ashley evidently understood that LLC6 could not be compelled to pay a dividend (see [46] above) but nonetheless considered that a covenant of that nature would be critical. If Ms Choudhury's submission was right he would be insisting on something that he knew added nothing.

95. Mr Ashley's position on this issue is in fact further, and helpfully, explained in his second witness statement, which the FTT must be taken to have taken into account. That describes three possible versions of what was described in section 14f of the joint statement ([48] above):

> "(1) a covenant for the benefit of the third party investors ensuring that LLC6 will pay the preference share dividends to LLC5 in advance of anything paid to holders of the ordinary shares;

> (2) a covenant in favour of the third party investors to the effect that no other form of cash distribution from LLC6 to holders of the ordinary shares (e.g. loans or loan repayments) was permitted as a means of subverting the preference share dividends; or
>
> (3) a signed consent and acknowledgement or other appropriate undertaking from LLC4 as the holder of the ordinary shares to the effect that nothing was able to interrupt the preference share dividend payments from LLC6 to LLC5 and / or that it would take no steps to subvert payment of the preference share dividends to LLC5."

96. It was therefore clear that the covenants Mr Ashley had in mind were ones that would ensure that the preference share rights were adhered to. That is reflected in section 14f of the joint statement, which as already noted refers to covenants which "ratify" LLC5's position.

### Summary

97. In summary on the Transfer Pricing issue, I would conclude that deductions for interest on the Loans are not restricted under the transfer pricing rules. I would therefore allow LLC5's appeal on Ground 1, set aside the UT Decision on that issue and re-make it by dismissing HMRC's challenge to the conclusion reached by the FTT. Insofar as the conclusion I have reached relies on evidence before the FTT about the risks assumed in the actual transaction that was not reflected in a finding of fact (see [65] and [66] above) I would make additional findings of fact, pursuant to s.14 of the Tribunals, Courts and Enforcement Act 2007, that accept that unchallenged evidence. I would also dismiss HMRC's challenge to the FTT's findings about the expert evidence (HMRC's Ground 1).

## THE UNALLOWABLE PURPOSE ISSUE

### Relevant legislation

98. The unallowable purpose rule in s.441 CTA 2009 forms part of Part 5 of that Act, which contains the provisions governing the treatment of "loan relationships" for corporation tax purposes. The concept of a loan relationship includes any lending transaction, such as the Loans (s.302). In very broad terms, Part 5 provides for credits and debits from loan relationships to be determined in accordance with generally accepted accounting practice. For a non-trader like LLC5, net profits (that is, any excess of credits over debits) are taxed as non-trading profits. A net loss (being an excess of debits over credits) is a "non-trading deficit" (s.301). Among other things, non-trading deficits are available to be surrendered by way of group relief to offset UK profits of other group members.

99. Sections 441 and 442 CTA 2009 relevantly provide:

> "**441 Loan relationships for unallowable purposes**
> (1) This section applies if in any accounting period a loan relationship of a company has an unallowable purpose.
> …

> (3) The company may not bring into account for that period for the purposes of this Part so much of any debit in respect of that relationship as on a just and reasonable apportionment is attributable to the unallowable purpose.
> …
> (6) For the meaning of "has an unallowable purpose" and "the unallowable purpose" in this section, see section 442.
>
> **442 Meaning of 'unallowable purpose'**
> (1) For the purposes of section 441 a loan relationship of a company has an unallowable purpose in an accounting period if, at times during that period, the purposes for which the company—
> (a) is a party to the relationship, or
> (b) …
> include a purpose ("the unallowable purpose") which is not amongst the business or other commercial purposes of the company.
> …
> (3) Subsection (4) applies if a tax avoidance purpose is one of the purposes for which a company —
> (a) is a party to a loan relationship at any time, or
> ...
> (4) For the purposes of subsection (1) the tax avoidance purpose is only regarded as a business or other commercial purpose of the company if it is not—
> (a) the main purpose for which the company is a party to the loan relationship…, or
> (b) one of the main purposes for which it is or does so.
> (5) The references in subsections (3) and (4) to a tax avoidance purpose are references to any purpose which consists of securing a tax advantage for the company or any other person."

100. "Tax advantage" is defined in s.1139 Corporation Tax Act 2010. It is common ground that the deduction of loan relationship debits in respect of interest pursuant to Part 5 CTA 2009 is a tax advantage.

## The issues on this appeal in outline

101. As already indicated, the FTT decided that, although there was an "unallowable purpose" in the form of a main purpose of securing of a tax advantage, there was also a commercial purpose. It further decided that none of the interest deductions should be attributed to the unallowable purpose on a just and reasonable apportionment, with the effect that they were deductible in full.

102. The UT decided that the FTT had erred in applying the reasoning in the well-known case of *Mallalieu v Drummond* [1983] 2 AC 861, 57 TC 330 ("*Mallalieu*") in deciding whether there was an unallowable purpose, but nevertheless concluded that there was no material error in the FTT's conclusion that there was a main purpose of obtaining a tax advantage. However, the UT also decided that the FTT did make a material error in its application of the just and reasonable apportionment test, and determined that all of the debits should be attributed to the tax advantage purpose.

103. BlackRock agree that the FTT erred in applying *Mallalieu* but say, as Ground 2 of their appeal, that the UT should not have substituted its own finding of a tax avoidance purpose in the absence of any finding by the FTT that LLC5 actually did have such a purpose. Ground 3 is that the UT erred on the apportionment issue.

104. In their Respondent's Notice, HMRC say that the UT erred in concluding that the FTT had been entitled to find that one of the main purposes of LLC5 and the Loans was a commercial purpose (HMRC's Ground 2), and that the UT was wrong to decide that the FTT had misapplied the test in *Mallalieu* and subsequent authorities (HMRC's Ground 3).

## Interpretation of s.442: common ground

105. There was a significant element of common ground between the parties in their interpretation of s.442. In particular, both parties accepted that this court should follow a summary by Newey LJ (with whom the other members of the court agreed) in *Travel Document Service v HMRC* [2018] EWCA Civ 549, [2018] STC 723 ("*TDS*") at [41], in relation to the predecessor legislation in para. 13 of Schedule 9 to the Finance Act 1996:

> "i) A company had an "unallowable purpose" if its purposes included one that was "not amongst the business or other commercial purposes of the company" (see paragraph 13(2) of schedule 9 to FA 1996 );
>
> ii) A tax avoidance purpose was not necessarily fatal. It was to be taken to be a "business or other commercial purpose" unless it was "the main purpose, or one of the main purposes, for which the company is a party to the relationship" (see paragraph 13(4));
>
> iii) It was the company's subjective purposes that mattered. Authority for that can be found in the decision of the House of Lords in *Inland Revenue Commissioners v Brebner* [1967] 2 AC 18 , which concerned a comparable issue, viz. whether transactions had as "their main object, or one of their main objects, to enable tax advantages to be obtained". Lord Pearce concluded (at 27) that "[t]he 'object' which has to be considered is a subjective matter of intention", and Lord Upjohn (with whom Lord Reid agreed) said (at 30) that "the question whether one of the main objects is to obtain a tax advantage is subjective, that is, a matter of the intention of the parties"…"

106. It was also not disputed that, in deciding whether a loan relationship has an unallowable purpose, what matters is the company's subjective purpose or purposes in being a party to the loan relationship in question. In this case that means LLC5's purpose or purposes in being a party to the Loans. The focus can also be narrowed further to LLC5's entry into the Loans, because it is common ground that its purposes in being a party to the loan relationship did not change thereafter.

107. The parties were quite right not to dispute the fact that what matters is the company's subjective purpose or purposes in being a party to the loan relationship in question. The purpose or purposes for which a company is a party to a loan relationship may or may not be the same as, for example, the purpose or purposes for which the company exists, or the purpose or purposes of a wider scheme or arrangements of which the loan relationship forms part. Those other purposes may, for example, encompass the purposes

of other actors. There is a contrast here between the unallowable purpose rule and the "targeted anti-avoidance rule" introduced by Finance (No.2) Act 2015 as ss. 455B-455D CTA 2009. That rule requires consideration of the main purpose or purposes of "arrangements".

108. It was also common ground that for a corporate entity such as LLC5, which can only act through human agents, it is necessary to consider the subjective purpose of the relevant decision makers. Unless they have been bypassed or are effectively acting on instruction, that will normally be the board of directors. The same would apply to LLC5, although strictly its board was termed a "Board of Managers", appointed pursuant to the terms of its LLC agreement. There was no suggestion that the board of LLC5 had either been bypassed or were acting on instruction when they agreed to enter into the Loans.

109. In contrast to the UT's conclusion that the FTT should have relied solely on the principles derived from *TDS*, both parties (rightly) accepted that it was appropriate to consider other case law, and in particular *Mallalieu*, *MacKinlay v Arthur Young McClelland Moores & Co* [1990] 2 AC 239, [1989] STC 898 ("*MacKinlay*") and *Vodafone Cellular Ltd v Shaw* [1997] STC 734 ("*Vodafone*"), However, they differed in the application of the principles to be derived from those cases to the facts of this case.

***Mallalieu, MacKinlay and Vodafone***

110. In *Mallalieu*, Baroness Mallalieu (then Miss Mallalieu) sought tax deductions for the cost of replacing and cleaning the (predominantly black) clothing that she wore in and on her way to court and chambers to work as a barrister. That clothing reflected Bar Council requirements about court dress. On her appeal against the Inland Revenue's refusal to allow those amounts as expenses "wholly and exclusively laid out or expended for the purposes of" her profession, the General Commissioners found that she would not have bought the disputed items but for the requirements of her profession, and that considerations of warmth and decency had not crossed her mind when she did. However, and other than in respect of a collar designed to enable bands to be worn, they dismissed the appeal on the basis that she had a dual purpose, in the following terms (recorded in Lord Brightman's speech [1983] 2 AC 861 at p. 872):

> "We consider, in the present case, that when Miss Mallalieu laid out money on clothes for wearing in court her purpose in making that expenditure was to enable her to earn profits in her profession and also to enable her to be properly clothed during the time she was on her way to chambers or to court and while she was thereafter engaged in her professional activity, and in the other circumstances indicated in paragraph 2 we do not consider that the fact that her sole motive in choosing the particular clothes was to satisfy the requirements of her profession or that if she had been free to do so she would have worn clothes of a different style on such occasions altered the purpose of the expenditure which remained the purpose of purchasing clothes that would keep her warm and clad during the part of the day when she was pursuing her career as well as the purpose of helping her to earn profits in that career. We think, therefore, that the expenditure had a dual purpose one professional and one non-professional ..."

111. The full version of the Commissioners' case stated appears in the Tax Cases report (57 TC 330). Apart from the comment – inappropriate at least to 21st century eyes – that

"Miss Mallalieu is an attractive blonde barrister", paragraph 2 (referred to in the quoted passage above) recorded the Commissioners' findings that the clothes in question were not to her taste, that she virtually never wore them except at or travelling to work, and that she wore them in chambers due to her busy court practice and the likelihood of being required to attend court at short notice. It was also the case, however, that the disputed items were of a kind that others might wear by choice.

112. The High Court reversed the Commissioners' decision, holding that the only proper conclusion on the facts was that the sole purpose was to satisfy professional requirements. The Court of Appeal affirmed that conclusion. However, the House of Lords allowed the Inland Revenue's appeal. Lord Brightman gave the leading speech, with which Lords Diplock, Keith and Roskill agreed. Lord Elwyn-Jones gave a short dissenting speech agreeing with the courts below, essentially on the basis that it was not open to the Commissioners to disregard the evidence that they had accepted of Miss Mallalieu's "actual motive and purpose", which was to carry on her profession, other benefits being "purely incidental".

113. Lord Brightman described the "wholly and exclusively" test, then in s.130(a) Income and Corporation Taxes Act 1970 ("ICTA 1970"), in the following terms (at p.870):

> "To ascertain whether the money was expended to serve the purposes of the taxpayer's business it is necessary to discover the taxpayer's "object" in making the expenditure: see *Morgan v Tate & Lyle Ltd*. [1955] AC 21, 37, 47. As the taxpayer's "object" in making the expenditure has to be found, it inevitably follows that (save in obvious cases which speak for themselves) the commissioners need to look into the taxpayer's mind at the moment when the expenditure is made. After events are irrelevant to the application of section 130 except as a reflection of the taxpayer's state of mind at the time of the expenditure.
>
> If it appears that the object of the taxpayer at the time of the expenditure was to serve two purposes, the purposes of his business and other purposes, it is immaterial to the application of section 130 (a) that the business purposes are the predominant purposes intended to be served.
>
> The object of the taxpayer in making the expenditure must be distinguished from the effect of the expenditure. An expenditure may be made exclusively to serve the purposes of the business, but it may have a private advantage. The existence of that private advantage does not necessarily preclude the exclusivity of the business purposes. For example, a medical consultant has a friend in the South of France who is also his patient. He flies to the South of France for a week, staying in the home of his friend and attending professionally upon him. He seeks to recover the cost of his air fare. The question of fact will be whether the journey was undertaken solely to serve the purposes of the medical practice. This will be judged in the light of the taxpayer's object in making the journey. The question will be answered by considering whether the stay in the South of France was a reason, however subordinate, for undertaking the journey, or was not a reason but only the effect. If a week's stay on the Riviera was not an object of the consultant, if the consultant's only object was to attend upon his patient, his stay on the

> Riviera was an unavoidable effect of the expenditure on the journey and the expenditure lies outside the prohibition in section 130."

114. Thus, in all but obvious cases it is necessary to "look into the mind" of a taxpayer, and object must be distinguished from effect. Both of those points apply equally to the unallowable purpose rules.

115. After considering the wider ramifications of a decision in the taxpayer's favour, Lord Brightman went on to reject the lower courts' conclusion that all that mattered was what was in Miss Mallalieu's conscious mind, and that warmth and decency was merely an incidental effect. He said this (at p.875):

> "My Lords, I find myself totally unable to accept this narrow approach. Of course Miss Mallalieu thought only of the requirements of her profession when she first bought (as a capital expense) her wardrobe of subdued clothing and, no doubt, as and when she replaced items or sent them to the launderers or the cleaners she would, if asked, have repeated that she was maintaining her wardrobe because of those requirements. It is the natural way that anyone incurring such expenditure would think and speak. But she needed clothes to travel to work and clothes to wear at work, and I think it is inescapable that one object, though not a conscious motive, was the provision of the clothing that she needed as a human being. I reject the notion that the object of a taxpayer is inevitably limited to the particular conscious motive in mind at the moment of expenditure. Of course the motive of which the taxpayer is conscious is of a vital significance, but it is not inevitably the only object which the commissioners are entitled to find to exist. In my opinion the commissioners were not only entitled to reach the conclusion that the taxpayer's object was both to serve the purposes of her profession and also to serve her personal purposes, but I myself would have found it impossible to reach any other conclusion."

116. So while object and effect are not the same, object is not "inevitably limited" to conscious motives. The reality was that Miss Mallalieu obviously needed clothes for warmth and decency, and no doubt would have had to accept that if she was asked. This could not be described as merely an incidental effect or consequence. Her choice of a particular style and colour, which she would not otherwise wear, did not change that inescapable fact.

117. *MacKinlay* related to a policy of a large accounting firm to reimburse specified domestic removal expenses of partners who were required to move to work in a different office. Moves were made at the request of the executive committee of the partnership, which was also responsible for the policy and its operation. The expenses covered certain costs of the moving process, such as fees of estate agents, plus some additional costs such as relaying carpets and refitting curtains. A deduction was claimed in the partnership tax return for the removal expenses of two such partners but was denied. On appeal, the Commissioners found for the partnership. That decision was reversed by Vinelott J in the High Court. The Court of Appeal allowed the partnership's appeal, but that was overturned in the House of Lords with the result that the deduction was denied.

118. As in *Mallalieu*, the issue was whether the expenditure was wholly and exclusively for the purposes of the business. However, in that case the business was the business of the partnership, considered as if it were a separate entity from the recipient partner (p.250A).

119. Lord Oliver gave the leading speech, with which Lords Bridge, Brandon, Templeman and Goff agreed. Lord Oliver concluded that the Court of Appeal had erred in segregating the purpose of the partnership, considered as if it was a separate legal entity, from the purpose of the individual partners (p.253C). What had to be considered was the purpose of the outlay, and whether it was exclusively for the purposes of the partnership business. That could not simply be answered by considering the motive behind the move. As Lord Oliver explained at p.255:

> "One is, accordingly, brought back, first, last and all the time to the question whether an expenditure upon a partner's removing expenses can be said to be laid out not just partly but exclusively for the purposes of the partnership business. That cannot, in my judgment, be answered simply by ascertaining what was the motive with which the move was undertaken. It is inescapable as it seems to me, that the expenditure, motivated no doubt by the fact of moving house, which in turn was motivated by the desire to put the partner concerned in a better position to further the interests of the firm, was an expenditure serving and necessarily and inherently intended to serve the personal interests of the partner in establishing his private residence for himself and his family and it cannot be said to be exclusively for the purposes of the partnership practice.
>
> Your Lordships have been referred to what may be regarded as a seminal decision of this House in *Mallalieu v Drummond* [1983] 2 AC 861 and much argument has been addressed to the question whether the purpose of the particular payment falls to be ascertained objectively or by reference only to the subjective intention of the payer. For my part, I think that the difficulties suggested here are more illusory than real. The question in each case is what was the object to be served by the disbursement or expense? As was pointed out by Lord Brightman in *Mallalieu's* case, this cannot be answered simply by evidence of what the payer says that he intended to achieve. Some results are so inevitably and inextricably involved in particular activities that they cannot but be said to be a purpose of the activity. Miss Mallalieu's restrained and sober garb inevitably served and cannot but have been intended to serve the purpose of preserving warmth and decency and her purpose in buying cannot but have been, in part at least, to serve that purpose whether she consciously thought about it or not. So here the payment of estate agents' fees, conveyancing costs and so on, and the provision of carpets and curtains cannot but have been intended to serve the purpose of establishing a comfortable private home for the partner concerned even though his motive in establishing a home in that particular place was to assist him in furthering the partnership interests. Nobody could say with any colour of conviction that in purchasing new curtains he or his wife was acting upon partnership business. In my judgment once one escapes from what I regard as the fallacy of confusing the purpose of the expenditure with the motives of the members of the executive committee (and, inferentially, of the other partners) in resolving to reimburse the expenditure, the case presents very little difficulty and is, indeed, a much clearer and easier case than *Mallalieu v Drummond*. For my part, I entertain no doubt that the decision of Vinelott J was correct and I would allow this appeal."

120. Therefore, motive is not necessarily the same as object or purpose. Further, "some" results are "so inevitably and inextricably involved" in an activity that they must be a purpose for it. An example of that was Miss Mallalieu's sober garb. Another was the facts of the instant case, where the costs "cannot but have been intended to serve the purpose of establishing a comfortable private home for the partner concerned".

121. *Vodafone* also concerned a claim to deduct under s.130(a) ICTA 1970, but in that case in a corporate context. It concerned an amount paid by the taxpayer to bring to an end a fee agreement related to the acquisition of know-how which it turned out was not required. The Special Commissioners accepted that the payment was of a revenue nature but dismissed the taxpayer's appeal on the basis that the payment was made to benefit the trading position of the whole group, and not solely for the purposes of its own trade. Their decision was upheld in the High Court but the taxpayer successfully appealed to the Court of Appeal.

122. Millett LJ, with whom Sir John Balcombe and Hirst LJ agreed, pointed out that the question of whether a payment is made exclusively for the purpose of the taxpayer company's trade or partly for that purpose and partly for another is a question of fact. He went on to say (at p.742):

> "In the case of an individual taxpayer, the other purpose is usually a private purpose of his own. In a case like the present, where the taxpayer company is a company forming part of a group, the other purpose is likely to be the purpose of the trade of one or more of the other companies in the group. But the same principles apply. The trade of a parent company is for tax purposes distinct from the trade of its subsidiary. The two companies are separate taxable persons, and the trade or business of one is not the same as the trade or business of the other, however closely it may affect it (see *Odhams Press Ltd v Cook (Inspector of Taxes)* (1938) 23 TC 233 at 254, 257).
>
> The leading modern cases on the application of the exclusively test are *Mallalieu v Drummond (Inspector of Taxes)* [1983] STC 665, [1983] 2 AC 861and *MacKinlay (Inspector of Taxes) v Arthur Young McClelland Moores & Co* [1989] STC 898, [1990] 2 AC 239. From these cases the following propositions may be derived. (1) The words for the purposes of the trade mean to serve the purposes of the trade. They do not mean for the purposes of the taxpayer but for the purposes of the trade, which is a different concept. A fortiori they do not mean for the benefit of the taxpayer. (2) To ascertain whether the payment was made for the purposes of the taxpayer's trade it is necessary to discover his object in making the payment. Save in obvious cases which speak for themselves, this involves an inquiry into the taxpayer's subjective intentions at the time of the payment. (3) The object of the taxpayer in making the payment must be distinguished from the effect of the payment. A payment may be made exclusively for the purposes of the trade even though it also secures a private benefit. This will be the case if the securing of the private benefit was not the object of the payment but merely a consequential and incidental effect of the payment. (4) Although the taxpayer's subjective intentions are determinative, these are not limited to the conscious motives which were in his mind at the time of the payment. Some consequences are so inevitably and inextricably involved in the payment that

> unless merely incidental they must be taken to be a purpose for which the payment was made.
>
> To these propositions I would add one more. The question does not involve an inquiry of the taxpayer whether he consciously intended to obtain a trade or personal advantage by the payment. The primary inquiry is to ascertain what was the particular object of the taxpayer in making the payment. Once that is ascertained, its characterisation as a trade or private purpose is in my opinion a matter for the commissioners, not for the taxpayer. Thus in *Mallalieu v Drummond (Inspector of Taxes)* the primary question was not whether Miss Mallalieu intended her expenditure on clothes to serve exclusively a professional purpose or partly a professional and partly a private purpose, but whether it was intended not only to enable her to comply with the requirements of the Bar Council when appearing as a barrister in court but also to preserve warmth and decency.
>
> Similarly, in my opinion, the present case does not involve an inquiry whether the directors who resolved to enter into the fee cancellation agreement consciously intended to obtain a benefit thereby for one company rather than another. The primary inquiry is to ascertain the particular object which the directors sought to achieve by it. Once that is ascertained the characterisation of that object as serving the purposes of the trade of one particular company or another is not a finding of primary fact, but a conclusion based upon the primary facts."

123. In *Vodafone*, the Commissioners had found that the directors of the taxpayer had in mind its legal obligations under the fee agreement, rather than the position of its subsidiaries which had no such obligation but which it had been contemplated would reimburse the taxpayer for ongoing fees. The Commissioners had nonetheless inferred that the directors "must have had in mind" that the cancellation of the agreement would be of greater benefit to the subsidiaries because of the reimbursement arrangements. Millett LJ observed that this finding could not be supported, because it was based on a misunderstanding of their earlier findings that there was no agreement or formal arrangement in place, and in its absence the taxpayer would not have been properly able to seek reimbursement for the provision of know-how that was not required. However, he concluded that the appeal should be allowed on the simpler basis, by focusing on "what was the particular object which the directors were seeking to achieve?" (p.744h). Although it was self-evident that the directors' purpose was to rid the group of a trading liability owed to a third party, the liability was that of the taxpayer alone, "ergo the directors' intention, whether articulated or not, was exclusively to serve the purposes of the taxpayer company's trade". The impact on the wider group was a consequential or incidental effect (p.745).

124. Millett LJ's useful summary brings out the points already referred to derived from *Mallalieu* and *MacKinlay*. For present purposes "object" can also be regarded as synonymous with purpose. So far as relevant to this case, and gathering the points together, I would summarise the key points as follows:

    a) Save in "obvious" cases, ascertaining the object or purpose of something involves an inquiry into the subjective intentions of the relevant actor.

b) Object or purpose must be distinguished from effect. Effects or consequences, even if inevitable, are not necessarily the same as objects or purposes.

c) Subjective intentions are not limited to conscious motives.

d) Further, motives are not necessarily the same as objects or purposes.

e) "Some" results or consequences are "so inevitably and inextricably involved" in an activity that, unless they are merely incidental, they must be a purpose for it.

f) It is for the fact finding tribunal to determine the object or purpose sought to be achieved, and that question is not answered simply by asking the decision maker.

**Relevant findings of fact and evidence**

125. For reasons which will become apparent I will deal in some detail with the facts found by the FTT, elaborated to some extent by reference to the documentary evidence before it and also by reference to some oral evidence referred to by the UT. Cross-references are to paragraphs of the FTT Decision unless otherwise indicated.

126. BRI announced the proposed acquisition of BGI on 11 June 2009. The acquisition of BGI US completed on 1 December 2009. Between those dates a lot of work was done on structuring the acquisition, led (as such work usually was) by BlackRock's corporate tax group. In particular, Ernst and Young ("EY") were asked to consider where "debt push downs" should be done (in this context meaning "pushing" debt incurred to fund the acquisition down to other entities in the group through intra-group loans). EY, who had a "very broad remit", suggested the use of a UK entity to acquire BGI US to take advantage of the "generous tax regime for interest deductions". This fairly quickly developed into using an LLC, and by late July 2009 to a structure involving two LLCs, one of which was UK tax resident, with the UK resident LLC acquiring BGI US. (See paras. 9, 13-15 and 21-22.)

127. By mid-August the proposed structure changed to include a third LLC, for the reasons mentioned at [16] above.

128. Four UK-based BlackRock executives were identified as potential members of LLC5's board. They comprised Mr Kushel, who at the time was Chairman of the BlackRock group's international business, Colin Thomson (Head of BlackRock's Financial Reporting Group for the international business), Roger Tooze (Head of BlackRock's Business Finance) and James DesMarais (General Counsel for BlackRock's international business). Mr Fleming, who was BlackRock's head of tax for EMEA (Europe, Middle East and Africa) prepared a briefing note to be shared with Mr Thomson, Mr Tooze and Mr DesMarais (Mr Kushel's senior leadership role meant that he was already involved in work on the acquisition). The note, dated 26 October 2009, explained among other things that "the purpose of [LLC5] is to effect the acquisition of the BGI US business from Barclays", that its central management and control needed to be in the UK, and that:

> "The business of LLC5 will be relatively simple. It will hold preference shares in LLC6 which will only provide for 10% voting control. Accordingly, it will not be in a position to manage any of the underlying US business activities, nor will it be called upon to do so. Rather, it will be required to

> consider its own business of making and managing passive investments and managing its commitments in terms of issuing a Eurobond (that will be listed on the Cayman Exchange) in order to finance the acquisition. Thus, it will consider the likelihood that the business conditions pertaining in the US subsidiaries will enable the preference share dividends to be met, in order to meet its own financing costs."
> (Para. 34)

129. Mr Fleming met with Mr Thomson, Mr Tooze and Mr DesMarais on 10 November 2009. The "main focus" of the discussions was to explain the UK tax rules regarding deductions for interest (paras. 36 and 38). By that stage the transaction had received regulator and internal stakeholder approval and was "largely final" and subject to revision only in "limited circumstances" (para. 37).

130. The board meeting was originally arranged for 27 November but was re-arranged to 30 November following a discussion with Mr Kushel. This was due to a clash with Thanksgiving which initially led to him intending to attend by telephone, before being told that the meeting was "important for UK tax purposes" (paras. 40-41).

131. The FTT deals with the 30 November board meeting at paras. 42 to 53. The meeting took place in London, with all four board members present and Mr Kushel acting as chairman. Those attending were not doing so "in a vacuum", given the prior discussions. The meeting lasted around 45 minutes. Mr Fleming was present to explain LLC5's role. Mr Kushel's evidence, which was accepted (see [14] above), indicated that he clearly understood his fiduciary duty to act in the best interests of LLC5. However, provided that it was in the company's best interests to enter into a transaction he did not consider it part of his remit to question or suggest changes to the "underlying capital structure" of a proposed transaction. The UT Decision notes at para. 172 that Mr Kushel's oral evidence was that the board "were not considering whether or not it was the right business of LLC5 to invest in the LLC6 Preference Shares", and at para. 176 that he "confirmed that there was no reasonable possibility that LLC5 would not enter into the transaction" and that Mr Fleming also accepted that the board was presented with a "fait accompli".

132. Further, the meeting was very shortly before the completion of a complex transaction for which a detailed "step plan" had been prepared. Provided the board concluded that the transaction was commercially advantageous for the company it "would not have been sensible or open to the directors to consider an alternative transaction" (para. 52 of the FTT Decision). Rather, Mr Kushel saw it as his responsibility to satisfy himself that a proposed transaction had been:

> "… properly advised on and poses no risk of reputational damage or other harm to either the entity or myself and my fellow board members. As a board member I may test a question or a proposal in terms of its anticipated financial outcomes or to ensure that all relevant regulatory considerations have been taken into account, but typically I will be able to take comfort that these matters have been considered fully by those responsible for framing and approving the transaction before it is presented to me in my capacity as a board member." (Para. 48.)

133. The FTT also records that Mr Kushel regarded the other board members as "diligent and thoughtful" people who would not simply "rubber stamp" a transaction (para. 45).

134. Following initial references to the acquisition of BGI and to the step plan (prepared by EY), the most material section of the board minutes, which was accepted to be an accurate record, reads as follows:

> "3. REVIEW OF STEP PLAN AND COMPANY'S ROLE
> The Chairman invited Mr Fleming to present an overview of the Step Plan and an outline [of] the Company's role.
>
> Mr Fleming advised that although the incorporation of the Company and the proposed transactions formed part of wider arrangements to effect the Acquisition in a tax-efficient manner they were, nevertheless, a commercially valid transaction for the Company on a stand alone basis. The Company formed part of the structure that was to acquire Barclays Global Investors, National Association.
>
> It was noted that a tax opinion had been provided by Ernst & Young LLC (E&Y) supported by consultations with Kevin Prosser QC (senior tax counsel) and that Duff & Phelps had produced a fair purchase price allocation (included in the Board Materials) which had been agreed with Barclays PLC.
>
> Mr Fleming updated the board on the UK debt cap rules which were being introduced for accounting periods beginning on or after 1 January 2010 and which potentially restricted the UK tax deduction for interest costs of UK companies which formed part of a large group. The rules would mean that aggregate UK corporation tax deductions for financing costs could not exceed the group's external financing costs on a worldwide basis.
>
> The group had USD6bn of debt before the cap applied which comprised USD4.5bn in BlackRock Finco UK ltd and USD1.5bn in the Company. E&Y had determined a supportable level of debt and interest rate from a UK tax perspective by comparing key financial ratios (debt to equity, debt to earnings before interest, taxes, depreciation, and amortization ("EBITDA") and interest cover) with other similar companies. These were reviewed extensively by the board to ensure that, at the level of debt to be incurred, the transaction was appropriate and commercial for the Company. It was noted that the Company itself would gain no benefit from a UK tax deduction for the interest, since it was group policy for such interest to be surrendered between group affiliates for no payment – it was necessary for the transaction to be considered by the board as viable for the Company without taking any UK tax advantage into account.
>
> E&Y had concluded that, after the Acquisition, BlackRock's pre-eminence within the asset management industry would enable it to obtain financing on the most favourable terms and at the top of the range in respect to its peer group. Mr Fleming did not consider the Company's debt amounts, which had been put to HM Revenue and Customs ("HMRC") unreasonable. The structure would give rise to interest deductions between USD50 and USD70m per annum, with a larger interest deduction of USD29m in December 2009 since the debt cap rules were not in effect during that month.

> Mr Fleming stated that HMRC currently considered BlackRock to be low risk, and that he did not feel that structuring the Acquisition in a tax-efficient manner was inconsistent with HMRC's position. Although the proposals were complex, the main purpose was to complete a third party transaction and there was no element of tax avoidance. If the Acquisition resulted in the group being viewed as medium or high risk there would be increased scrutiny of other issues such as transfer pricing. It was noted that there were no UK regulatory implications…."

135. The minutes record that the board went on to consider the terms of the first loan note and how it would be repaid, the relative values of the common and preference shares and unwind provisions (should they be required). The final comment before the formal resolutions reads:

> "Mr Fleming emphasized that, although the Company was incorporated in the state of Delaware in the United States, management and control would be exercised from London, where the Company's books and records would also be kept. It was anticipated that the Management Board would meet two to three times each year or more frequently when required by the Company's affairs."

136. As can be seen from the minutes, the board understood that LLC5 would obtain no benefit from the interest deductions. This was because – as well as LLC5 having no taxable income itself against which the expense could be offset – the group practice was to make group relief surrenders for no payment. Given that LLC5's assets reflected an interest only in the US operations of BGI, it would also have been apparent to board members that no indirect benefit could be derived through its preference share investment.

137. Mr Kushel's explanation that Mr Fleming's advice to leave any UK tax advantage out of account would have been followed was evidently accepted by the FTT. Similarly, the FTT accepted Mr Kushel's evidence that if the tax benefits had fallen away it would have been too late to alter the structure.

138. These points are also reflected in the following passages of Mr Kushel's witness statement:

> "40. The 'purpose' of LLC5, and therefore its corporate mission or aim, was to facilitate the acquisition of BGINA in a manner that was efficient from all perspectives including tax, as recorded in the minutes of the 30 November 2009 Board meeting. However, to me the key aspect of this was the acquisition of BGINA, with the potential for efficiencies being very much a secondary consideration. Certainly by the time the LLC5 Board meeting took place on 30 November 2009, any tax considerations had been eclipsed by the desire to complete the Acquisition. The ultimate goal from the perspective of the BlackRock Group was to acquire BGINA and that aim was unaffected by any tax efficiencies that might follow from structuring the acquisition in a particular manner. Capital transactions as significant as the BGI Acquisition require considerable time and resources to plan and cannot be revised at late stages if it transpires that certain anticipated tax or other consequences may not materialise. If by November 2009 Corporate Tax Group had formed the view that there were no efficiencies to be made by acquiring BGINA through

> LLC5, LLC5's place and purpose in the acquisition structure would have been unchanged. If by this late stage the anticipated tax benefits of structuring the acquisition in a particular manner had for any reason fallen away, it would have been too late to revise the structure and the acquisition would have gone ahead as planned, subject to the considerations I have highlighted in this statement about the need for the LLC5 Board to have been satisfied that the proposed transactions represented a commercially sound and appropriate investment for LLC5 to make. By November 2009, LLC5's purpose in the Acquisition structure was not dependent on any tax efficiencies that might result from acquiring BGINA through LLC5. Its purpose by that stage was to raise capital which it could invest in LLC6 in order to finance the acquisition.
>
> 41. When resolving to enter into the transactions that were proposed at the meeting on 30 November 2009 as a member of the LLC5 Board, I was looking to complete the proposed investment in BGINA via LLC6. It was necessary for the LLC5 Board to satisfy itself that both the proposed investment (i.e. the investment in LLC6) and the proposed means of financing that investment (i.e. the Loan Notes) represented a good deal for LLC5 as an individual entity and I explain above the basis on which that conclusion was reached and the considerations that had to be taken into account. Having satisfied myself that the proposed investment in BGINA via LLC6 was in the commercial interest of LLC5, my purpose in resolving that LLC5 should proceed with issuing the Loan Notes to LLC4 was to raise capital to finance the onward investment in LLC6 and BGINA in a manner that I considered was also in the best interests of LLC5 as an individual entity.
>
> 42. The minutes of the LLC5 Board meeting on 30 November 2009 (JRK1/12 to 25) record Mr Fleming advising the Board members that 'it was necessary for the transaction to be considered by the board as viable for the Company without taking any UK tax advantage into account.' I cannot now recall the details of the board meeting but I have no reason to think that I would not have acted in accordance with Mr Fleming's advice. Moreover, for the reasons that I have explained above, if a transaction had not been viable for LLC5 in commercial, financial and governance terms, the LLC5 Board members would not and could not have resolved to enter into it."

## The FTT's reasoning

139. After referring to the need to ascertain the subjective intentions and purposes of LLC5's directors, the FTT's analysis is set out in the following three paragraphs:

> "119. Although, and perhaps not surprisingly as it was some ten years before the hearing, Mr Kushel could not recall the details of the board meeting held on 30 November 2009 but said that he had not taken account of any UK tax advantage into account in making the decision to proceed with the transaction. Minutes of the meeting confirm that Mr Fleming advised that such an approach should be taken and Mr Kushel believed he had followed this advice and the minutes do not record that any of the other Board members had not done so. Also, Mr Kushel said that as he was comfortable with it and

> had [no] concerns over its commercial viability the transaction would have proceeded even if, at the last minute, the tax advantage had ceased to exist. Additionally, he confirmed that, in making the decision to approve LLC5 entering into the Loans, he considered his fiduciary duty was satisfied.
>
> 120. Mr Kushel did not go so far as Ms Mallalieu, who "had no thought of warmth and decency" when she bought her "working clothes", and say that a tax advantage was not an object or purpose of LLC5. However, adopting the reasoning of the House of Lords in *Mallalieu v Drummond* as further explained in *Vodafone* to the present case it is necessary to look beyond the conscious motives of LLC5 and take account of the inevitable and inextricable consequences of it entering the loan relationship with LLC4. Having regard to all the circumstances of the case it is, in my judgment, clear that the securing of a tax advantage is an inevitable and inextricable consequence of the Loan between LLC4 and LLC5.
>
> 121. This cannot be described as merely incidental and, as such, is clearly an important purpose, so much so that I consider it to be a main purpose of LLC5 in entering into the Loans. However, the evidence is that LLC5 entered into the Loans in the furtherance of the commercial purpose of its business of making and managing passive investments. This too is clearly an important purpose and, as such, is to be regarded as a main purpose also."

**The UT Decision**

140. The UT considered and rejected HMRC's challenge to the FTT's finding at para. 121 that there was a commercial purpose, on the basis that it did not meet the high threshold required under *Edwards v Bairstow* principles ([1956] AC 14). There was evidential support for the factual conclusion reached (paras. 150 -152 of the UT Decision).

141. The UT then considered Mr Prosser's arguments that the FTT erred in relation to *Mallalieu*, saying at para. 161:

> "… it should have relied on the principles derived from *TDS*, the only authority on this legislative wording. The FTT should have considered LLC5's main purposes in relation to the Loans from all the evidence before it rather than apparently focusing solely on the "*inevitable and inextricable consequences*" of entering into the Loans."

142. However, it then went on:

> "162. Nevertheless, we are not satisfied that there was any material error in the FTT's finding that LLC5 also held a tax advantage main purpose in relation to the Loans. The FTT was entitled to look beyond the stated motives of LLC5's board members when determining the purposes of LLC5 in entering into the Loans.
>
> 163. There are two important matters to bear in mind. First, Mr Kushel accepted in his witness statement at [40] that tax efficiencies were part of the purpose for the inclusion of LLC5 in the transaction, albeit he said that it was the secondary purpose and not the key purpose. The FTT made a similar

finding at [120] that '*Mr Kushel did not go so far as Ms Mallalieu, … and say that a tax advantage was not an object or purpose of LLC5*.'

164. Second, it is undisputed, as evidenced in the minutes of the board meeting of 30 November 2009 and in Mr Kushel's statement, that the board members of LLC5 were specifically advised to put any tax advantage out of their minds when considering the viability and hence whether to approve the Loans. As a result of this advice, the stated subjective intentions of the only director to give evidence were circumscribed and cannot represent the nature of the directors' intentions had they been left freely and willingly to decide the main purposes of the transaction.

165. Therefore, it is necessary to look beyond the directors' stated intentions. The effectiveness of anti-avoidance legislation cannot be undermined by tax advisers telling parties to ignore the tax advantage purposes of a transaction which has been planned by them or others for precisely that purpose. To hold otherwise would provide an easy way round the legislation.

166. We therefore conclude that the FTT was entitled to look beyond the stated motives or intentions of the board members to determine LLC5's actual subjective purpose. This is supported by the approach in *TDS* where it is apparent that Newey LJ was prepared to infer a different purpose for Mr Turner using the shares in the swap (namely a tax advantage) than he stated in his evidence to be his subjective intention for continuing to hold the shares (which was an exclusively commercial purpose).

167. In our view there was ample evidence, as explained below, to support the finding that securing a tax advantage for the Group (which is a tax advantage to LLC5) was a main purpose of the creation of LLC5 and thereafter, its intention and purpose in entering into the Loans. These purposes were subjectively held by LLC5, even if the directors were told to disregard them in considering their approval to entering into the Loans."

143. The UT went on to consider the evidence in more detail, at paras. 168-179, under a sub-heading "FTT's findings and evidence in support of tax advantage main purpose". It concluded as follows:

"180. The evidence is that the BlackRock Group would not have used an acquisition structure with a UK resident LLC in the absence of the UK tax benefits of doing so. Absent those tax benefits, LLC5 would not have existed and so obviously would not have entered into the Loans to acquire the Preference Shares. LLC5 was aware of this when it approved the Loans.

181. The FTT's findings therefore demonstrate that LLC5 was only included in the structure and thereby entered into the Loans so as to take the tax benefits for the Group. LLC5 contended that it merely being engaged in tax planning does not mean that it had a tax avoidance main purpose. It argued that in any case involving a substantial borrowing for commercial purposes, the borrower will take tax advice and will be told that the interest is deductible; this cannot mean that there is a tax main purpose. That might be

> true where the borrowing is needed for and driven by the commercial purposes. In this case, however, the borrowing by LLC5 specifically in the structure for that purpose was primarily motivated by securing a tax advantage.
>
> 182. The FTT was therefore entitled to find that LLC5 had a tax advantage purpose as one of its main purposes and as a main purpose of the Loans. The FTT did not make a material error of law in finding that LLC5 had an unallowable tax advantage purpose as a main purpose of the Loans it entered into."

**Errors in approach: inevitable consequences**

144. In my view there were errors in the approach of both the FTT and UT.

145. I disagree with Mr Ewart's submission that the tax advantage was the sort of "inevitable and inextricable consequence" referred to in *MacKinlay* in discussing *Mallalieu*, and in *Vodafone* in discussing both of those cases. Rather, what can be drawn from those authorities are the points summarised at [124] above.

146. Purpose must be distinguished from effect. Even unavoidable effects are not necessarily the same as purposes. This is particularly clear from Lord Brightman's example in *Mallalieu* of a medical consultant's trip to the South of France (see [113] above). It cannot therefore be the case that <u>any</u> inevitable consequence can be a purpose. Indeed, the authorities spell that out: both Lord Oliver in *MacKinlay* and Millett LJ in *Vodafone* refer to "some" consequences or results being inevitably and inextricably involved in particular activities ([119] and [122] above).

147. As to what kinds of consequences fall into that category, the facts of *Mallalieu* and *MacKinlay* provide good examples of what Lord Oliver and Millett LJ would have had in mind. Miss Mallalieu obviously needed clothes for warmth and decency, and the clothes in question were ones that others could wear by choice. Miss Mallalieu would just not have chosen that particular colour or style. But, once acquired and worn, her black clothes performed the necessary functions of keeping her warm and decent. She would obviously have had to accept, if asked, that the items she was replacing or taking to the cleaners would not only fulfil those functions, but that she intended that they would do so. That was very far from the consultant in Lord Brightman's example who benefits from incidental enjoyment during a work trip.

148. Similarly in *MacKinlay*, Lord Oliver explained that the expenditure "cannot but have been intended to serve the purpose of establishing a comfortable private home for the partner concerned", and that the partner and his wife could not be said to have been acting on partnership business when they bought new curtains. That too is a clear example. In both cases the conscious business purpose necessarily encompasses another, non-business, purpose.

149. In contrast, in *Vodafone* any benefit to the wider group was merely consequential: see [123] above.

150. How then should this point be addressed in the context of s.442? The unallowable purpose rule forms part of a code, contained in Part 5 of CTA 2009, which governs the

treatment of loan relationships for corporation tax purposes, and which among other things specifically contemplates tax relief for interest and other expenses of raising debt. The corporation tax relief available is obviously a valuable relief. It is unrealistic to suppose that it will not form part of ordinary decision-making processes about methods of funding a company. Indeed, it might well be wrong for directors to ignore that consideration in deciding what is in the best interests of the company concerned. I agree with Mr Prosser's submission that it cannot have been Parliament's intention that the inevitable consequence of taking out a loan should engage the unallowable purpose rules, subject only to consideration of whether the value of the tax relief is sufficient to make it a "main" purpose. Something more is needed.

151. I therefore agree with BlackRock that the FTT should not have applied the test in *Mallalieu* as it did. This is not for the reason given by the UT (to the effect that it should simply have applied *TDS*) because it is not the case that *Mallalieu* and the later cases that discuss it are irrelevant. Rather, the FTT made an error of law in proceeding on the basis that the "inevitable" consequence of tax relief was, without more, a main purpose.

**Errors in approach: UT**

152. I also consider that the approach that the UT then adopted contained both substantive and procedural errors.

153. First, the UT made references to the purpose of LLC5's existence and inclusion in the transaction (see in particular at para. 163) without making it clear that the statutory test requires a focus on LLC5's purpose or purposes for being a party to the Loans. While one may of course impact on the other, it is important to recognise that the purposes for which an entity exists and its purposes in entering into a transaction may be different.

154. Secondly, the UT were in my view not entitled to take the approach adopted at para. 164, in which subjective intentions were described as "circumscribed" and not what they would have been "had [board members] been left freely and willingly to decide the main purposes of the transaction". Apart from the test of purpose not being answered simply by asking the decision maker (see [124] above), there was no evidence, let alone a finding, that the board was not free to consider the transaction properly. There is no suggestion that board members were acting on instruction. It is right that they were advised to leave any UK tax advantage out of account in assessing the viability of the transaction for LLC5, but that was for the entirely proper reason that the company would itself obtain no benefit from it. Given that last point, it was also inappropriate for the UT to make the unqualified comment that it did in para. 165 about there being an easy way round the legislation if tax advisers could tell parties to ignore tax advantages. In this case there was a sound reason for the board to leave tax out of account in assessing whether the transaction was in the best interests of LLC5.

155. Thirdly, the conclusion in paras. 165 and 166 that "it is necessary to look beyond the directors' stated intentions" gives at least the appearance of concluding that the evidence of BlackRock's witnesses should not have been accepted at face value. Instead, the UT needed squarely to address the point that the FTT did accept their evidence and that the only reason it gave for going beyond it to find that there was a tax avoidance purpose was *Mallalieu*. There is no factual conclusion beyond that to the effect that LLC5 had such a purpose in entering into the Loans.

156. This last point leads into the procedural error. Where the UT determines that the FTT has made an error of law, it may (but need not) set that decision aside: s.12(2)(a) Tribunals, Courts and Enforcement Act 2007 ("TCEA"). If, but only if, it does so then it must decide whether to remit the case or re-make the decision (s.12(2)(b)). It is only if it chooses to re-make the decision that it has power to make findings of fact: s.12(4).

157. In this case, it is apparent from para. 162 of its decision that the UT chose not to set the FTT Decision aside because it considered that there was no material error of law. In those circumstances it was not entitled to go on to make further findings of fact. However, I consider that that is what it then purported to do, both in the paragraphs just referred to and in the analysis in para. 168 onwards which considered not only the FTT's findings of fact but further evidence.

158. In my view the only proper approach was to determine that, due to the FTT's error, its conclusion that LLC5 had a tax advantage main purpose could not stand. There was not only a material error of law but the FTT Decision lacks the necessary factual findings to support the decision on a different basis.

**Consequences of the UT's errors**

159. It is then necessary to determine what the consequences of this should be. The thrust of Mr Prosser's submissions was that HMRC have lost the chance to put their case in a different way. HMRC have consistently relied on the concept of consequences that are "inevitably and inextricably involved" and have defended the FTT Decision on that basis. More significantly, Mr Kushel's evidence on the critical issue was never properly challenged. It was not put to him that, despite maintaining that the board members followed the advice that tax needed to be left out of account, they must have been thinking about tax, or that they intended or desired to achieve a tax advantage. Instead, the FTT accepted Mr Kushel's evidence. That would have included what he said about purpose in his witness statement (see [138] above).

160. It would clearly be unfair to give HMRC another bite of the cherry by remitting the case in a way that would allow the evidence to be revisited and enlarged upon. An alternative would be to remit it on a basis that did not permit that, but inviting the FTT to make additional findings based on the existing evidence and findings of fact. However, I have come to the conclusion that remittal is not necessary. Rather, the appropriate course is for this court to re-make the decisions of both tribunals and, in doing so, to exercise this court's own power (pursuant to s.14 TCEA) to make findings of fact to the extent required, based on the evidence before the FTT.

**Whether there was a tax main purpose**

161. The FTT found that Mr Fleming's advice to leave any UK tax advantage out of account was followed. It also found that the Loans would still have been entered into if the tax benefits had fallen away at the last minute. However, I agree with Mr Ewart's submission that the factual enquiry is not limited to the factors that the board took into account in deciding that the transaction was in the best interests of LLC5, and that it is also not sufficient that the transaction would have proceeded without the tax benefits because it was too late to make changes.

162. As Nugee LJ suggested in argument, a simple starting point in ascertaining a person's purpose for doing something is to consider "why" they did it. While this will not cover all the nuances – and in particular the potential distinction between purpose and motives discussed in *MacKinlay* – it is a sensible starting point.

163. There is an obvious answer to that question on the facts of this case. However it might be dressed up, LLC5 became a party to the Loans to obtain a tax advantage.

164. As has already been said, the board members of LLC5 were not operating in a vacuum. Mr Kushel was involved in the transaction in any event and the others had been briefed at an earlier stage. Much of the substantive discussion at the board meeting was about tax. The board obviously understood what the Loans were designed to achieve. Although, as already discussed, the purpose or purposes of being a party to a loan relationship cannot simply be elided with the purpose for which the relevant entity exists, in this case LLC5 had no other function. Its sole raison d'être was to enter into the Loans to obtain tax advantages for the BlackRock group.

165. That is obvious from the diagrammatic representation of the structure appended to this decision. Passing funds to LLC6 via a (UK tax resident) LLC5, rather than direct from LLC4, and doing so in part by means of loans rather than the pure equity contributions made at each other level in the structure, sought to achieve the objective of reducing the group's UK tax bill. LLC5 gained no control over the BGI US group and therefore had no meaningful function in that respect. It was, and was structured to be, a mere passive recipient of preference share dividends without control or indeed any real influence. Its (UK based) directors would in any event have been unlikely to have any meaningful involvement with an entirely US based sub-group. (Mr Kushel was a senior executive, but Mr Fleming's witness statement records that the intention was for him to "come off the board after closing".)

166. It would be artificial to seek to divorce what occurred at the board meeting from its context. That context included:

 a) EY's proposal to use a UK entity to take advantage of the "generous tax regime for interest deductions" ([126] above) in circumstances where a UK entity would clearly not otherwise have been appropriate;

 b) the subsequent variation to the structure to overcome the problems that having a UK-based entity in the ownership chain of an entirely US-based business by a US group would actually cause; and

 c) the fact that the briefing of the board members in advance of the board meeting, as well as the discussion at it, largely focused on tax.

167. I do not overlook that the board concluded that the transaction was commercially advantageous for LLC5. It is obvious that it was. The anticipated dividend flow on the preference shares was such that it would very comfortably exceed the cost of servicing the Loans. On that basis I have no difficulty with the FTT's conclusion that LLC5 had a commercial purpose in entering into the Loans: it was set to make very significant profits from its investment. However, the fact that it would be able to make such profits was a consequence of the need to ensure that the transfer pricing analysis was robust, so that interest costs could not be denied on the basis that LLC5 was thinly capitalised. From the

group's perspective the commercial impact for LLC5 was in truth a by-product of the tax planning. Nevertheless, as far as LLC5 was concerned it was more than a (very welcome) consequence or effect, because it meant that the transaction made commercial sense from its perspective. As a result the board was able to conclude that it was in LLC5's best interests to enter into the proposed transactions, including the Loans.

168. It makes no difference to the analysis that, by the time it got to the date of the board meeting, it would have been too late to change the structure if the hoped-for tax advantage had been no longer available. Quite apart from the fact that the board was presented with a fait accompli (see [131] and [132] above), the point was an entirely hypothetical one. In reality, it continued to be thought that a tax advantage would be available.

169. I do not consider that these conclusions involve an inappropriate attack on the unchallenged evidence of Mr Kushel or Mr Fleming, or on the FTT's findings of fact. I agree with the UT that there is an analogy with *TDS*. In that case a conclusion that the company had a tax main purpose in using the relevant shares as it did was found not to be inconsistent with the honestly held view of the relevant director, a Mr Turner, that the shares continued to be held exclusively for the commercial purpose for which they were originally acquired. Similarly, in this case the fact that LLC5 had a tax avoidance main purpose is not inconsistent with board members properly putting the tax benefits out of their minds when deciding whether the transaction was in LLC5's best interests on a standalone basis. The two questions are different.

170. Accordingly, I would conclude that LLC5 entered into the Loans with a main purpose of securing a tax advantage. In other words, I agree with the FTT and UT in the result.

171. I should emphasise that my conclusion that LLC5 had a tax main purpose is a conclusion reached on the particular facts of this case. It does not follow that other debt incurred in connection with a commercial acquisition – as the acquisition of BGI US undoubtedly was – would fall foul of the unallowable purpose rule even if the decision to borrow had regard, as it often would, to tax considerations. The facts of this case include, among other things, the use of a debt-funded UK resident entity in what is otherwise a wholly US-based, and equity funded, ownership chain, the related lack of any commercial rationale for LLC5, and the structure that then had to be put in place to ensure that LLC5 did not have control over the BGI US group, such that LLC5 not only had no commercial rationale but had no real commercial function.

**Commercial purpose**

172. It follows from what I have already said that I would further conclude that the FTT reached the correct decision in finding that LLC5 also had a commercial main purpose for entering into the Loans.

173. HMRC criticise the judge's reference to LLC5's business of "making and managing passive investments" as having no basis other than Mr Fleming's briefing note (see [128] above), but it was an accurate description of what was anticipated to be a highly profitable activity. LLC5 could not legitimately have entered into the Loans except as part of a transaction that enabled it to deploy its newly acquired assets in its commercial interests, such that it was anticipated that it would not only meet its obligations under the Loans but would also make a profit.

## Just and reasonable apportionment

174. The FTT's reasoning on this issue was very brief. After the passage set out at [139] above, the FTT Decision went on as follows:

> "122. Having come to the conclusion that there was a commercial and a tax purpose, it is therefore necessary to consider a "just and reasonable apportionment", as required by s 441 CTA 2009. In doing so I have adopted the approach taken by Judge Beare in *Oxford Instruments* [*Oxford Instruments UK 2013 Limited v HMRC* [2019] UKFTT 254 (TC)].
>
> 123. The evidence of Mr Kushel is that LLC5 would have entered into the Loans with LLC4 even if there had been no tax advantage in doing so. Like Judge Beare, and as the tax advantage purpose has not increased the debits, I consider that, on a just and reasonable basis, that all of the relevant debits arising in respect of the Loans should be apportioned to the commercial main purpose rather than the tax advantage main purpose."

175. The UT considered that the FTT had wrongly adopted a subjective approach, and instead what was required was an objective consideration of all the facts and circumstances. A "but for" approach may be helpful as a check, but in this case the Loans would not have been incurred at all but for the tax purpose. The FTT had instead asked itself a different question, namely whether the loans would have existed if the tax relief had been withdrawn just before the transaction was due to complete.

176. Mr Prosser sought to support the FTT's conclusion by submitting that the correct approach was one based on causation, and in particular a "but for" test. Further, although the exercise was objective in the sense that it was for the tribunal to determine what a just and reasonable apportionment would be, the apportionment was between the subjective purposes that had been identified (in other words, between the tax main purpose and the other, permissible, main purpose or purposes). In this case the board of LLC5 would have entered into the Loans even if the tax advantage had not existed. This "but for" approach was one that had been adopted in previous cases and gained some support from *TDS* at [50]-[54], a passage discussed at para. 124 of the *Oxford Instruments* decision relied on by the FTT.

177. Mr Yates also made submissions about the approach that should be adopted were we to conclude that it would not be correct to apportion 100% of the debits to LLC5's commercial purpose. Two approaches were put forward. The first was to apportion by reference to the relative anticipated financial significance of the tax relief and the commercial advantage (being the excess of dividends over interest payable), taking account of the fact that at the time the Loans were entered into it was anticipated that tax relief for a substantial portion of the interest costs would be denied under the worldwide debt cap rules. These are the "debt cap rules" referred to in the board minutes (see [134] above). At the time they were contained in Part 7 TIOPA and, very broadly, restricted deductions in respect of financing costs of UK members of a group by reference to the group's external financing expense. When the Loans were entered into a substantial disallowance was anticipated under those rules due to the way in which BlackRock expected that certain external liabilities would be characterised, but work in 2013 and 2014 resulted in agreement with HMRC that there would be no such disallowance.

178. The second approach was to allocate to the tax advantage purpose the proportion of the total interest expense that was anticipated to be allowable at the time the Loans were entered into, again after taking account of the anticipated restriction under the worldwide debt cap rules, with the balance being apportioned to LLC5's commercial purpose.

179. I agree with Mr Prosser that what the legislation requires is a just and reasonable apportionment by reference to the relevant purposes. Those purposes are identified using a subjective approach: see above. The statutory test requires the identification and disallowance of "so much of" any debit that is "attributable" to the unallowable purpose: s.441(3). That is the enquiry that the tribunal must undertake. While the determination of a just and reasonable apportionment is an objective exercise, it is not necessarily the same as the consideration of "all the facts and circumstances" referred to by the UT, if by that the UT did not intend to have regard to the requirement to apportion by reference to the relevant purposes. The framework for the apportionment is the purposes that have been identified by the fact-finding tribunal. Subject to that point, however, I agree that all relevant facts and circumstances should be considered.

180. The position is straightforward if all the debits, or perhaps a defined part of them, are properly attributable solely to a tax avoidance main purpose. Conversely, if they are properly attributable to a purpose which is not an unallowable purpose then there will be no disallowance under s.441. Where debits are attributable to more than one purpose then an apportionment is required. As to the precise mechanism by which this is done, the legislation is not prescriptive. The answer to that question will inevitably be fact specific.

181. On the facts of this case I agree with the UT that the FTT was wrong to focus on what would have happened if tax relief had been withdrawn at the last moment. I would also concur with the result reached by the UT, namely that 100% of the debits should be apportioned to the unallowable purpose.

182. As already discussed, the purpose for which LLC5 was created cannot be divorced from its purpose in entering into the Loans. Further, the structure of the transaction was presented as a fait accompli to the board. The commercial advantage to LLC5 was of significance to it because it would not benefit from the tax advantage, but overall it was more in the nature of a by-product. On the facts there is no principled basis to identify any particular amount or proportion of the debits as being attributable to the commercial purpose.

183. The answer to the apportionment question is not altered by imagining what might have happened if the tax rules had changed at the last moment. That did not occur. In reality the board accepted and adopted the structure that had been devised to achieve a tax advantage.

184. While I understand Mr Yates' submissions about alternative approaches and can see that some form of apportionment based on economic advantage could be appropriate in some cases, I do not consider that it would be appropriate to adopt either of the two approaches put forward in this case. Apart from the fact that the FTT was not asked to consider those alternatives, they both re-introduce subjective elements into what should be an objective exercise, namely LLC5's expectations about the relative level of tax benefits as compared to other factors.

185. In any event, there is a simpler answer based on the "but for" approach that both parties were content that we should adopt on the facts of this case. If that approach is adopted then the only proper answer is not the one that the FTT gave. Rather, in the absence of the tax advantage the decision to enter into the Loans would never have been made.

186. Accordingly, I would dismiss LLC5's appeal against the UT's conclusion on apportionment.

## CONCLUSION

187. In summary, I would:

a) allow LLC5's appeal on the Transfer Pricing issue (Ground 1) and dismiss HMRC's challenge to the FTT's findings on the evidence (HMRC's Ground 1), with the result that deductions for interest on the Loans are not restricted under the transfer pricing rules (see [97] above);

b) on the Unallowable Purpose issue, conclude that the FTT did make a material error in applying *Mallalieu*, and as a result would also allow Ground 2 of BlackRock's appeal, dismiss HMRC's Ground 3 and set aside the tribunals' decisions on that issue;

c) re-make the decisions with the same result, that is by concluding that LLC5 had a tax advantage main purpose in entering into the Loans but also had a commercial main purpose (such that HMRC's Ground 2 is also dismissed); and

d) dismiss Ground 3 of the appeal, concluding that the UT was correct to decide that 100% of the debits in respect of the Loans should be attributed to the tax advantage main purpose.

188. The result of this is that tax deductions for the interest on the Loans are disallowed under the unallowable purpose rule.

## Lord Justice Nugee:

189. I am very grateful to Falk LJ for her clear and comprehensive judgment with which I agree. I add just a few words on the Unallowable Purpose issue. If one stands back from the detail, I think that the evidence did show that the Loans had an unallowable purpose.

190. It is perhaps worth going back to the wording of the statute (see [99] above where it is set out). By s.441(1) CTA 2009 the statutory question is whether "a loan relationship of a company has an unallowable purpose"; and by s.442(1) that will be the case if "the purposes for which the company is a party to the relationship" include a purpose which is not amongst the business or other commercial purposes of the company. By the combined effect of s.442(3) and (4) if one of the purposes for which a company is a party to a loan relationship is a tax avoidance purpose, that is only regarded as a business or other commercial purpose if it is not "the main purpose for which the company is a party to the loan relationship" or "one of the main purposes for which it is". By s.442(5) a tax avoidance purpose is any purpose which consists of securing a tax advantage for the company or any other person. So the question can be reduced to this: was securing a tax advantage for the group the main purpose, or one of the main purposes, of LLC5 being a party to the Loans?

191. The minutes of the meeting of the board of managers of LLC5 on 30 November 2009 record that:

> "the Chairman [Mr Kushel] proposed that the Company enter into a series of transactions in accordance with the Project Onyx Closing Step Plan prepared by Ernst & Young LLP."

In other words, the purpose of LLC5 in entering into these transactions was to take its place in the structure that had been devised to enable the acquisition to take place.

192. But its place in that structure was entirely driven by tax considerations, or, to use the language of the statute, in order to secure a tax advantage for other persons. That was what its participation in the structure was designed to achieve. In those circumstances if one asks what was its purpose in agreeing to the transactions, I do not think there is really any doubt that its purpose was to play the part that had been devised for it so as to obtain that advantage. As Falk LJ nicely puts it at [164] above, LLC5's sole raison d'être was to enter into the Loans to obtain tax advantages for the BlackRock group. When the board were presented with the proposal that it should do just that, they no doubt had to satisfy themselves, as Mr Kushel said, that it was in the interests of LLC5 itself to enter into the transactions (and, as Falk LJ explains, in considering that question they quite rightly put out of their minds the tax advantages, which would accrue not to LLC5 but to other members of the group), but I do not think that means that there was no tax advantage purpose in LLC5 being a party to the Loans. That was why the board were asked to sign up to the transactions, and that was I think plainly why they did. That as Falk LJ says does not involve an attack on Mr Kushel's (or Mr Fleming's) evidence; indeed I regard it as following from what Mr Kushel said.

193. I agree therefore that we can and should re-make the decision by concluding that LLC5 had a tax advantage main purpose in entering into the Loans.

194. On the other issues (transfer pricing, and apportionment), I agree with Falk LJ and do not wish to add anything.

195. I therefore agree with her proposed disposal of the appeal.

**Lord Justice Peter Jackson:**

196. I agree with both judgments.

## APPENDIX
## ACQUISITION STRUCTURE