Raiders of the loss relief

Large Corporate OMB

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Keith Gordon considers the First-tier Tribunal’s decision in Leekes

Key Points

What is the issue?

The Leekes case concerns a challenge made by HMRC to a company’s attempt to apply CTA 2010 s 944 in order that historical losses can be transferred from one company to another

What does it mean for me?

Corporate reconstructions (including mergers and acquisitions) can take place under which loss-making companies can be ‘acquired’ but do not need to be retained, yet the benefit of any brought forward losses is not necessarily lost

What can I take away?

The First-tier Tribunal rejected HMRC’s argument that the loss relief should be available only in relation to profits arising from the merged trade, as opposed to the entirety of the merged trade

In the early days of my tax career, nearly 25 years ago, there was a legislative provision that I thought a very useful relief. ICTA 1988 s 343 (now found in CTA 2010 Ch 1 Pt 22) dealt with ‘company reconstructions without a change of ownership’.

Its origins could be traced to anti-avoidance provisions before 1965 when companies were subject to income tax and parliament wished to prevent companies taking advantage of the rules that applied when a trade started or was discontinued. (These anti-avoidance themes can still be seen within s 343(2) (now CTA 2010 ss 948 and 949.) For me, the magic was in the rules that allowed historical losses to be transferred from one company to another, something that seemed to contradict every other rule I was learning at the time about carrying forward past losses. The rule is clearly set out in what is now CTA 2010 s 944 (formerly ICTA 1988 s 343(3)).

To paraphrase the statute, the essential conditions are that a trade that is transferred from one person to another has at least 75% common ownership at some time within two years of the transfer.

One major practical effect of the rules is that corporate reconstructions, including mergers and acquisitions, can take place under which loss-making companies can be ‘acquired’ but do not need to be retained, yet the benefit of any brought forward losses is not necessarily lost.

A challenge was made by HMRC to a company’s attempt to apply these rules in *Leekes Ltd v HMRC* [2015] UKFTT 93 (TC).

The facts of the case

Leekes Ltd carries on a trade of running out-of-town department stores. In 2009, it ran three in Wales and a fourth in Wiltshire. In the November, it purchased the entire share capital of Coles of Bilston Ltd (Coles), a company whose trade at the time comprised three furniture stores, plus warehousing in the West Midlands. At the date of the purchase, Coles had accumulated trading losses of more than £2.2 million, plus a further £950,000 in the eight months until the date of the purchase.

After the purchase, Coles’s trade was hived up to Leekes (at fair value to avoid any restriction on the relief from being imposed) and Coles became dormant. The (former) Coles stores were rebranded as Leekes. Over the next four months, these outlets sustained a further trading loss of £176,000.

However, Leekes, as a whole, made taxable trading profits of £1.6 million. The company therefore claimed relief in relation to the brought-forward losses (deriving from Coles), with the result that it had no corporation tax to pay on its trading profits for the year ended 31 March 2010.

Although HMRC accepted that the conditions for s 343 to apply were met in the present case, they refused to accept that Leekes could take advantage of Coles’s past losses. This was because, HMRC argued, the loss relief should be available only in relation to profits arising from the Coles part of the merged trade, as opposed to the entirety of the merged trade.

The tribunal’s decision

The arguments before the tribunal followed two main themes. The first was the meaning of the term ‘trade’. Did it mean the trade as previously carried on by Coles, or could it embrace the enlarged trade now carried on by Leekes? Second, the tribunal considered the question of quantum, and whether it was relevant that Coles, which was still loss-making, would not (had it remained in independent ownership) have been in a position to claim relief for its earlier losses.

Judge Rachel Short, sitting with Mr Nicholas Dee, noted with surprise that the legislation, which was at least 50 years old, had not apparently been the subject of prior authority. There was the case of *Falmer Jeans Ltd v Rodin* 63 TC 55, but that concerned a different subsection, what later became s 343(8) and is now CTA 2010 s 951.

The tribunal considered that the natural reading of the legislation was to interpret ‘trade’ as embracing the enlarged trade (as in the taxpayer’s arguments). In particular, it noted that there was no express requirement for the financial performance in the enlarged trade to be streamed (keeping separate the Coles and the Leekes elements of the business), as would have been required on HMRC’s interpretation. Further, subsection (8), which deals with a different scenario, does expressly provide for such streaming. Therefore, given that parliament was prepared to allow streaming in one provision, it was considered unlikely that it would have required this only implicitly in another closely related provision.

For similar reasons, the tribunal rejected HMRC’s arguments on quantum, favouring commercial reality and the obvious difficulties that would result from trying to keep separate the two strands of a business. It should be noted that, in many cases, activities would often be operationally merged, especially as the amalgamation and associated cost savings would commonly be a principal driver for the merger of the companies in the first place.

As a result, Leekes’s appeal was allowed.

Commentary

Having taken the stance to oppose Leekes’s claim, I would expect HMRC to pursue this case on appeal to the Upper Tribunal and perhaps beyond.

Nevertheless, this decision provides a common sense answer to a situation that could be encountered. I hope that any future appeal by HMRC would be unsuccessful, given the higher courts' willingness to find a common sense interpretation wherever possible (see *Pollen Estate Trustee Company Ltd and King's College London v HMRC*).

There is nothing obvious from the decision that could give rise to criticism of HMRC's decision to take the case. Nevertheless, I would be interested to ascertain why HMRC have decided to adopt this interpretation after so long. Is it an indication of a reinterpretation by officers with a view to maximising the tax take (as has occurred elsewhere), or have other potential appellants simply not had the stomach to take on HMRC in a tribunal?

Further information

Read Keith's article 'Mind the (property) gap' the Court of Appeal's decision in *Pollen Estate Trustee Company Ltd and King's College London v HMRC* from the November 2013 issue of *Tax Adviser*.