AN COIMISIÚN UM ACHOMHAIRC CHÁNACH
TAX APPEALS COMMISSION

03TACD2023

Between/

[redacted]

Appellant

-and-

THE REVENUE COMMISSIONERS

Respondent

Determination

A. *Introduction*

1. This is an appeal against an amended assessment to Corporation Tax issued to the Appellant by the Respondent on 25 July 2014 in respect of the [redacted]-month accounting period ending on 31 December 20[redacted]. In essence, the issue to be determined is whether the sum of US$517,777,305 (hereinafter rounded to $518 million), or part thereof, was a deductible expense under section 81 of the Taxes Consolidation Act 1997 (hereinafter "**TCA 1997**") for the purpose of calculating the profits of the Appellant chargeable to corporation tax.

B. *Background and Summary of Evidence*

2. The Appellant is a company involved in the production of [redacted] products and since 30 November 20[redacted] it has been owned by [redacted] (hereinafter **"COMPANY A1"**), a subsidiary of **COMPANY A2** whose ultimate parent company is **COMPANY A3**.

3. Prior to becoming a **GROUP A** subsidiary, the Appellant was part of **GROUP B**. In October 2011, while still in **GROUP B** ownership and as part of an internal **GROUP B** re-organisation, the Appellant purchased the [redacted] business of another subsidiary, [redacted] (hereinafter **"COMPANY B1"**). As consideration for this purchase, the Appellant assumed liability for two ten-year fixed term loan agreements (hereinafter **"the Original Loan Agreements"**) entered into between **COMPANY B1** and another **GROUP B** entity named **COMPANY B2** in January 2011. The borrowing under the Original Loan Agreements, which totalled some $988 million, comprised:-
   (a) a subordinated loan agreement for approximately $341 million; and,
   (b) a senior loan agreement for approximately $647 million.

4. The interest on the senior loan agreement was fixed at a rate of 6.5% and that on the subordinated loan agreement was fixed at 7.4%. This resulted in a blended fixed rate of 6.81%.

5. Repayment of the principal amounts was to be made at the end of the term of the Original Loan Agreements in January 2021. However, each loan agreement also contained an "*Optional Prepayment*" mechanism under Section 2.02, which provided:-
   "The borrower shall have the right, at its option, on any Business Day, to prepay the Loan in whole or in part. Upon such prepayment, the Borrower shall be obligated to pay the Lender the greater of (i) 100 per cent of the principal amount being prepaid on such Business Day ("the Prepaid Amount"), or (ii) the sum of the present values of the remaining scheduled payments of principal and interest corresponding to the Prepaid Amount, discounted to such Business Day on a semi-annual basis at the Prepayment Rate, plus, in each case, accrued and unpaid interest on the Prepaid Amount to but excluding the prepayment date."

6. In or about August 2011, **GROUP B**, through its tax advisers Ernst & Young, entered into discussions with the Respondent regarding the tax treatment of interest payments made in respect of the Original Loan Agreements. This resulted in the Respondent confirming on 30 September 2011 that the interest payments on the Original Loan Agreements, which prior to the **GROUP B** restructuring had been viewed by it as deductible for the purpose of calculating **COMPANY B1**'s corporation tax, remained so in respect of the liability assumed by the Appellant.

7. At some point shortly after this internal re-organisation, **GROUP B** decided to put its [redacted] business, including the Appellant, up for sale. A tendering process ensued, from which **GROUP A** emerged as the successful bidder. I heard evidence that in doing so, **GROUP A** had faced stiff competition from **GROUP C**, a major commercial rival. On 21 April 20[redacted] **COMPANY A3** duly entered into a Stock and Asset Purchase Agreement (hereinafter **"the SAPA"**) with **COMPANY B3**. Pursuant to the SAPA, **GROUP A** agreed to purchase **GROUP B**'s [redacted] business, which included the purchase of the Appellant's shares.

8. Section 2.5 of the SAPA detailed certain obligations that **COMPANY A3** would assume as purchaser. Section 2.6 then went on to describe certain residual liabilities that would be retained by **GROUP B** following the sale. This provided:-

   "*Notwithstanding any provision in this Agreement, the Sellers shall retain and be responsible only for the following Liabilities relating to the Business, whether belonging to the Sellers or any of their Affiliates or the Conveyed Subsidiaries or their Subsidiaries (unless otherwise expressly specified below) ("the Retained Liabilities"), provided that, for the avoidance of doubt, only the Seller Parent shall have indemnification obligations for such Retained Liabilities pursuant to and to the extent set forth in Section 6.5(d)(i) and 7.1(a)(i):*

   …

   (l) all Liabilities arising under Actions arising out of the matters set forth on Section 2.6(l) of the Seller Disclosure Letter.

   Seller Parent shall, at its sole cost and expense, use commercially reasonable efforts to take (or cause one of more of its Affiliates to take) such action (including

preparing any necessary transfer documentation therefor) as is necessary or advisable for Seller Parent or one or more of the Affiliates to assume and concurrently discharge the Conveyed Subsidiaries and their Subsidiaries from, no later than the Closing Date, the Retained Liabilities".

9. Section 2.6(l) of the Seller Disclosure Letter referred to in Section 2.6 of the SAPA defined the term "*Retained Liabilities*". The second paragraph thereof was headed "*Ireland*" and included *inter alia*:-

> "*All rights and obligations of* **THE APPELLANT** *pursuant to that certain US$340,980,556 Subordinated Loan Agreement dated January 31, 2011, by and between* **COMPANY B1** *and* **COMPANY B2** *(as lender) and that certain US$647,230,289 Senior Loan Agreement, dated January 31, 2011, by and between* **COMPANY B1** *and* **COMPANY B2** *(as lender)."*

10. Under Section 2.7 of the SAPA, the aggregate purchase price for **GROUP B**'s [redacted] business, including assumed liabilities, was set at $[redacted]. A "*Preliminary Allocation Schedule*" allocated some $2.625 billion of this to the purchase of the Appellant's shares.

11. By reason of the foregoing, the agreement concluded in April 20[redacted] was that **GROUP A** would not be required to assume the Appellant's obligations to repay the outstanding principal and interest due under the Original Loan Agreements. Experts called to give evidence for both parties in this matter were in agreement that it would be highly unusual for this debt to be left in place following the transfer of the Appellant to **GROUP A**. This issue is discussed in greater detail hereunder.

12. The sale of **GROUP B**'s [redacted] business for $[redacted] billion, agreed in headline terms under the SAPA, did not close until 30 November 20[redacted]. Unsurprisingly, there were a great many steps necessary to give effect to such a sizeable transaction. During the period between the conclusion of the SAPA and completion, it was decided at a high level within **GROUP A** that it would prefer that the Appellant be acquired with the Original Loan Agreements still in place. **GROUP A**'s wish was that immediately after transfer, the Appellant would make early repayment to **GROUP B** of the Original

Loan Agreements, with the purchase price agreed under the SAPA reduced by an amount corresponding to the cost of early repayment.

13. While **GROUP B** proved to be willing to facilitate this revised arrangement, I heard evidence that it insisted that the terms of Section 2.02 of the Original Loan Agreements be adhered to. This meant that there would be a cost additional to the repayment of the principal amounts due to the lender.

14. **GROUP A** had engaged Ernst & Young to advise it on the structuring of the acquisition of the Appellant. Dubbing the transaction "█████", Ernst & Young ultimately produced a Tax Structure Memorandum dated 23 November 20█, which set out the proposed steps in the acquisition of the Appellant that would "*…take place simultaneously at the effective date of closing (i.e. 11.59pm GMT on 30 November 20█).*

15. Among these were steps 9 and 10 of the Memorandum, which provided that the Appellant would borrow by way of inter-company loans $988 million and $385 million from two **GROUP A** entities, namely **COMPANY A4** and **COMPANY A5**. These sums would not be transferred to the Appellant but instead were to be held on trust by **COMPANY A4** and **COMPANY A6.** Steps 11 and 12 provided that thereafter:-

> "*11.* **THE APPELLANT** *instructs* **COMPANY A4** *(who in turn instructs* **COMPANY A6***) to use the funds borrowed to settle the bonds issued by* **THE APPELLANT** *totalling $988,210,845.*
>
> *12.* **THE APPELLANT** *instructs* **COMPANY A6** *to use the funds held on trust to pay* **GROUP B** *the <u>early repayment charge</u> in relation to the* **APPELLANT** *bonds, totalling $385,599,990."* [emphasis added]

16. Steps 13-17 would then "*take place between the effective date of closing (11.59pm GMT on 30 November 20█) and midnight on 30 November 20█ in the following order*". Steps 13 and 16 provided as follows:-

> "*13.* **COMPANY A2** *subscribes for 385,599,990 USD$1 ordinary shares in* **THE APPELLANT***. In consideration for the shares issued,* **COMPANY A2** *assigns Note 3 (totalling STG£ equivalent of $385,599,990) to* **THE APPELLANT***.*

…

17. **THE APPELLANT** *uses Note 3, received from* **COMPANY A2**, *to repay its $385,599,990 inter-company loan with* **COMPANY A5**".

17. The final page of the Ernst & Young Memorandum listed three post-closing actions in bullet points. The second of these was "*Finalise analysis in relation to the deductibility of $385,599,990 refinancing charge.*" [emphasis added]

18. The Appellant characterised this document as evidencing the renegotiation of the terms of the sale of the Appellant a week before it was scheduled to occur.

19. The purchase of **GROUP B**'s ██████ business was completed on 30 November 20██ and, in relation to the purchase of the Appellant, proceeded in accordance with the steps detailed by Ernst & Young in its Memorandum of the previous week. **COMPANY A3** and **COMPANY B3** entered into a letter of agreement dated 30 November 20██. Section 3(c) of the letter was headed "*Repayment of Irish Debt*" and provided as follows:-

"*Notwithstanding anything to the contrary in the* [SAPA], *Seller Parent and Purchaser agree that: (i) Seller Parent shall not settle, or caused* [sic] *to be settled, effective as of the Global Closing Date, the intercompany indebtedness listed as item number 2 in Section 2.6(l) of the Seller Disclosure Letter (such amount being referred to herein as the "Irish Payable"); (ii) at the Closing, Seller Parent and Purchaser shall execute and deliver, and shall each use their reasonable commercial efforts to cause Deutsche Bank Trust Company Americas, a New York banking corporation and a wholly owned subsidiary of Deutsche Bank AG, in its capacity as escrow agent (the "Escrow Agent"), to execute and deliver, an escrow agreement, substantially in the form set forth in* ***Exhibit B*** *hereto (the "Escrow Agreement"); and (iii) at the Closing, Purchaser or an Affiliate of Purchaser shall deposit with the Escrow Agent USD1,373,810835 (the "Payoff Amount"), which amount shall be used by Seller Parent within two (2) Business Days thereafter, to discharge the Irish Payable, together with any interest, prepayment penalty or other amount that may be required to be discharged in connection with the early settlement thereof. For the avoidance of doubt, to the extent that the amount required to discharge the Irish*

Payable (together with all interest, prepayment penalties and other amounts required to discharge the same in full) exceeds the Payoff Amount, such excess amount shall be treated as Indebtedness for purposes of the [SAPA] *and shall be taken into account in the calculation of Net Debt of the Business. As a result of the Irish Payable remaining outstanding as of the Global Closing Date, the parties agree that the amount payable for the shares of* **THE APPELLANT** *shall be reduced to USD 1,251,189,165."*

20. The effect of this agreement was that the principal and interest payments outstanding on the Original Loan Agreements, which were originally specified as liabilities to be "*retained*" by **COMPANY B3** under the SAPA, were in the event assumed by **GROUP A** as purchaser of the Appellant and would be discharged following the closing.

21. The escrow account referred to in Section 3(c) of the Letter of Agreement was set up on 30 November 20██ pursuant to an Escrow Agreement of that date between Deutsche Bank Trust Company Americas, **COMPANY A3** and **COMPANY B4** (referred to therein as "*the Company*"). The first paragraph of the recitals provided:-

"WHEREAS, **COMPANY B3** *and* **COMPANY A3** *have entered into a Stock and Asset Purchase Agreement (the "Purchase Agreement"), dated as of April 21, 20██, pursuant to which* **COMPANY A3** *agreed to purchase from* **COMPANY B3** *certain assets as described therein…"*

22. The fourth and fifth recitals of the Escrow Agreement then provided as follows:-

"WHEREAS, the Company (on behalf of **COMPANY B3** *and the Lenders) and* **COMPANY A3** *(on behalf of itself and* **THE APPELLANT***) desire to provide for the discharge* <u>*in full*</u> *of all indebtedness* <u>*including pre-payment penalties*</u> *and other amounts due under such loan agreements, and accordingly, desire to establish an escrow account to facilitate such repayment;*

WHEREAS, in connection with the foregoing, **COMPANY A3** *has agreed to deposit the Escrow Amount (as defined below) with the Escrow Agent and the parties wish such Escrow Amount to be held and disbursed by the Escrow Agent in accordance with the terms and conditions set forth herein."* [emphasis added]

23. Section 2 of the Escrow Agreement was entitled *"Deposit into the Escrow Property"* and the beginning thereof provided:-

> *"***COMPANY A3***, simultaneously with the execution and delivery of this Agreement, has caused to be deposited with the Escrow Agent the sum of $[ ] in immediately available funds (the "Escrow Amount"), and which Escrow Amount shall be held by the Escrow Agent upon the terms and conditions hereinafter set forth."*

24. Section 4 of the Escrow Agreement was entitled *"Distribution of the Escrow Property"* and it provided as follows:-

> *"(a) The Escrow Agent shall hold the Escrow Property in its possession until instructed by the Company, at the Company's sole discretion, to deliver the Escrow Property or any specified portion thereof in accordance with a written release notice signed by an Authorized Person of the Company; provided, that such delivery shall not occur prior to the date that is one (1) Business Day after the Closing Date. If Escrow Property is disbursed in accordance with a court order, the provisions of Section 9(m) shall apply. The Escrow Agent shall not be responsible for knowledge of when Closing Date has or will occur.*
>
> *(b) Promptly upon receipt of a written release notice signed by an Authorized Person of the Company and in any event within 1 business day after such receipt, the Escrow Agent shall distribute the Escrow Property (including all Distributions) in accordance with the instructions provided in such notice."*

25. As is apparent from the foregoing, the structure of the Escrow Agreement was that the **GROUP A** would, on the day of the completion of the acquisition of the Appellant, ensure the deposit of the $1.3 billion with the escrow agent, Deutsche Bank. One day later, a **GROUP B** company would be able to procure the release of the $1.3 billion for the purpose of settling the Original Loan Agreements.

26. On the same day as the acquisition, the newly-appointed board of the Appellant, comprising two **GROUP A** employees named **WITNESS 1** and **WITNESS 2**, resolved to refinance the Original Loan Agreements that were due to mature on 31 January 2021. This was done by utilising the "*optional prepayment*" mechanism under Section

2.02 of the Agreements, which required the Appellant to pay to the **GROUP B** lender a sum amounting to the aggregate of the present value of the principal amounts outstanding (some $855 million) plus remaining interest payments thereon reduced to present value (some $518 million).

27. The Resolution was passed by the directors at 23.59 on 30 November 20██. Clause 1 thereof, headed "*Refinancing*" provided as follows:-

> ***"IT IS NOTED** that <u>as a result of the acquisition</u> of the Company by* **COMPANY A1***, it is proposed that all rights and obligations of the Company pursuant to that certain USD$ 340,980,556 Subordinated Loan Agreement dated 31 January 2011, by and between* **COMPANY B1** *and* **COMPANY B2** *(as lender) and a USD$ 647,230,289 Senior Loan Agreement dated 31 January 2011, by and between* **COMPANY B1** *and* **COMPANY B2** *(as lender) (the **Assumed Bonds**) now be refinanced (the **Refinancing**) <u>as set out in a Restructuring Memorandum (the **Step Plan**)</u>, a copy of which is appended to these resolutions."* [emphasis added]

28. Clauses 2.1 and 2.2 of the Resolution resolved that the Appellant would immediately take out intra-group loans of $988,210,845 and $385,599,000 from **COMPANY A4** and **COMPANY A5** respectively, which sums would be held on trust for the Appellant by **COMPANY A4** and **COMPANY A6.**

29. Under Clause 2.3, the new board of the Appellant resolved:-

> *"(a) that the Company's entry into the Intra-Group Loan Agreements will be of material benefit to the Company, in its commercial interest and within its corporate powers and (b) that the entry by the Company into the Intra-Group Loan Agreements and the Trust Notifications be and is hereby approved.*"

30. Under Clause 3, headed "*Payment Instructions*", the Appellant's directors resolved:-

> " *…that the Company instruct* **COMPANY A4***, and* **COMPANY A6** *to make payments on the Company's behalf pursuant to the following payment instructions (drafts of which are appended to these Resolutions):-*
>
> *3.1.1* **COMPANY A4** *to pay the sum of US$ 988,210,845 by way of settlement of the Assumed Bonds; and*

3.1.2 **COMPANY A6** *to pay the sum of US$ 385,599,990 by way of settlement of an* *<u>early repayment charge</u>* *arising in relation to the prepayment of the Assumed Bonds."* [emphasis added]

31. The loan agreement of 30 November 20█ made between **COMPANY A4** and the Appellant for the loan of $988 million described the purpose of the loan as being *"Re-financing of debt associated with the business of* [the Appellant]". The interest payable on the loan was the 6 months Libor plus a margin of 484 basis points. Under the heading "*Termination*", the agreement recorded that:-

> *"The Loan is to be provided solely in connection with the acquisition by* **COMPANY A1** *of the entire issued share capital of* [the Appellant] *and the distribution business and assets of* **COMPANY B5** *(the* ***Transaction****). If the Transaction does not complete the Loan will immediately terminate."*

32. Similarly, the loan agreement of 30 November 20█ made between **COMPANY A5** and the Appellant for the loan of $385 million described its purpose as "*The payment of an <u>early repayment charge</u> in relation to bonds issued by* [the Appellant]" [emphasis added]. No interest was payable on the loan because the loan was to be repaid within 24 hours of entry into the agreement. Under the heading "*Term/Repayment*", the agreement recorded that:-

> *"The Loan is to be provided solely in connection with the acquisition by* **COMPANY A1** *of the entire issued share capital of* [the Appellant] *and the distribution business and assets of* **COMPANY B5** *(the* ***Transaction****). The Loan will be fully repaid on the closing date of the Transaction. If the Transaction does not complete, the Loan will immediately terminate."*

33. In accordance with the foregoing, $1.373 billion was transferred on 30 November 20█ to the Deutsche Bank escrow account and from there to **GROUP B** for the early settlement of the Original Loan Agreements. In recognition of this, the purchase price allocated for the Appellant, which was set in the SAPA at $2.625 billion, was reduced by an exactly corresponding amount to $1,251,189.165, which was duly paid (subject to minor variations) by **GROUP A**.

34. I heard evidence from **WITNESS 1** who, prior to her retirement in 20, had been a chartered accountant employed in a variety of senior management positions in the **GROUP A**, including as Chief Financial Officer of **COMPANY A2** and of its subsidiary **COMPANY A1**. Following the conclusion of the SAPA, she was informed by **GROUP A** that she would be made a director and the Chief Financial Officer of the Appellant upon the completion of its acquisition from **GROUP B**.

35. **WITNESS 1** said that as a member of a **GROUP A** steering group, she was involved in planning for the integration of the **GROUP B** companies to be acquired. Her evidence was that she was not involved in the negotiations between **GROUP A** and **GROUP B** concerning the completion of the acquisition and the revision of terms of the SAPA. That job would have fallen to **GROUP A**'s mergers and acquisitions personnel, though she said that her opinions would have been fed back up to those personnel in the course of the negotiations.

36. She said that, despite her not being involved in the renegotiation discussions and not becoming a director until completion on 30 November 20, she was considering its implications "*knowing what was coming along the road*". She said that in or around September 20 she received detailed advice from **MR A**, Head of Tax in **COMPANY A2**, and from Ernst & Young concerning the advantages and disadvantages of the proposed revisions, and she concluded that they would be to the Appellant's benefit.

37. **WITNESS 1** said there were four main reasons why, as part of the newly-appointed board of the Appellant, she resolved on 30 November 20 to repay and refinance the Original Loan Agreements. Firstly, she said she had been advised that the long term cost of the **GROUP A** financing would be cheaper because of the lower interest rate applicable. This was a floating rate of 6-month LIBOR plus 484 basis points (4.84%). Secondly, she had been advised that repayment of the loans would result in a reduction of the principal due to the lender from $988 million to $855 million, representing a saving of $133 million. Thirdly, the replacement **GROUP A** finance would be more flexible because it would not contain an onerous early repayment clause such as that found in the Original Loan Agreements. Fourthly, opting to repay,

she said, would free the Appellant from borrowing with *"…an external third party other than a bank or other lending financial institution"*.

38. With regard to the final point, **WITNESS 1** agreed when it was put to her in cross-examination that had no renegotiation occurred, **GROUP B** would have had to deal with the intercompany balances and would have had to deliver the Appellant to the **GROUP A** free from debt in return for consideration of $2.6 billion.

39. **WITNESS 1** also gave evidence that another factor in her thinking was that in mid- to late September 20██, she became aware that the **GROUP A** Tax team and Treasury team understood that **GROUP B** had obtained a ruling from the Respondent that interest on the loans payable under the Original Loan Agreements was fully tax deductible. She said that she assumed during the planning for the completion of the transaction that any prepayment of interest would also receive the same tax treatment and be fully deductible.

40. In this regard, she averred in her witness statement furnished for the appeal:-

> *"I recall that the information provided to me by* **MR A** *at the time demonstrated that in the scenario in which the Original Loan Agreements were repaid and replaced with internal financing from within* **GROUP A**, *a material interest saving would be made. Our discussions also considered the potential impact of the Interest Prepayment. This was a substantial amount and was greater than the potential interest saving which* **MR A** *had calculated would arise from the replacement of the Original Loan Agreements with internal* **GROUP A** *financing.*
>
> *However, we assumed for the reasons set out above that, if* **GROUP B** *did ultimately insist on the Interest Prepayment being made, that it would be tax deductible. It would be normal to take into account the tax consequences of any action, together with all other commercial considerations, before taking a final decision as to the terms on which to proceed. Indeed, as a proposed director of* **THE APPELLANT** *who would ultimately be responsible and answerable to that company for any decision to refinance the Original Loan Agreements, I do not believe that I would have fulfilled*

my duties to **THE APPELLANT***, once appointed a director of that company, to ignore these tax considerations."*

41. **WITNESS 1** was pressed by Counsel for the Respondent on the actual involvement of herself and **WITNESS 2** in the acquisition of the Appellant. She agreed that they had no function in the payment of the $1.3 billion to **GROUP B** but said that they had been willing to let this happen because, prior to completion and the entry into the Escrow Agreement, they had reached the conclusion that it was the best way to proceed in the interests of the trade of the Appellant.

42. **WITNESS 1** also accepted under cross-examination that whatever way the transaction was structured, it was never intended that the debt under the Original Loan Agreements would remain in place. The debt would either have had to be extinguished prior to the acquisition as originally intended, or settled immediately thereafter as in fact occurred.

43. Counsel for the Respondent cross-examined **WITNESS 1** on the contents of an email chain that was exhibited as part of her witness statement. One of these was from **MR A** to her dated 14 September 20██, which stated:-

'██,

Just so you are aware that we are exploring the possible P&L impact of the <u>*USD350 early settlement.*</u>

I have also asked E&Y whether another alternative might be to leave the bond in place in Ireland, but **COMPANY A3** *buys the bond direct from* **COMPANY B3***"* [emphasis added]

44. This followed an email sent earlier the same day by **MR C**, a tax advisor from Ernst & Young, to various tax specialists in **GROUP A**, including **MR A**. This stated:-

"Dear ██████, ███,

I hope you are both well. ██████ and ███ have asked me to contact you with regard to the repayment by **THE APPELLANT** *of the* <u>*$988 million loans post closing.*</u>

It has been brought to our attention via the ongoing discussions between the respective EY Ireland **GROUP A** *and* **GROUP B** *teams that the* **APPELLANT** *loan agreements (attached for your reference) include clauses (at 2.02) stating that early repayment would require* **THE APPELLANT** *to repay the loan principal plus a premium of around $350 million (this figure has been mentioned by* **GROUP B** *to us).*

On the weekly **COMPANY A3-COMPANY B3** *tax call yesterday I questioned whether* **GROUP B** *intended to vary the loan terms (such that no premium would be payable) or to proceed based on the current wording of the loan agreements (and for the premium to be applied). They said that they were considering this would revert to us on 20th September.*

That said, they confirmed that the total cash they expected **GROUP A** *to pay to* **GROUP B** *regarding the acquisition of* **THE APPELLANT'S** *shares and* **THE APPELLANT***'s repayment of the debt would be $2.6 billion i.e. if the early repayment premium applied they would not be seeking an incremental $350 million.*

██████*, from a Group accounting perspective,* ██████*,* ███ *and I were particularly concerned to highlight this to you, as the* **GROUP A** *group income statement implications of the $350 million premium being applied were unfamiliar to us. The closing/post closing cashflows would be:*

- At Closing – **COMPANY A1** *pays $1.25 billion to* **GROUP B** *for the shares in* **THE APPELLANT** *(cash transferring via the single global payment mechanic)*

- Closing +1 Day – **THE APPELLANT** *pays $1.35 billion to* **GROUP B** *to repay the* **APPELLANT** *loan (again, cash via the global payment)*

As such, we wondered whether the $350 million on Closing +1 Day could be an expense in the income statement, despite the fact that it effectively reduces the purchase price of the shares. If this could be the case, then no doubt you this [sic] *could be a major issue from* **GROUP A***'s perspective.*

I am copying in the key members of the **GROUP A** *side EY tax team in UK and Ireland who are involved. If it would be helpful to have a call to discuss this further please let me know."* [emphasis added]

45. It was put to **WITNESS 1** that the import of this email correspondence was essentially two-fold. Firstly, the principal being discussed at this time was still $988 million, not the figure reduced to present value of $855 million that the Appellant's accounts ultimately recorded. Secondly, Counsel for the Respondent suggested that it was relevant to the Appellant's claim that it relied on the 2011 ruling given to **GROUP B** by the Respondent regarding the deductibility of regular interest payments under the Original Loan Agreements. It was put to **WITNESS 1** that this email in fact showed that **GROUP A**'s tax advisors were aware in September 20██ that somewhere in the region of $350 million (and not $518 million) on top of the principal might not be deductible. **WITNESS 1** did not dispute this.

46. In a similar vein, **WITNESS 1** was cross-examined on the reference in the Ernst & Young Memorandum to the need to "*…finalise analysis in relation to the deductibility of $385,599,990 refinancing charge"*. **WITNESS 1** agreed that the figure of $518 million only came to be considered by **GROUP A**'s tax advisors to be the amount deductible after the acquisition of the Appellant. Prior to this point, they were aware in broad terms of an amount additional to the principal of $988 million that would need to be paid; however, upon receipt of the terms of the Original Loan Agreements they became aware of the nature of the formula contained therein at Section 2.02. Asked whether one would expect a high level of accuracy in a document such as the Ernst & Young Memorandum as to the deductible figure, **WITNESS 1** said that this was based on the material then available. She clarified that the entirety of the material on which the figure of $518 million was reached was Section 2.02 of the Original Loan Agreements. She did not disagree with Counsel for the Respondent that there was no document produced by the Appellant which demonstrated that **GROUP B** ever in fact discounted the principal.

47. I also heard evidence from **WITNESS 2**, a senior business and marketing executive in **GROUP A**, who also was made a director of the Appellant on 30 November 20██ and,

at around the same time, given the role of Business Manager to various **GROUP A** ██████ companies, including the Appellant. **WITNESS 2**, an ██████ by training, said that as best she could recall, she had been asked to become a director of the Appellant in the second half of October 20██. Her evidence was that in passing the board resolutions of 30 November 20██, she too had formed the view that they were beneficial to the Appellant's trade. She said that she came to this conclusion based entirely on advice she received from **WITNESS 1** and **MS B**, Head of Legal for **GROUP A** UK & Ireland, which she allowed was "*broad brush*" in nature. **WITNESS 2** said that it had been explained to her that the **GROUP A** finance would be considerably more flexible than the Original Loan Agreements and would come with a lower interest rate attached. She readily conceded that she was no expert in financial matters and had not examined documents such as the SAPA, the Original Loan Agreements or the Escrow Agreement prior to signing the board resolutions on 30 November 20██.

48. **WITNESS 2** said she did not recall having seen a draft copy of the board resolutions before she signed them on 30 November 20██. She did not recall having read the Ernst & Young Memorandum that was appended to the resolutions and was clear that she had not been briefed or advised by Ernst & Young on it prior to signing. She repeated that her opinion on the transaction being in the interests of the trade of the Appellant was founded on the views of others communicated to her.

49. **WITNESS 2** said that she considered the most compelling reason for early repayment to be that it did not make any sense for the Appellant to continue to have borrowings with **GROUP B** after the date of completion. She accepted in cross-examination that there was never any possibility that the Appellant would be acquired with the Original Loan Agreements still in place, given the terms of the SAPA. Lastly, she said in her witness statement that the question of whether a tax advantage arose from the re-financing did not occur to her in forming her views.

50. I further heard evidence from Mr Peter Coyne, an expert witness called by the Appellant, in relation to two discrete issues, namely (a) how common it is in an acquisition for the intra-group borrowings of a "target company" to be discharged on or around completion, and (b) the common reasons for such discharge. Mr Coyne, a

chartered accountant and former director of AIB Corporate Finance with an expertise in mergers and acquisitions, testified that in acquisitions companies are invariably valued by reference to their enterprise value. It would be extremely rare indeed for pre-existing, intra-group debt to transfer over to a purchaser. What occurred in the great majority of acquisitions was that the debt would be settled either before or very shortly after completion, so that the acquired company would be able to obtain finance of a kind best suited to its needs under new ownership. Flexibility in financing, he said, was a priority for large corporations. From the perspective of a vendor, it would in almost all cases be undesirable to keep borrowing in place after acquisition. If problems arose post-closing regarding a transaction, it would be possible for the purchaser to use outstanding debt as leverage in a dispute. Mr Coyne stated that it was not out of the ordinary in an acquisition for the responsibility for settling borrowings to shift from the vendor to the "target company", in this instance the Appellant.

51. Mr Coyne had prepared an expert report for the purposes of the appeal. He stated that in preparing his report on the possible reasons for the discharge of intra-group debt around the time of the completion of an acquisition, he had not had sight of a variety of documents specific to the acquisition at issue in this appeal. These included the SAPA, the Disclosure Letter, the completion letter of 30 November 20██ and the resolutions of the board of the Appellant of the same date.

52. Mr Coyne said in his report that, the parties having re-arranged the acquisition so that the Original Loan Agreements would not be settled by **GROUP B** prior to completion, it had become a matter for the Appellant to weigh any commercial advantage in making early repayment against the cost of so doing. He accepted in cross-examination that the fact that the net cost of $385 million was covered by way of a promissory note from **COMPANY A2**, furnished in return for the provision of share capital, did not amount to "free money" for the Appellant.

53. In identifying the possible commercial advantages for the Appellant in repaying the Original Loan Agreements early, Mr Coyne reiterated his point about the need for flexible finance and the desirability of putting in place a financing and debt structure

that would conform to the Appellant's needs under new ownership. However, Mr Coyne accepted when it was put to him that this would always have been the case under the SAPA, because **GROUP B** was obliged to discharge the Original Loan Agreements prior to completion, as they were "*retained liabilities*". Mr Coyne was asked whether he considered that a tax benefit to the Appellant, such as a reduction in the stamp duty payable on the purchase of shares or, more substantially, a tax saving of some $50 million, would constitute a commercial advantage; he stated that it certainly would.

54. Mr Coyne was asked to comment on whether, having opted to keep the debt under the Original Loan Agreements in place post-acquisition, it made commercial sense in the context of interest calculations to repay early. He stated that he had not been asked to consider this and it was outside his area of expertise. He therefore could not contradict expert evidence proffered by the Respondent to the effect that, when one added up the cost of $385 million associated with early repayment and the interest due on the replacement **GROUP A** finance, the effective rate of interest of refinancing was 11.5%. He opined, however, that if this was the rate, **GROUP A** and the board of the Appellant probably considered that it was a price worth paying for more flexible finance.

55. The Respondent called Dr Desmond Fitzgerald, an expert in corporate finance, to give evidence on two related questions, namely (a) the equivalent rate of interest that applied as a consequence of the decision to refinance, and (b) the commercial rationale for the Appellant making early repayment after completion. In so doing, Dr Fitzgerald had reference to the acquisition documents referred to in the earlier part of this Determination and the Original Loan Agreements.

56. Dr Fitzgerald agreed with Mr Coyne that it would be very unusual for an acquired company to maintain borrowings with an entity that was part of the group to which it formerly belonged. However, he had doubts about whether the reasons given by the Appellant for the decision to retain the debt under the Original Loan Agreements and then repay early stood up to scrutiny. By his analysis, the Appellant's suggestion that re-financing resulted in lower interest payments required one to disregard the break

cost associated with availing of the early repayment option under Section 2.02 of the Original Loan Agreements. This, in his view, had to be added to the rate of interest attached to the finance provided by **GROUP A**. By his calculations, the cost of paying the additional $385 million equated to an interest rate on the Original Loan Agreements of 5.13% (4.77% in present value terms), plus an equivalent fixed rate of 6.38% per annum (being the fair fixed rate swapped for USD 6-month LIBOR plus 484 basis points) on the new finance from **GROUP A**. The result was an effective annual interest cost of approximately 11.5%, which was substantially higher than the blended rate under the Original Loan Agreements of 6.81%.

57. These calculations were challenged vigorously in cross-examination by Counsel for the Appellant, and it emerged therefrom that Dr Fitzgerald's estimate of an equivalent fixed rate of 6.38% was calculated on the basis that the replacement **GROUP A** loans were repayable over a period of ten years, rather than the actual term of three years. The Appellant did not call its own expert evidence on this issue and there was therefore some lack of clarity as to what the equivalent fixed term interest rate was taking account of this fact. What was not in doubt, however, was that regardless of the exact equivalent fixed rate on the **GROUP A** loans, this interest and the interest equivalent to the break cost of $385 million amounted in the aggregate to a rate that was in excess of the 6.81% blended rate payable under the Original Loan Agreements.

58. As regards the Appellant's contention that the early payment of the Original Loan Agreements had resulted in a reduction in the principal payable, Dr Fitzgerald pointed out that the sum actually paid, $1.3 billion, was substantially greater than the principal owed of $988 million. He accepted that the formula for repayment that was employed under Section 2.02 of the Original Loan Agreements was based on calculating the present value at the time of repayment of the principal sought to be repaid and the interest thereon. This, however, did not alter the net effect, which was that early repayment required not only the settlement of the full principal borrowed, but also the sum over and above that representing a penalty.

59. Dr Fitzgerald did agree with Counsel for the Appellant that the terms of the Original Loan Agreements were onerous, and that finance which was over a shorter term, on

a floating rate and, most of all, had no early repayment clause similar to Section 2.02, was more flexible in its terms. It was put to Dr Fitzgerald by Counsel for the Appellant that in providing his written report, he had failed to account for the fact that by the time of the hearing, the **GROUP A** borrowing had been paid down to approximately $200 million. This would not have been possible under the Original Loan Agreements without incurring additional costs. The rapid repayment of the loan demonstrated the reality of its flexibility.

60. Counsel for the Appellant also put it to Dr Fitzgerald that his analysis had not taken into account the fact that it was always intended that the **GROUP A** debt representing the $385 million would be converted into equity in the Appellant. Dr Fitzgerald did not accept that this had a material impact on his calculations regarding interest. In his view, giving equity for finance did not constitute free money.

61. Dr Fitzgerald made the point that repayment of the loan by way of the escrow transaction had no substantive impact on the agreement concluded in April 20██. This was because the arms-length price agreed between the parties for the purchase of the Appellant was reduced by the exact amount required to repay early. As he put it in his expert report:-

> *"…the early repayment of the loans made no difference to the total price* **GROUP B** *received for* **THE APPELLANT***, and hence the total transaction was economically neutral."*

62. Dr Fitzgerald further observed that if **GROUP A** had managed to persuade **GROUP B** to forego the additional cost of repayment of $385 million over the principal, it would have made no difference to either party in circumstances where the reduction in the purchase price of $2.6 billion paid for the Appellant on 30 November 20██ would have been correspondingly less.

63. Dr Fitzgerald further went on to say that, in light of the terms of the agreement reached in April 20██ regarding the retention of liability for the Original Loan Agreements:-

> "*It seems clear to me it was always intended that payment of the early redemption charges would form part of the* **APPELLANT** *purchase transaction. In my view, any logical analysis of the transaction was consistent with the early repayment of the* **APPELLANT** *intra-company loans as a condition of acquisition by* **GROUP A***".*

64. It was put to Dr Fitzgerald that, although he was an expert in finance, he was not one in mergers and acquisitions. Dr Fitzgerald accepted that it was not within his expertise to judge whether any commercial benefit to the Appellant was worth the cost of repaying early. That was something for those involved in the business to determine.

65. The Appellant's financial statements for the ██-month period ended 31 December 20██, which were audited by KPMG, recorded the $1.3 billion payment made pursuant to the escrow transaction. The profit and loss account therein recorded "*Interest Payable and Similar Charges*" of some $599 million. Note █ in the financial statements gave further details in this regard. $72 million was interest payable to group undertakings, being the interest payable in respect of the replacement **GROUP A** group finance. The other $518 million (being the figure received by **GROUP A** from **GROUP B** as the amount paid in respect of the present value of the interest payable under the Original Loan Agreements) was recognised as an "*interest payment on early loan redemption*". Note █ further recorded the sum of $132 million received as being a "*gain on early loan redemption*". This figure represented the difference between the principal of $988 million due on foot of the Original Loan Agreements and the amount reduced to its present value on early repayment, namely $855 million.

66. I heard expert evidence from Professor Ciarán Ó hÓgartaigh, then Professor and Chair of Accounting in UCD, on whether the accounting treatment of the $518 million gave a "*true and fair view*" of the transaction as a whole. This related specifically to whether under Irish Generally Accepted Accounting Principles (Irish GAAP) it should have been represented as an interest expense or a net loss on the redemption of the loans in 20██. In answering this, Professor Ó hÓgartaigh, who was called by the Respondent, said he had regard to the relevant Irish and international accounting standards, namely FRS 5: Reporting the Substance of Transactions, IAS 1:

Presentation of Financial Statements, FRS 25: Financial Instruments: Disclosure and Presentation, and IAS 32: Financial Instruments: Disclosure and Presentation.

67. Professor Ó hÓgartaigh's view was that the expense incurred was not one arising from the Appellant's borrowings during the relevant period. Rather, the event to which it should have been "matched" under the principles of accrued accounting was the event that created it. This, he said, was the termination of the loan. Interest could not be due on a loan which did not exist.

68. Professor Ó hÓgartaigh took issue with the "*bifurcation*" in the financial statements of the aggregate sum of $1.3 billion between the gain of $132 million on the part representing present value principal, and the cost of $518 million representing present value interest. In so doing, he referred to paragraph 14 of FRS 5, which then provided:-

> "*A reporting entity's financial statements should report the substance of the transactions into which it has entered. In determining the substance of the transaction, all its aspects and implications should be identified and greater weight given to those more likely to have a commercial effect in practice. A group or series of transactions that achieves or is designed to achieve an overall commercial effect should be viewed as a whole*."

69. Professor Ó hÓgartaigh said that the substantive effect of opting to repay early was that the Appellant incurred a cost of $385 million, being the sum required to be paid on top of the principal amount. Dividing the loan into the gain made on one part of the repayment formula in Section 2.02 on the one hand against the loss made on the other did not, in his view, reflect its real impact on the Appellant's finances.

70. Professor Ó hÓgartaigh testified that the conditions were met for "*netting off*" the gain made in relation to the reduction in principal and the cost of paying the present value amount of future interest payments. In this regard he pointed to paragraph 42 of FRS 25, which then provided:-

> "*A financial asset and a financial liability shall be offset and the net amount presented in the balance sheet when, and only when, an entity:*

(a) currently had a legally enforceable right to set off the recognised amounts; and

(b) intends to settle on a net basis, or to realise the asset and settle the liability simultaneously."

71. In his view, the criteria set out at (a) and (b) above were met in relation to the payment made to bring about the early repayment of the Original Loan Agreements.

72. Professor Ó hÓgartaigh further observed that correspondence of 21 February 20██ from the lender, **COMPANY B2**, to the Appellant recorded that the former had treated the payment in precisely the manner he suggested was appropriate. This correspondence stated:-

"**GROUP B** *received USD 1,373,810,835 in full and final discharge of the Senior Loan Agreement and Subordinated Loan Agreement that was assigned to* **THE APPELLANT** *on 31 October 2011.*

GROUP B *applied the settlement payment received from* **THE APPELLANT** *against the undiscounted full loan principal amount then outstanding between the* **GROUP B** *affiliates in the amount of USD 988,210,845 and included the remaining balance in income as termination/lieu of interest payment in the amount of USD 385,599,990."*

73. In Professor Ó hÓgartaigh's opinion, the correct accounting treatment from the Appellant's perspective was the mirror image of this, namely the recording of a net cost on early loan repayment of $385 million.

74. The Appellant did not call expert evidence regarding the accounting treatment of the early repayment of the Original Loan Agreement but challenged Professor Ó hÓgartaigh's evidence vigorously in cross-examination. The central criticism made was that his analysis took no account of the actual terms of the Original Loan Agreements, which expressly split the amount to be paid for early redemption between a reduced principal and a reduced sum corresponding to future interest payments. It was also put to him that in documents other than that of 21 February 20██, **GROUP B** had split the repayment figure in the same manner that the Appellant

had. In this regard, an email of 23 May 20██ from a **GROUP B** employee to **GROUP A** employees attached an account statement drawn up on 3 December 20██ that listed each future interest payment calculated at its presented value, which together comprised this portion of the $1.3 billion. The email stated:-

> *"For the purpose of calculating the total settlement amount the NPV comprised:*
>
> *Principal USD 831,249,428.98*
>
> *Interest USD 542,551,405.92*
>
> *Total USD 1,373,810,834.90"*

75. It is appropriate to record that the above figures presented by the **GROUP B** employee in the email were in fact in error but nothing turns on this.

76. On 14 June 20██, the Appellant wrote to the Respondent seeking confirmation that the expense it incurred attributable to the present value of the interest on the pre-paid principal was deductible as a Case I expense. A detailed explanation as to the reasons for early repayment and the deductibility of the expense in law was provided in this correspondence. The submissions made therein are described in the part of this Determination covering the Appellant's submissions.

77. There followed further correspondence in which the Appellant stressed that the reason for early repayment was to obtain finance at a cheaper rate of interest and, most of all, to rid itself of borrowing from another commercial entity. A meeting occurred between representatives of the Appellant and the Respondent on this issue on 9 October 20██ and, on 1 November 20██, the Respondent wrote to **GROUP A** stating as follows:-

> *"Having considered all documentation and information received at the meeting, we are of the opinion that we have not been provided with enough evidence and/or documentation to satisfy ourselves that the €517m "interest" claimed as a deduction by* **THE APPELLANT** *is an allowable expense for Corporation Tax purposes.*
>
> *The reasons are as follows:*

- *Revenue has not been furnished with a copy of the official correspondence from* **GROUP B** *to* **THE APPELLANT**, *confirming the repayment of the loan and payment of "interest" amounting to €517m*.
- *If* **GROUP B** *did not sell* **THE APPELLANT**, *then* **THE APPELLANT** *would not have redeemed the loan with* **GROUP B**. *The reason for redeeming the loan was not to benefit* **THE APPELLANT'S** *trade, but as a result of* **GROUP A** *purchasing* **THE APPELLANT** *from* **GROUP B**; **GROUP A** *did not want* **THE APPELLANT** *(and* **GROUP A**) *to have a third party loan as you confirmed at the meeting. In effect* **THE APPELLANT** *merely replaced an existing loan with another loan, and in doing so, incurred a lump sum payment because of an early redemption clause in the original agreement with* **GROUP B**.
- *It has been confirmed that there were no negotiations or discussions on the payment of €517 million "interest" that was charged because of the early redemption of the loan. Therefore, there is no documentation available to suggest that* **THE APPELLANT** *had any involvement in the redemption of the loan and the payment of the interest. Can you confirm that this is the case and that the terms of the loan repayment were not addressed in any other agreement with* **GROUP B**.
- *Calculations giving details of savings that* **THE APPELLANT** *would make by paying €517 million "interest" to* **GROUP B** *(for periods 20██ to 2021 inclusive) and paying the interest on the new* **GROUP A** *loans, set against the interest that was due to be paid (to* **GROUP B**) *for periods 20██ to 2021 inclusive, have not been presented. It has not been demonstrated that it is economically more efficient for* **THE APPELLANT** *to redeem the* **GROUP B** *loan, pay €517 million "interest" and pay interest on the replacement loan from* **GROUP A**.
- *The capital balance of €988,277,471 was refinanced in total as confirmed by a copy of loan agreement, which has been provided, between* **COMPANY A4** *and* **THE APPELLANT** *and also by the extract provided from the Written Resolution of the directors of* **THE APPELLANT** *in relation to the refinancing of the loan.*

- *The case law quoted in your correspondence of 14 June 20██ does not relate to this situation as* **GROUP A** *and not* **THE APPELLANT** *decided to redeem the loan.*

In the absence of further documentation addressing these points, I will have to disallow the claim for deduction of €517m in the Corporation Tax computation."

78. **GROUP A** responded by letter dated 21 November 20██, which stated *inter alia*:-

"I note your comment that if **GROUP B** *had not sold* **THE APPELLANT***, then the loan would not have been redeemed. This is speculation, and not relevant when considering the rationale behind the decision of the new board of directors of* **THE APPELLANT** *to redeem the original loans. Following the sale of* **THE APPELLANT***, it was decided by the board of directors of* **THE APPELLANT** *that having a substantial loan outstanding to a non-banking third-party would be detrimental to the future trading activities of* **THE APPELLANT***. Written resolutions were then put in place by the directors stating that they wished to refinance the debt in the best interest of the company. As already stated, this decision was taken for the ultimate benefit of the trade of* **THE APPELLANT***.*

Please note that at all times in relation to this loan redemption, the board of **THE APPELLANT** *had the primary decision-making responsibilities as evidenced by the company resolutions. Extracts of the resolutions were provided to* ██████████ *in my email of 30 August 20██.*

As a contractual arrangement was in place, by way of the loan arrangements, to cover the early redemption of the borrowings, the parties did not engage in discussions in relation to the terms of repayment. In addition, consent was not required from **GROUP B** *to redeem the debt early. It is clear from the written resolutions of the* **APPELLANT'S** *board of directors that the ultimate decision to refinance the debt was made by them, in the best interests of the company. To the best of our knowledge, the terms of the loan redemption were not addressed in any other agreement with* **GROUP B***.*

I note your comments around the economic efficiency of the loan redemption. While the loan was refinanced on better commercial terms (i.e. lower interest rate) it is unlikely that the total interest paid on early redemption plus the new lower interest rate payable will give rise to any pure monetary savings in the short term. However for cash flow purposes going forward, the refinancing will result in lower interest payments being made by **THE APPELLANT** *on an annual basis due to the lower interest rate on the new debt. The refinancing also provides greater flexibility with regards to the repayment of some or all of the new facility (i.e. no adverse early repayment terms). It should be noted that in determining whether a decision in relation to a company is made for the benefit of its trade, there are many factors that are taken into consideration in addition to the pure monetary savings. For example, a critical commercial aspect would be the increased flexibility which inter-group lending affords a business as opposed to being governed by rigid external third party borrowings, particularly those borrowings from a non-banking third party. It also does not make commercial sense from a group perspective to pay a higher rate of interest to a third party entity where it is possible to pay a lower rate of interest to a* **GROUP A-***related entity."*

79. After further communication between the parties on the question of the deductibility of the relevant part of the payment, the Respondent wrote on 10 July 20█ to indicate that it was refusing to allow the deduction and would issue an amended assessment. In this regard it stated:-

"*The purchase price allocation schedule dated 21st April 20█ shows preliminary purchase price for* **THE APPELLANT** *$2,625,000,000. The purchase price allocation schedule at 31/12/█ shows the purchase price at $1,289,450,287.*

The difference in price represents the repayment of the loan and the interest plus the adjustment for working capital. It is accepted that the loan was repaid to **GROUP B** *with interest of $385,599,990; however it appears that subsequently the value of shares in* **THE APPELLANT** *was discounted to reflect this repayment.*

Under section 81(4)(2)(a) Consolidated Taxes Acts 1997- 'no sum shall be deducted in respect of any disbursement or expenses, not being wholly and exclusively laid out or expended for the purposes of the trade'.

There appears to be a duality of purpose to the payment in that it was not solely related to the funding of the Irish company but also in relation to facilitating the change of ownership.

Given that the board of **THE APPELLANT** *have been unable to present supporting documentation regarding the decision to repay the loan and that the series of transactions did not have an overall economic effect on* **THE APPELLANT***, I do not consider that the interest charge in the accounts for one month ended 31/12/█ of $385,599,990 was wholly and exclusively expended for the purposes of the trade of* **THE APPELLANT** *and I intend to disallow it as a deduction, as a Case 1 expense, for Corporation Tax Purposes."*

80. A notice of amended assessment was issued by the Respondent on 25 July 20█ assessing the Appellant as having an additional liability to corporation tax, which was duly appealed by the Appellant.

C. Legislation

81. Section 81 of TCA 1997 sets out the general rules as to deductions under Case I and II of TCA 1997. This case turns on the proper interpretation and application of subparagraphs (a) and (f) of subsection 2, which provide as follows:-

(2) Subject to the Tax Acts, in computing the amount of the profits or gains to be charged to tax under Case I or II of Schedule D, no sum shall be deducted in respect of—

(a) any disbursement or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade or profession;

…

(f) any capital withdrawn from, or any sum employed or intended to be employed as capital in, the trade or profession;"

D. <u>Submissions of the Appellant</u>

82. The Appellant submitted that the sum of $518 million paid by the Appellant was an interest payment in nature which, as with payments made in respect of interest due under the Original Loan Agreements, was made "*wholly and exclusively*" for the purposes of the Appellant's trade. Consequently, it was deductible under section 81 of TCA 1997.

83. In this regard, Counsel for the Appellant drew my attention to the listing of the characteristics of 'interest' given by the Court of Appeal in ***Pike –v- Revenue and Customs Commissioners* [2014] STC 2549**:-

"*First, it is calculated by reference to an underlying debt. Second, it is a payment made according to time, by way of compensation for the use of money. Third, the sum payable accrues from day to day or at other periodic intervals. Fourth, whilst the payment so accrues, it does not, in order for it to be interest, have to be paid at any intervals: it is possible for interest not to become payable until the principal becomes payable... Fifth, what the payment is called is not determinative; the question must always be one as to its true nature. Sixth, the fact that an interest payment may be aggregated with a payment of a different nature does not "denature" the interest payment…"*

84. The Appellant submitted that the expenditure of $518 million had all of these characteristics. The amount of interest was calculated by reference to the principal amount owed under the Original Loan Agreements, to be paid for the use of these sums over a period of ten years. If the Appellant wished to terminate the loans it had the option to do so, but was required to settle the remaining interest reduced to its present value. Although terms like "*premium*" and "*early repayment penalty*" were

used in some documents, these descriptions did not preclude the payment from being interest.

85. In support of the "*wholly and exclusively*" argument, the Appellant referred me to ***Vodafone –v- Shaw* [1997] STC 734,** a judgment of the Court of Appeal of England and Wales. In that case, a company called Racal had entered into an agreement with another company, Millicom, for the provision of technological know-how relating to cellular mobile networks. In return for this, Millicom received a minority share in Vodafone, the company set up to operate the mobile network, and a share of its profits for a period of fifteen years. In due course it became apparent to Racal that the technology Millicom had to offer could be obtained from elsewhere at lower cost. Consequently, Racal bought Millicom's shares in Vodafone and extinguished its obligation to share profits for the sum of £30 million. One of the questions that arose was whether this was a payment laid out wholly and exclusively for the purposes of Vodafone's trade.

86. Millet LJ (with whom Hirst LJ and Sir John Balcombe agreed) provided the following summary of the principles relevant to this question:-

> *"The leading modern cases on the application of the exclusively test are Mallalieu v Drummond (Inspector of Taxes) [1983] STC 665, [1983] 2 AC 861 and 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 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."

87. Counsel for the Appellant argued that when assessing whether money was expended wholly and exclusively for the purposes of a trade, one must ask what was the object of the expenditure. This is not be confused with the question of who benefits. This, he submitted, was consistent with the following passage at page 743 of Millet LJ's judgment in ***Vodafone***:-

"*…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."*

88. It was submitted by Counsel for the Appellant that the object of the Appellant's decision to repay early was simply to repay one trading loan and replace it with

another trading loan. In his submission, this object was not to be confused with the context in which it occurred, namely the sale of the Appellant to **GROUP A** as part of its acquisition of **GROUP B**'s global [redacted] business.

89. There were, he submitted, clear commercial benefits to repayment, and refinancing was the obvious business decision. The Appellant accepted that there was no "pure monetary saving" arising from it. The key benefit was that **GROUP B** intra-group financing provided greater flexibility compared with financing obtained from a third party, especially a non-banking third party. It was not plausible that the Appellant would want to maintain the original loan agreements given that a **GROUP B** company was the lender. This, he submitted, was something that was agreed by both the expert for the Respondent, Dr Fitzgerald, and that for the Appellant, Dr Coyne.

90. Any conceivable attraction to the proposition of keeping the Original Loan Agreements in place was eliminated by their onerous terms, including the terms regarding early repayment. In addition, the refinancing resulted in lower payments of interest on an annual basis, which helped the Appellant in terms of its cashflow. As **WITNESS 1** had put it, refinancing involved a "*short term hit*" but longer term gain. In this respect, both she and **WITNESS 2** had given evidence that there were plans to grow the Appellant's business. An important part of these plans was ridding the Appellant of the borrowing. The initial evidence of Dr Fitzgerald had been that the transaction made little economic sense because the rate of interest equivalent to paying off the Original Loan Agreements early and taking out the new **GROUP A** finance was 11.5%. This was much higher than the blended rate of 6.81% that applied in respect of the Original Loan Agreements themselves. However, the Appellant submitted that this had been shown in evidence be a flawed estimate, in circumstances where Dr Fitzgerald had assumed the term of expiry of the replacement finance would be 2021, which was not the case. Rather, the Appellant was able to deal with €385 million net cost of repaying early through the promissory note provided to the Appellant.

91. Counsel for the Appellant further pointed to the evidence of **WITNESS 1** and **WITNESS 2** that they had been advised that the early repayment bore commercial

benefits and had reached the conclusion that doing so was in the best interests of the trade of the company. In this respect, among the benefits they had in their minds was a reduction in the combined principal to be repaid from $988 million to $855 million.

92. It was submitted that, while **GROUP A** had renegotiated the basis on which the Appellant was to be acquired with **GROUP B**, the decision to authorise payment of the funds to repay the Original Loan Agreements was that of the Appellant. This had been done by way of board resolution. Had it been felt that the decision was not in the interests of the trade of the Appellant, the directors would not have resolved as they did. The effect of such a course of action would have been that **GROUP A** would have acquired the Appellant with the loans in place.

93. The timing of the resolution was not a critical factor according to the Appellant. While it had occurred in the immediate aftermath of the acquisition, this was the earliest point at which it could have been made by the new board. Their decision to so resolve had evolved prior to their appointment.

94. Summarising its argument in its written submission, the Appellant stated:-

> *"The change of ownership event could have been achieved with the debt left in situ until its maturity. However, the trade benefits outlined above could not have been achieved by* **THE APPELLANT** *unless the debt was repaid, triggering the lump sum interest expense. Therefore, the purpose of impairing the interest expense was not to facilitate the change of ownership, albeit both events occurred within a closed time frame, as the decision had been taken to refinance the debt at the earliest possible opportunity."*

95. The Appellant did not accept that the early repayment amounted to consideration for the purchase of its shares by **GROUP A**. Counsel for the Appellant sought to distinguish the cases relied on by the Respondent in this context such as ***James Snook & Co Ltd –v- Blasdale (HM Inspector of Taxes)*** **[1952] 33 TC 244** and ***Parnalls Solicitors –v- Revenue and Customs Commissioners*** **[2010] SFTD 284**. In both these cases, the taxpayer had sought to deduct sums expended for the purpose of extinguishing existing obligations. In ***Snook***, an agreement for the sale of shares of

the appellant company provided that the purchaser would procure the company to pay compensation for loss of office to the directors and the auditor who, under the agreement, were to resign. Similarly in ***Parnalls Solicitors****,* the purchaser sought to deduct an expense incurred in ending an obligation to pay an annuity to a former partner in a solicitor's firm.

96. The critical distinguishing feature, according to the Appellant, was that in both of these cases the taxpayer entered into new obligations to deal with an onerous revenue liability. This indicated that expenditure was not for the purposes of the taxpayer's trade, but rather to facilitate completion of its acquisition. This was not the position with regard to the Appellant. The requirement under Section 2.02 of the Original Loan Agreements to pay an additional sum over the principal on early repayment was in existence well before the purchase occurred. It was not a term reached as part of the purchase agreement.

97. Counsel for the Appellant also submitted that the expenditure was a revenue expense, and not capital in nature. He pointed out that the interest payments under the Original Loan Agreements had been an allowed deduction by the Respondent. Moreover, not long before the acquisition, the Respondent had confirmed that these interest payments would continue to be deductible subsequent to the Appellant becoming a **GROUP A** company.

98. The Appellant also referred me to ***Vodafone –v- Shaw*** in the context of the capital/revenue question. It was submitted that the decision was authority for the proposition that the nature of an interest payment as revenue expenditure should not be altered because it arises on the calculation of an existing obligation. In giving the Court of Appeal's judgment, Millett J stated in relation to this question:-

> *"There is no single test or infallible criterion for distinguishing between capital and revenue payments (see* Van den Berghs Ltd v Clark *(*Inspector of Taxes*)* [1935] AC *431 at 438, 19 TC 390 at 428-429 Lord Macmillan,* Comr of Income Tax v Nchanga Consolidated Copper Mine Ltd [1964] AC 948 at 959 *per Lord Radcliffe and* Regent Oil Co Ltd v Strick *(*Inspector of Taxes) [1966] *AC 295 at 313, 43 TC 1 at 29 per Lord Reid). On the contrary, there are many factors which tend in one direction or the*

other, some of which are more relevant in some situations and some in others. Some factors are particularly relevant when the question arises on an acquisition and others are of particular relevance when the question arises on a disposal, as it does in the present case.

Two matters are of particular importance: the nature of the payment, and the nature of the advantage obtained by the payment. The fact that the payment is a lump sum payment is relevant but not determinative. In a case such as the present, where the payment is made in order to get rid of a liability, a useful starting point is to inquire into the nature of the liability which is brought to an end by the payment. Where a lump sum payment is made in order to commute or extinguish a contractual obligation to make recurring revenue payments then the payment is prima facie a revenue payment."

99. The Appellant understandably laid emphasis on the second paragraph of the above passage. It submitted that the effect of the lump sum expense incurred by the Appellant was to extinguish its obligation to make future recurring tax deductible interest payments. This was, it said, exactly what happened in ***Vodafone –v- Shaw*** and consequently the expense should be considered revenue in nature.

100. The Appellant submitted that the sum sought to be deducted amounted to interest paid in a lump sum. It was not in dispute that interest payments are revenue and not capital expenditure. In support of this contention, the Appellant cited ***Garett Paul Curran –v- HMRC* [2012] UKFTT 517**, a decision of the UK First Tier Tax Tribunal, in which it was found that the prepayment of a loan did not affect the taxpayer's right to claim a deduction for the expense in the year of payment, provided that the loan was taken out for an allowable purpose. In that case, the appellant had taken out a series of loans, each with a thirty year term, and then proceeded, with the lender's agreement, to prepay the interest due over the entire term. The Tribunal found that even though it had been prepaid as a lump sum, it retained its character as interest.

101. The Appellant submitted that the use of the term "*early repayment charge*" in respect of the $398 million in documents such as the Ernst & Young

Report was to signify the net extra cost of the formula that applied to early repayment of the loan notes. This did not, however, change the nature of the formula set out in Section 2.02 of the Original Loan Agreements, which it said should determine how it should be characterised. It was submitted by the Appellant that just because there was a net cost did not mean that the different elements of the early repayment formula should have the same tax consequences. The latter part was allowable as a deduction because it was interest, which was paid up-front.

102. The Appellant submitted that in order to find for the Respondent, I would have to ignore the contents of the Appellant's audited accounts. The $1.3 billion paid in respect of the early redemption of the Original Loan Agreements was accurately represented in its Financial Statements for 20[redacted] having regard to the terms of Section 2.02 therein. The bifurcation of the sum between present value principal and interest reflected the formula arrived at by the Appellant and the **GROUP B** lender. Agreement in this regard was reached well before the prospect of **GROUP A** purchasing the Appellant came into view.

103. The Appellant said that in calling into question the accounting treatment of the sum, the Respondent was seeking to go behind accounts that had been audited by a prestigious firm. As Counsel for the Appellant put it in oral submissions, if the Respondent wished to take on the "*weighty task of launching a frontal attack*" on the Appellant's financial statements, it was incumbent on it at a minimum to call the expert evidence of an auditor. This it had not done. Without calling into question the expertise in his own field of Professor Ó hÓgartaigh, called by the Respondent to give accounting evidence, the Appellant submitted that he was not an expert in auditing and by his own admission had not participated in an audit for many years. It was submitted that it was not for the Appellant to call evidence proving the accuracy of accounts which it had ensured were audited. The burden rested with the Respondent in this context.

E. Submissions of the Respondent

104. The Respondent argued that the whole expense incurred by the Appellant was not an allowable deduction for two reasons. Firstly, it was not an expense "*wholly and exclusively*" incurred for the purposes of the Appellant's trade. Secondly, the expense was a capital expense, rather than a revenue expense, as section 81 of the TCA 1997 required it to be. Lastly, the Respondent argued that even if it was wrong in arguing that no deduction could be claimed, the correct figure for deduction would be $385 million rather than the $517 million claimed by the Appellant.

Wholly and exclusively for the purpose of the Appellant's trade

105. The Respondent submitted that the evidence clearly showed that the purpose of the payment was to facilitate and give effect to the sale by **GROUP B** of the Appellant to **GROUP A** pursuant to the SAPA in April 2012. Such an expense was not one laid out for the purpose of the Appellant's trade in ██████ products. Moreover, even if it could be shown that it was partially laid out for the purpose of the Appellant's trade, the use of the word "*exclusively*" meant that any duality of purpose excluded the allowance of the deduction.

106. The Respondent challenged the core premise of the Appellant's appeal, namely that the decision to enter into the agreement of 30 November 20██ was a commercial decision taken independently by the directors of the Appellant for the benefit of its trade. The Respondent submitted that the evidence showed that the repayment of the loan by **GROUP A** and the subsequent re-financing was not in fact motivated by the desire to put in place financing that was on better terms and more suited to the Appellant's commercial needs. The reality, according to the Respondent, was that it always was a term of the SAPA that the Appellant would transfer over to **GROUP A** debt free. The original consideration for the Appellant's shares, agreed at arms-length, was $2.6 billion on the basis that it would transfer over debt free. While the parties agreed late in the day that the transfer would occur with the debt still in place, this decision had no net effect. The only consequence of the escrow transaction was that the parties decided to swap part of the consideration due in respect of shares of

a debt-free company for the payment by **GROUP A** of the Appellant's debts to **COMPANY B2**.

107. To illustrate and support this contention regarding what it said was the true position, the Respondent drew my attention to various documents relating to the purchase of the Appellant. Firstly, the Respondent referred me to Clause 2.6 of the SAPA, whereby **GROUP B** undertook, at its sole cost and expense, to assume liability for discharging "Retained Liabilities" prior to the closing of the transaction. As stated above, these liabilities were defined in the disclosure letter as including the senior and subordinated loan agreements.

108. Next, the Respondent pointed to the terms of the letter of 30 November 20■■, which was stated expressly to be for the purpose of "*supplementing*" and "*implementing*" the SAPA agreed some five months earlier. It was, according to the Respondent, a document that completed the transaction already agreed. It could not be taken as having replaced it.

109. To further underline that the SAPA and the escrow transaction were all part of "the one deal", the Respondent pointed to the post-closing document drafted by **GROUP A** entitled "*Sale of* ■■■■■■■■ *Business – Summary of Purchase Price Allocation*". This specified that of the overall purchase price for **GROUP B**'s ■■■■■■■■ business of $■■ billion, $1,251,189,165 was for the purchase of the Appellant's shares and $1,373,810,835 was for the payment of the "loan".

110. The Respondent further pointed to the Escrow Agreement itself, the terms of which detailed the precise manner in which the $1.3 billion was to be paid by **GROUP A**. It drew my attention to the recitals therein that it said evidenced a clear "*direct linkage*" between the escrow transaction and the purchase of the shares in the Appellant by **GROUP A** under the SAPA.

111. As regards the claim that the directors of the Appellant, in entering into the Escrow Agreement, were making a decision independent of the SAPA that stood to benefit the Appellant, the Respondent submitted that the terms of the agreement itself did not

suggest that there was any "discount" whatsoever on the loan. The purpose of the escrow was to "*provide for the discharge in full of all indebtedness*", which included *"pre-payment penalties and other amounts due*".

112. The Respondent further submitted that it was clear from section 4 of the Escrow Agreement that the decision was not, in reality, dependent on the resolution of the Appellant's board. This provided that it was entirely at the discretion of **GROUP B** to authorise the escrow agent to release the funds held for the purpose of paying off the loans. The mechanism for repayment of the loans by **GROUP A** did not depend on the judgment of the directors of the Appellant as to what was in the Appellant's best commercial interests.

113. The Respondent further submitted that the Appellant's suggestion that there was a commercial advantage for the Appellant turned in part on an interpretation of the prepayment clauses in the Original Loan Agreements that characterised them as giving a "discount" on the principal sums due. To look at the transaction in this way ignored its substantive effect and was artificial. The Respondent accepted that the prepayment clause included a methodology that was based on the "present value" of the principal at the time of pre-payment. This, submitted the Respondent, was merely a method of calculating the amount of the penalty payment due in addition to the principal.

114. The Respondent cited numerous authorities which, it argued, supported its submission that a disbursement for the purpose of giving effect to the purchase of the Appellant was not "for the purposes" of its trade. One of these was ***James Snook & Co –v- Blasdale***, cited above, in which the purchaser of the appellant company agreed that it would ensure that the outgoing directors would be paid compensation for their resignation upon sale. The Court of Appeal held that this did not constitute an expense deductible under the general rule. In so doing, Evershed MR explained the reasoning of the Court in the following passage of the judgment:-

"…there was the situation of the buyers, Bell & Nicolson, Ltd., and. its directors. They were concerned to get the best possible bargain for their company. Assuming, as I do, that the purchasers rightly considered it important, if they were going to get

value for what they were giving, to have the existing old-fashioned management replaced by new blood, it was essential to obtain the agreement of the existing directors of the Appellant Company to make way for other persons and that they would only be prepared to do if they received compensation.

Having stated that much, I think it is plain that the motives or purposes in this matter must have been mixed. It was, no doubt - and I accept the statement of the Commissioners and of Mr. Bell - considered advantageous, from the point of view of the Appellant Company as a trading concern, that these directors should be persuaded to retire. But the bargain was made by the shareholders of the Appellant Company with somebody who had a separate interest in the matter, namely, the concern of getting the best bargain they could for that which they were giving. In those circumstances, it seems to me that there can be no quarrel with the Commissioners when they state that, having considered all the evidence which had been given, they were not satisfied that the onus had been discharged by the Appellant Company of proving that the sum in question was "wholly and exclusively expended" for the purposes of the Appellant Company's trade.

I only add a reference to one sentence in Donovan, J's judgment. He said: "The mere circumstance that compensation to retiring directors is paid on the change of shareholding control does not of itself involve the consequence that such compensation can never be a deductible trading expense. So much is common ground. But it is essential in such cases that the Company should prove to the Commissioners' satisfaction that it considered the question of payment wholly untrammelled by the terms of the bargain its shareholders had struck with those who were to buy their shares and came to a decision to pay solely in the interests of its trade". With that sentence no one has quarrelled, and I venture to think no one could quarrel. The learned Judge came to the conclusion that the Commissioners were justified in saying that the onus which the Appellant Company had to discharge had not been discharged."

115. The Respondent also cited ***Basset Enterprises Ltd –v- Petty* [1938] 21 TC 728** for the purpose of demonstrating the importance of the word "*exclusively*". In that

case, the appellant company was controlled by near relatives of the original proprietor of its business, many of whom had contracts of employment that entitled them to wages higher than market rates. As part of the purchase agreement, the purchaser agreed to pay a sum to these relatives to terminate their contracts. After the sale, the company sought to deduct this expenditure on the grounds that the contracts were onerous and it was for its benefit that the transaction occurred. Lawrence J held:-

> *"…it is clear here that Mr. Watts undertook, as part of the arrangement for the purchase of the shares, that the compensation moneys for these service agreements should be paid by the Company of which he and his nominees were acquiring control. It follows, in my opinion, that the Company's payment was not wholly and exclusively laid out for the purposes of the Company's business, because it was really laid out on account of the obligation which had been undertaken by Mr. Watts. At any rate, the circumstances are such that they afford, in my opinion, evidence upon which the Commissioners could find that the expense of the sums paid to the members of the Bassett groups was not incurred in the interests of the Company, but was part of the share purchase transaction."*

116. The Respondent also opened ***George Peters & Co. –v- Smith* [1963] 41 TC 264**. This was a case in which the appellant company was acquired in circumstances where part of the consideration paid by the purchaser was set aside to compensate outgoing directors and employees who became redundant as a consequence of the sale. This occurred by way of a resolution passed by the board of the purchased company just prior to the completion of the sale. Wilberforce J held in relation to the Appellant's claim for a deduction of the expenditure in line with the resolution:-

> *"It may well be, although I am not convinced that this is necessarily so, that the Commissioners did not appreciate, when they made this finding, that the offer had become unconditional before the passing of the ordinary resolution. That is a fact which has been brought out by the ingenuity of Mr. Mustoe, and one would not blame the Special Commissioners if they failed to appreciate that point. But whether that is so or not, it seems to me quite unrealistic to suppose that when they did pass that ordinary resolution they did so independently of any consideration relating to the offer to purchase their shares. As has already appeared from the passages I have*

quoted, the proposal to compensate the directors - and, indeed, the figure at which the directors should be compensated - was one which had arisen at the earliest possible stage in the negotiations and was part of the terms as decided upon by Friary Meux. The decision that they should be compensated, and be compensated in the figure of £46,000, was not one which the shareholders made on 22nd January. It was one which had been made aliunde - one which had been made by Friary Meux when they decided they were going to purchase the shares. It was a decision which was made not by reference to the trading interests of Peters - although, of course, the trading interests of Peters came into the picture in so far as they were to be part of the Friary Meux group - but a decision made essentially, as I see it, in relation to the general policy of the Friary Meux group as a whole. It may be that technically the shareholders would have been free to reject the resolution put before them, although I am not sure what the consequences would have been, but I am quite satisfied - if it is necessary for me to approach the matter in such a positive way - that the shareholders when they passed this resolution were not acting in the untrammelled manner in which it has been held it would have been necessary for them to act if the compensation were to be regarded as a trading expense."

117. The Respondent submitted that there were clear similarities between facts in ***George Peters*** and this appeal. In both instances the payment in question was "*part and parcel*" of the acquisition. According to the Respondent, none of the evidence produced showed that the decision to make early repayment was one taken "for the benefit of the Appellant". Rather, it was a decision that was motivated by the terms of the deal done previously in April 20██.

118. In particular, the Respondent emphasised the significance of the requirement that the Appellant prove that the expenditure was *"wholly untrammelled by the terms of the bargain"*. In its submission, the great weight of documentary evidence pointed to the payment of the additional sum being intrinsically associated with the agreement concluded in April 20██ between **GROUP B** and **GROUP A** for the purchase of the Appellant.

119. The Respondent also relied on the passage at page 742 of ***Vodafone Cellular Ltd –v- Shaw***, cited by the Appellant, to the effect that the key question was whether the expenditure was to "*serve the trade*" rather than the taxpayer. It was submitted again that the express purpose of the board resolution was to complete the sale agreed in April 20██. The Respondent stated that if the new loans provided greater flexibility, that was a consequence of the decision to refinance rather than its object. The key question was what its objects were. It was plain that the overriding objective was the completion of the sale previously agreed, which the Respondent submitted was not an object for the purposes of its trade. To further underline this, the Respondent pointed to page 744 of the court's judgment, where Millett LJ held:-

> *"The reasoning of the Special Commissioners also contains two errors of law. It confuses the purposes of the taxpayer company's trade with benefit to the taxpayer company (i e the purpose of the payment with its effect); and it seeks to answer the question 'which company were the directors intending to benefit?' instead of 'what was the particular object which the directors were seeking to achieve?'"*

120. The Respondent said that there was in fact a dearth of evidence to prove that the directors of the Appellant had in their minds the trade purposes contended for at the hearing of the appeal. Both **WITNESS 1** and **WITNESS 2** were by their own admission reliant on the advice of others within **GROUP A** in relation to the implications of the escrow transaction.

121. The Respondent submitted that the documentary evidence showed that the decision to keep the Original Loan Agreements in place had been made prior to their appointment as directors and with little or no input on their part. **WITNESS 1** said that she was aware of the implications of the SAPA in a global sense before her appointment. However, her evidence did not suggest that she had understood how the decision stood to benefit the Appellant.

122. According to the Respondent, the evidence of Dr Fitzgerald suggested that, in any event, the escrow transaction made no sense from an economic perspective. This was so even if one took at its height the Appellant's case regarding the correct calculation of the effective rate of interest in paying off the original loans and refinancing.

123. Ultimately, however, the Respondent stressed that the crucial point was that even if I took the view that there were benefits of which the aforementioned directors were cognisant in making the resolution, it could not credibly be said that the object of the escrow transaction was "*wholly untrammelled*" by the SAPA. The documentary evidence showed that this was at very least one of the objects involved, which was fatal to the Appellant's appeal.

The letter and the Tax Briefing

124. The Respondent further submitted that in seeking to rely upon the Respondent's 2011 letter regarding the deductibility of interest and Tax Briefing Issue 37 from October of 1999, the Appellant was making a case in "*quasi-legitimate expectation".* Counsel for the Respondent submitted that such arguments could not be determined by the Tax Appeals Commission.

125. Even if these points were not viewed in this light, the Respondent submitted that they could have no impact. The 2011 letter concerned allowing the deductibility of interest payments on a loan. The interest due annually in respect of the original loans and the one-off penalty due on foot of their early repayment were, in the words of Counsel for the Respondent, "*two entirely different animals".* The Respondent made the point that the interest due on the replacement **GROUP A** facilities would be deductible for the same reason as that due on the original facilities. The 2011 letter could not be taken to govern both kinds of expenditure.

126. The Tax Briefing opened by the Appellant concerned deductions allowable in respect of income falling under Case V of Schedule D of TCA 1997, namely certain kinds of rental income. Such deductions are governed by section 97 of TCA 1997 and the Respondent submitted that they were entirely distinct from the "wholly and exclusively" test applicable to Case I and II deductions. Simply put, it had no relevance.

Capital expenditure, not revenue

127. On the question of whether the expenditure was capital or revenue, the Respondent again referred me to ***Vodafone Cellular Limited -v- Shaw****.* In addition to the passage relied upon by the Appellant, the Respondent cited the following passage from the judgment of Millet LJ:-

> "*But the principle that a payment made in order to commute or discharge a liability to make recurring revenue payments is itself a revenue payment is subject to an important qualification. If the liability to make recurring revenue payments is reduced or brought to an end by the modification or disposal of an identifiable capital asset, then any payment made for the modification or disposal is itself a capital payment.*"

128. The Respondent submitted that the payment in this instance was one to terminate capital liabilities of the Appellant in the form of the original loans. It was not, therefore, capable of being defined as a revenue payment despite the fact that the interest payments themselves met the definition of a revenue expenditure.

129. Another case cited by the Respondent in relation to this issue was a decision of the Special Commissioners of England and Wales in ***Kato Kagaku Limited –v- Revenue and Customs Commissioners*** **[2007] STC 412***.* This concerned the prepayment of a loan by a company involved in the purchasing of commercial property in London. The loan had been obtained from a Japanese bank and was repayable after ten years in sterling. In order to obtain the sterling to fund the loan, the Japanese bank had borrowed dollars and entered into a swap transaction. The loan contained a pre-payment provision that the company opted to trigger when the variable interest rate on the loan rose. The company was required under the terms of the loan however to indemnify the Japanese bank against penalties due to its swap counterparty consequent on the early repayment of the loan. Having fulfilled this obligation, the company sought to deduct the indemnification amount in computing its profits chargeable to income tax. This claimed deduction was disallowed by Revenue on the grounds that it was part of a transaction to extinguish a capital asset in the form of the loan and was thus capital expenditure, rather than revenue, that was excluded under the relevant legislation in England and Wales. This was appealed, with the company

arguing that the indemnity payment needed to be viewed separately from the repayment of the loan.

130. On appeal, the Special Commissioner agreed with the statement of Lord Goff in ***Lawson (Inspector of Taxes) –v- Johnson Matthew plc* [1992] STC 466** that the key question is whether:-

> "*…on a true analysis of the transaction, the payment is to be characterised as a payment of a capital nature. That characterisation does not depend on the motive or purpose of the taxpayer. Here it depends on the question whether the sum was paid for the disposal of a capital asset."*

131. The Respondent pointed to the Special Commissioner's finding that the payment made by the company was not, as it contended, a payment made to terminate the swap transaction that post-dated the repayment of the loan. Rather, on an objective analysis, it was expenditure to terminate a capital liability. Pre-payment could not have occurred without indemnifying the Japanese bank against the early termination penalty associated with the swap transaction.

132. By the same token, the Respondent submitted that the payment made by the Appellant was made for the termination of a capital liability. While its amount was calculated by a methodology connected to interest payments, what it was in reality was the entire repayment of the loan. This, the Respondent submitted, was supported by the evidence of Professor Ó hÓgartaigh regarding matching.

133. The Respondent also referred me to the case of ***Commissioner of Inland Revenue v New Zealand Forest Research Institute* [2000] STC 522**, a decision of the Privy Council. This concerned the acquisition by a private entity of research undertakings that were previously in the ownership of the Crown. A term of the acquisition was that the Appellant would not only take over the Crown's ongoing obligations in relation to the payment of its employees, it would also assume liability for "vested or contingent" rights that they possessed as against their former employer. Regarding the claim by the private entity to deduct the sum attributable to the vested and contingent employee rights, Lord Hoffman said:-

"…the position was that the institute, pursuant to the transfer agreement and as part of the consideration for the purchase of the assets, accepted a liability under its employment agreements with former Crown employees not merely to remunerate them for services to the institute but also to discharge obligations, either vested or contingent upon some future event, which were attributable to their previous service with the Crown. It seems to their Lordships plain that, viewed in this light, the payments were capital expenditure, being part of what was paid for the acquisition of the assets. There can be no doubt that the discharge of the vendor's liability to a third party, whether vested or contingent, can be part of the purchase price. It does not matter that the payment is not made at once but pursuant to an arrangement whereby the purchaser agrees to be substituted as debtor to the third party."

134. The Respondent submitted that the same analysis could be applied in the instant appeal. The transfer of the obligations under the loan agreements from **GROUP B** to **GROUP A** and the discharge of the same very shortly thereafter were, Counsel for the Respondent submitted, *"part and parcel of the agreement to purchase* **THE APPELLANT** *in the first place".* That it was inextricably linked to the acquisition of the assets of the Appellant was demonstrated by the original purchase price of $2.6 million and by the revised price that reduced the said purchase price by the amount corresponding to the cost of early pre-payment of the loans.

135. The final case opened by the Respondent on the question of whether the sum sought to be deducted was capital or revenue expenditure was ***Parnalls Solicitors***, cited above. The facts of the case are summarised in the headnote as follows:-

"*The taxpayer company acquired the business of a solicitors' practice (the partnership). There was no written agreement in respect of the business transfer but the taxpayer company took over all of the assets and liabilities of the business and assumed the obligation in respect of an annuity in favour of a former partner, P, and his widow. However, the annuity obligation was not included in the company's balance sheet on incorporation. The taxpayer company covenanted with P and the former partners of the partnership that it would perform the annuity obligation. The annuity was to accrue from day to day and was payable monthly. Subsequently, an agreement was reached between the taxpayer company and P (and his wife)*

whereby P and his wife would release the taxpayer company and the former partners from the obligation to pay the annuity in consideration of a lump sum payment of £1.15m. The lump sum was not paid immediately but was secured by a promissory note under which the taxpayer company and the former partners agreed to pay P and his wife the sum of £1.15m on demand with interest. The amount was credited to a loan account on which P was free to draw on demand. In the taxpayer company's accounts for the relevant year, that sum was shown as an extraordinary item deducted in computing profits. The Revenue took the view that the assumption of the annuity obligation was part of the consideration for the taxpayer company's acquisition of the partnership business. They contended that the provision made by the taxpayer company in the sum of £1.15m in respect of the lump sum payment due to P in commutation of the right of P (and his wife) to the annuity was capital in nature and therefore not an allowable deduction in computing the taxpayer company's profits chargeable to corporation tax. The taxpayer company appealed."

136. In finding that the payment of the lump sum was consideration for the purchase of the partnership business and consequently capital expenditure, the First Tier Tribunal examined, among other authorities, ***New Zealand Forest Research Institute Ltd.*** It observed that:-

"It is doubtless correct to say that both Royal Insurance Company and New Zealand Forest Research Institute Ltd were decided on their own facts. There is nevertheless a clear principle that can be derived from those cases. It is that where an obligation, whether vested or contingent, is assumed as part of the purchase price, or consideration, for the purchase of assets on a transfer of a business, payments in discharge of that obligation are capital expenditure, and not revenue expenditure. Whilst we agree with Mr Harvey that Royal Insurance Company concerned a lump sum payment, it is clear that, as New Zealand Forest Research Institute Ltd decided, the principle also extends to other obligations which, if paid by the vendor, would have been deductible revenue expenses. As Lord Hoffman remarked:-

> *'It is by no means remarkable that acceptance of liability to discharge another person's obligations to make payments in return for a capital payment or a capital asset should be a capital expense, even though the same payments if made by the original debtor would have been a revenue expense.*

In this case, their Lordships think there is no doubt that if the Crown had been a taxable entity and had itself paid the accrued staff liabilities, they would have been deductible revenue expenses. But that does not affect the conclusion that the institute's acceptance of liability to pay them was a capital expense.' "

137. The Respondent submitted that this too indicated that the expenditure should be viewed as capital rather than revenue. This was so even though the interest paid under the original loan agreements on an ongoing basis prior to the acquisition would have constituted revenue payments. The discharge of the loans by way of a lump sum was intrinsically linked to the purchase of the Appellant's shares and therefore was capital expenditure. The Appellant's argument, said the Respondent, was wholly predicated on the wording of Section 2.02 of the Original Loan Agreements. However, this could not change how it should be characterised on a true analysis of its nature.

138. The Respondent also addressed the question of whether the payment constituted interest and, as with the Appellant, did so by reference to ***Pike –v- Revenue and Customs Commissioners****.* The Respondent drew my attention to the fifth point identified therein by the Court of Appeal in its examination of the characteristics of interest payments, namely that:-

"…what the payment is called is not determinative; the question must always be one as to its true nature."

139. The Respondent submitted that the only basis for characterising the payment of $518 million as interest was the Appellant's interpretation of the wording in Section 2.02. In the Respondent's view, however, this clause simply prescribed two methods of calculating the penalty payment due on early redemption of the original loans. The second method, which applied in this instance, was based on paying the sum of the present values of the remaining principal and interest. This did not mean however that what the Appellant was doing was paying a "discounted" principal amount, along with a sum in interest that was deductible as a revenue expense. It was, submitted the Respondent, no more interest than if the first method had been used as the basis

for calculating the amount required to pre-pay – i.e. “*100 percent of the principal amount*”.

140. The fundamental factor governing how it should properly be defined was that the debt was gone upon payment. What it was not was compensation paid for the use of money. Nor was it calculated by reference to an existing debt on an ongoing basis. It could, in the Respondent’s submission, properly be described as any one of a “*repayment charge*”, “*penalty charge*”, *refinancing charge*”, “*premium*” or “*break cost*”. These were terms that the Appellant’s own advisers, Ernst & Young, had themselves used in describing it.

The accounting treatment

141. Finally, the Respondent addressed the question of the manner in which the early settlement of the loan agreements was accounted for in the Appellant’s annual accounts. In this regard it was submitted that the evidence of its own expert, Professor Ó hÓgartaigh had been clear that there was only one transaction, namely the payment of €1.3 billion to **GROUP B**. He had testified that it was not in accordance with generally accepted accounting practice to “bifurcate” the transaction between the €855 million representing the “discounted” principal and the $518 million representing the present value interest. The correct method of accounting, he said, resulted in a loss on early redemption of $385 million. Thus, the Respondent submitted that even were it found that the expense was deductible under section 81 of TCA 1997, this would be the maximum that could be deducted.

142. The Respondent challenged the Appellant’s submission that I should not look behind the accounts as they had been signed off by a prestigious and reputable firm of accountants. The Respondent said that it had called evidence as to the proper accounting treatment of the early redemption payment. The Appellant, in contrast, had provided no evidence as to the manner of the accounting treatment and the reasons for it. As in all tax appeals, the burden of proof rested with the taxpayer. The effect of the Appellant’s approach however was to sit back and attempt to reverse the burden.

F. Analysis & Findings

143. In deciding whether some or all of the amount expended on the early termination of the Original Loan Agreements is deductible under section 81 of TCA 1997, the first question is whether it was "*wholly and exclusively laid out or expended for the purpose of the trade*".

144. In considering this issue, I should state at the outset that I agree with the submissions made on behalf of the Respondent that the letter written by the Respondent to the Appellant's agents on 30 September 2011 is irrelevant to this first issue. The letter concerned the deductibility on an ongoing basis of the interest payable by the Appellant pursuant to the Original Loan Agreements, and did not address the issue of the deductibility of any sums payable on the early repayment of those loans.

145. Even if the letter had addressed the latter issue, any attempt to place reliance thereon would in effect amount to an argument based on legitimate expectation or estoppel, and such arguments fall outside the jurisdiction of the Tax Appeals Commission (see, *e.g.*, ***Kenny Lee –v- The Revenue Commissioners*** **[2021] IECA 18**). I therefore have not had regard to the contents of this letter in reaching the findings and conclusions below.

146. I further agree with the Respondent that the contents of its Tax Briefing 37 are irrelevant to my determination of this appeal. The relevant section thereof dealt with the deductibility of a fine of an additional amount of interest on the early cancellation of a loan, but did so in the context of Case V rental profits deductions. The test for deductibility in that context is materially different to the test contained in section 81, and I therefore believe that the contents of Tax Briefing 37 are not of assistance in my determination of this appeal, even by way of analogy.

147. I would also make the general statement that while the following decisions referred to in this Determination are decisions of the courts and tribunals of another jurisdiction, I am satisfied that the reasoning and principles enunciated therein are correct and are applicable to the equivalent Irish legislation for the purposes of determining this appeal.

148. Having carefully considered the judgment of the Court of Appeal in ***Vodafone –v- Shaw***, I believe that the following statements derived therefrom correctly describe the approach I ought to take in interpreting the words "*for the purposes of the trade*" as used in section 81 of TCA 1997:-

(a) "*For the purposes of the trade*" does not mean 'for the purposes of the taxpayer' or 'for the benefit of the taxpayer';

(b) In deciding whether a payment was made for the purposes of a taxpayer's trade, it is necessary to discover the taxpayer's object in making the payment, which involves an inquiry into the taxpayer's subjective intentions at the time the payment is made;

(c) The object of the payment is different to the effect of the payment, and the existence of a private benefit does not necessarily mean that the payment was not made for the purposes of the trade;

(d) The taxpayer's subjective intentions are not necessarily limited to the conscious motives in his mind at the time of the payment, but can include consequences inevitably and inextricably involved in the payment; and,

(e) The primary inquiry to be made by me is to ascertain the particular object of the taxpayer in making the payment. Once that is ascertained, I must then determine whether it was made for the purposes of the taxpayer's trade or instead for a private purpose.

149. The evidence offered on behalf of the Appellant by **WITNESS 1** and **WITNESS 2** was that there were four main objects of the Appellant in making the payment the subject matter of this appeal, all of which were for the purposes of the Appellant's trade. Those objects were:-

(a) To obtain cheaper financing by refinancing with new inter-company debt at a lower interest rate than the interest rates payable under the Original Loan Agreements;

(b) To secure a reduction of €133 million in the amount of principal due under the Original Loan Agreements;

(c) To secure more flexible financing , and in particular new financing which did not contain onerous clauses in relation to early repayment charges; and,

(d) To ensure the Appellant did not owe a debt to a third party which was not a banking or financial institution.

150. **WITNESS 1**'s evidence was that she first became aware of the proposed variation of the terms of the SAPA in or about September of 20██. She was briefed in relation to same by **MR A** and by Ernst & Young. **WITNESS 2**'s evidence was that she was briefed in relation to the proposed repayment of the original loans by **WITNESS 1** and by **MS B**.

151. I accept as correct the evidence of **WITNESS 1** that she had regard to the foregoing four reasons when she reached the conclusion that approving the resolution to repay the Original Loan Agreements was in the Appellant's best interests. I further accept as correct the evidence of **WITNESS 2** that she formed the view that she was satisfied that repayment of the Original Loan Agreements was in the best interests of the company because the replacement loans were at a lower interest rate, offered greater flexibility and, most importantly in her view, would mean that the Appellant no longer had borrowings from **GROUP B** after its sale to **GROUP A**. Their oral evidence in this regard is supported by the wording of the resolution, which recorded in Clause 2.3 that the directors resolved that the Appellant's entry into the new loan agreements to pay off the sums due on foot of the Original Loan Agreements was "*in its commercial interest*".

152. I further accept the Appellant's submission that the four reasons recited at paragraph 149 above could be considered objects which were for the purposes of the Appellant's trade. I am prepared to accept this notwithstanding that the Appellant acknowledged during the hearing that there was no pure monetary saving achieved

as a result of the refinancing, and notwithstanding the evidence given and submissions made on behalf of the Respondent that the refinancing did not make economic sense. There was a value to the Appellant in securing more flexible loan terms and, more importantly, in terminating its indebtedness to a third-party, non-banking entity.

153. However, in order for the payment made by the Appellant to be deductible pursuant to section 81, it is not sufficient for it to have been made for the purposes of the Appellant's trade; it must have been made "*wholly and exclusively*" for the purposes of the Appellant's trade. "*Wholly*" refers to the quantum of the expenditure and "*exclusively*" refers to the purpose or object of the expenditure (see ***Bentleys, Stokes & Lowless –v- Beeson*** **(1952) 33 TC 491**).

154. I agree with the Respondent that the decisions in ***Bassett Enterprise Ltd.***, ***James Snook & Co. Ltd.*** and ***George Peters & Co.*** are relevant and of assistance in my determination of this issue. Those decisions make it clear, in my view, that expenditure by a taxpayer in the context of a share purchase transaction will not be a deductible expense if it is paid in the interests of the purchase of the shares rather than in the taxpayer's interests. As the Master of the Rolls stated in ***James Snook***, approving the judgment reached by the High Court:-

> *"I only add a reference to one sentence in Donovan, J's judgment. He said: "The mere circumstance that compensation to retiring directors is paid on the change of shareholding control does not of itself involve the consequence that such compensation can never be a deductible trading expense. So much is common ground. But it is essential in such cases that the Company should prove to the Commissioners' satisfaction that it considered the question of payment wholly untrammelled by the terms of the bargain its shareholders had struck with those who were to buy their shares and came to a decision to pay solely in the interests of its trade". With that sentence no one has quarrelled, and I venture to think no one could quarrel."*

155. Similarly, in ***George Peters & Co.*** the taxpayer argued that because the purchaser's offer to acquire the taxpayer's shares had become unconditional by the

time the shareholders of the taxpayer passed a resolution to pay the compensation sought to be deducted, the expenditure could not be said to be related to the purchase of the shares and was therefore made solely in the interests of the taxpayer company. Wilberforce J rejected this argument, holding that on the evidence:-

> *"…it seems to me quite unrealistic to suppose that when they did pass that ordinary resolution they did so independently of any consideration relating to the offer to purchase their shares. As has already appeared from the passages I have quoted, the proposal to compensate the directors – and indeed the figure at which the directors should be compensated – was one which had arisen at the earliest possible stage in the negotiations and was part of the terms as decided upon by Friary Meux. The decision that they should be compensated, and be compensated in the figure of £46,000, was not one which the shareholders made on 22nd January. It was one which had been made aliunde – one which had been made by Friary Meux when they decided they were going to purchase the shares. It was a decision which was made not by reference to the trading interests of Peters – although, of course, the trading interests of Peters came into the picture in so far as they were to be part of the Friary Meux group – but a decision made essentially, as I see it, in relation to the general policy of the Friary Meux group as a whole. It may be that technically the shareholders would have been free to reject the resolution put before them, although I am not sure what the consequences would have been, but I am quite satisfied – if it is necessary for me to approach the matter in such a positive way – that the shareholders when they passed the resolution were not acting in the untrammelled manner in which it has been held it would have been necessary for them to act if the compensation were to be regarded as a trading expense. It is not necessary for me to go as far as that. It is only necessary for me to say that the Commissioners had evidence upon which they could properly find that the payment was not exclusively made for the purposes of the Company's trade."*

156. Counsel for the Appellant sought to distinguish these cases from the instant appeal on the grounds that the taxpayer in the former entered into new obligations to deal with onerous revenue liabilities. This indicated that expenditure was not for the

purposes of the taxpayer's trade, but rather to facilitate completion of its acquisition. In contrast, in the instant appeal, the requirement under Section 2.02 of the Original Loan Agreements to pay an additional sum over the principal on early repayment was in existence long before the purchase occurred, and was not a term reached as part of the purchase agreement. This distinction does not, in my view, detract from the force of the underlying statement of principle derived from the judgments.

157. Having carefully reviewed the documentary evidence before me in this appeal, it is clear that it was agreed by the terms of the SAPA entered into between **GROUP A** and **GROUP B** on 21 April 20██ that the Appellant would be acquired by **GROUP A** free from its debts under the Original Loan Agreements. This is clearly recorded in Section 2.6 of the SAPA and Section 2.6(l) of the Disclosure Letter of the same date. The Preliminary Allocation Schedule of the same date recorded that the total sum payable by **GROUP A** for the Appellant was $2.625 billion out of a total consideration for the ████ division of $████ billion.

158. The Letter Agreement executed by **GROUP B** and **GROUP A** on 30 November 20██ referred in its heading to the SAPA and was expressly stated to "*supplement the Purchase Agreement and* [set] *forth the understanding of Seller Parent and Purchaser with respect to certain matters impacting the Purchase Agreement.*" Section 3(c) of the Letter Agreement recorded the agreement of the parties to vary the SAPA in relation to the repayment of Irish debt. Instead of the Appellant being purchased free from its liabilities under the Original Loan Agreement, the parties agreed that those liabilities would remain with the Appellant; the parties would instead enter into the Escrow Agreement and **GROUP A** would deposit with the escrow agent the sum of €1,373,810,835 which would be used by **GROUP B** to discharge within two days of closing the "*Irish Payable*", being the Irish liabilities identified in Section 2.6(l) of the Disclosure Letter, "*together with any interest, prepayment penalty or other amount that may be required to be discharged in connection with the early settlement thereof.*" The Letter Agreement further recorded that as a result of the Irish Payable remaining outstanding as of the closing date, the amount payable by **GROUP A** for the shares of the Appellant was to be reduced to $1,251,189,165.

159. The '*Summary of Purchase Price Allocation Document*' produced by **GROUP A** in August 20██ recorded that the price paid by **GROUP A** for the shares in the Appellant was $1.251 billion and furthermore that **GROUP A** had paid $1.373 billion to discharge the loan.

160. I believe that the wording of the Escrow Agreement is also of relevance. The first Recital of that agreement made reference to the SAPA and the fifth Recital recorded that the parties wished "*to provide for the discharge in full of all indebtedness, including pre-payment penalties and other amounts due under such loan agreements…*" Section 4 of the Escrow Agreement provided that the escrow agent would release the sum held in escrow on receipt of a written release notice signed on behalf of **GROUP B** and distribute same in accordance with the instructions in that notice. **WITNESS 1** accepted in cross-examination that the escrow monies could be released under the Escrow Agreement irrespective of whether the Appellant resolved to refinance the Original Loan Agreements. However, Counsel for the Respondent submitted that it was clear from the payment instructions annexed to the board resolution that the monies were only going to be placed in escrow once the necessary resolutions had been passed by the Appellant.

161. I believe it is also relevant to note that the board resolutions resolved by **WITNESS 1** and **WITNESS 2** on 30 November 20██ recorded at paragraph 1 that:-

> *"**IT IS NOTED** that as a result of the acquisition of the Company by* **COMPANY A1***, it is proposed that all rights and obligations of the Company pursuant to that certain USD$ 340,980,556 Subordinated Loan Agreement dated 31 January 2011, by and between* **COMPANY B1** *and* **COMPANY B2** *and a USD$ 647,230,289 Senior Loan Agreement, dated 31 January 2011, by and between* **COMPANY B1** *and* **COMPANY B2** *(as lender) (the **Assumed Bonds**) now be refinanced (the **Refinancing**) as set out in a Restructuring Memorandum (the **Step Plan**), a copy of which is appended to these resolutions."*

162. The terms of the new loan agreements entered into by the Appellant are also of relevance in this regard. Both of the agreements recorded under "*Term/Termination*" that:-

> *"The Loan is to be provided solely in connection with the acquisition by* **COMPANY A1** *of the entire issued share capital of* **THE APPELLANT** *and the distribution business and assets of* **COMPANY B5** *(the* ***Transaction****)… If the Transaction does not complete, the Loan will immediately terminate."*

163. I also note that the 20██ Consolidated Financial Statements of **GROUP A** stated *inter alia* that:-

> *"Fair value of consideration transferred for* **THE APPELLANT** *included a CHF 1272 million* [the equivalent of $1.3 billion] *liability to the former shareholder that was immediately settled in cash."*

164. I believe it is also relevant to this issue that the evidence of **WITNESS 1** and **WITNESS 2** was to the effect that they did not themselves come up with the proposal to refinance the Original Loan Agreements. It was instead a proposal conceived of by the **GROUP A** mergers and acquisitions and tax departments and Ernst & Young who were working on the implementation and completion of the SAPA. It was communicated to **WITNESS 1** by **MR A** in September 20██. On her evidence, their discussion and consideration of the financial or economic benefits of the proposed refinancing appear to have been relatively cursory.

165. Having carefully considered the totality of the evidence, both documentary and oral, and in particular the evidence discussed in paragraphs 157 to 164 *supra*, I am satisfied and find as a material fact that the decision to discharge the Appellant's liabilities under the Original Loan Agreements, which resulted in the payment of $518 million now sought to be deducted, was made with the primary object of implementing and completing the SAPA entered into by **GROUP B** and **GROUP A** on 21 April 20██, as amended by the Agreement Letter of 30 November 20██. Put more simply, completion of the global purchase agreement was not merely the context in which the decision to refinance was reached; instead, the repayment of the Appellant's liabilities pursuant to the Original Loan Agreements was, as the

Respondent described it, part and parcel of the agreement reached between **GROUP B** and **GROUP A** for the sale of the former's [redacted] business.

166. While I accept that the four other reasons listed in paragraph 149 may have formed part of the rationale for the decision to refinance the Appellant's borrowings, rather than being mere incidental benefits or consequences of the decision, and further accept that they could be considered objects for the purposes of the Appellant's trade, I find as a material fact that they were secondary to the primary object of the decision.

167. I therefore find, to use the wording of Donovan J in ***James Snook & Co.***, that the Appellant has not proved to my satisfaction that it considered the decision to refinance the Original Loan Agreements wholly untrammelled by the terms of the agreement made between **GROUP B** and **GROUP A** for the sale of the former's [redacted] business.

168. I therefore find that the payment of $518 million made by the Appellant was not wholly and exclusively laid out for the purposes of the Appellant's trade, and therefore it cannot be deducted by virtue of the provisions of section 81(2)(a) of TCA 1997.

169. While the foregoing finding makes it strictly unnecessary for me to consider the other arguments advanced by the parties, I believe that it is appropriate for me to reach a decision in relation to same for the sake of completeness.

170. In relation to the issue of whether the payment was capital or revenue in nature, I agree with the parties that the following statements of principle derived from ***Vodafone –v- Shaw*** are relevant and of assistance:-

- **(a)** Whether a payment is a capital or revenue payment is a question of law;
- **(b)** There is no single test or infallible criterion for distinguishing between capital and revenue payments;
- **(c)** Two matters are of particular importance: the nature of the payment, and the nature of the advantage obtained by the payment. The fact that the payment is a lump sum payment is relevant but not determinative;

(d) Where a payment is made in order to get rid of a liability, a useful starting point is to inquire into the nature of the liability which is brought to an end by the payment;

(e) Where a lump sum payment is made in order to commute or extinguish a contractual obligation to make recurring revenue payments then the payment is prima facie a revenue payment; and,

(f) The principle that a payment made in order to commute or discharge a liability to make recurring revenue payments is itself a revenue payment is subject to an important qualification – if the liability to make recurring revenue payments is reduced or brought to an end by the modification or disposal of an identifiable capital asset, then any payment made for the modification or disposal is itself a capital payment.

171. The Appellant referred me to this decision as well as to the judgment in ***Garett Paul Curran –v- HMRC*** in support of its argument that the $518 million paid was interest, notwithstanding that it was paid in a lump sum. In the ***Garett Paul Curran*** decision, the First Tier Tribunal held that:-

"A payment in respect of a sum of money due that is calculated by reference to the time of use of that money, or the time of deprivation of that use, is interest however it is paid, whether periodically, or in a single or multiple lump sum, whether in advance or in arrears. The mechanics of payment do not affect the characterisation of a payment as interest if it satisfies the basic test as set out in the authorities.

…

We reject the argument that the present value of a future payment, discounted to reflect the time value of money, cannot by definition be "interest" because the effect of the present value calculation is to remove the effect of time. It does not remove the effect of time; it reflects it."

172. The Appellant submitted that the ***Garett Paul Curran*** decision was on all fours with the facts of the instant appeal and, more fundamentally, that it was clear from the wording of Section 2.02 of the Original Loan Agreements that the sum of $518 million paid by the Appellant was interest.

173. I believe, however, that the more correct interpretation of Section 2.02 is, as the Respondent submitted, that the reference to remaining scheduled payments of interest therein was made solely as part of a method to calculate the quantum of the repayment charge triggered by a prepayment of all or part of the loan. For the reasons set forth below, I do not believe that the reference to interest in Section 2.02 operates, or could operate, to make the payment of $518 million a payment of interest.

174. The decision in ***Garett Paul Curran*** predates the decision of the Court of Appeal in ***Pike –v- HMRC*** but I believe that it is consistent with the latter decision. I note in particular the findings of the Court of Appeal that interest is calculated by reference to an underlying debt, and is a payment made according to time, by way of compensation for the use of money.

175. I agree with the Respondent that the ***Garett Paul Curran*** is distinguishable from the facts of the instant appeal. It is clear that although the interest payable on the loans was pre-paid by the borrower in that case, the underlying loans continued in existence. This is, in my view, materially different from the instant appeal, where the sum of $1.373 billion paid by the Appellant discharged in full its liabilities under the Original Loan Agreements. The underlying debt was extinguished by the payments made by the Appellant and that is, in my view, irreconcilable with the Appellant's argument that the $518 million was a payment of interest. As the Court of Appeal stated in ***Pike***, interest is calculated by reference to an underlying debt and the discharge of that debt by the Appellant meant that it could have no further liability to interest. This is, in my view, consistent with the evidence given by Professor Ó hÓgartaigh in relation to the relevance to the proper accounting treatment of the $518 million payment of the fact that the underlying loan no longer existed.

176. I further accept as correct the Court of Appeal's decision that what the payment is called is not determinative; instead, the question must always be one as to its true nature. Accordingly, while the Appellant did point out that the Respondent had on two occasions referred in correspondence to the $518 million as being "*interest*", and the Respondent had equally referred to the fact that the Appellant and its advisors had referred to the payment as being an "*early repayment charge*", a "*refinancing*

charge", a "*prepayment penalty*" and an "*early repayment premium*" at various stages, such references are not in my view determinative of the question of whether or not the payment was a payment of interest, and I have not had regard to same in reaching these conclusions.

177. As stated above, the Respondent also referred me to the decision in ***Kata Kagaku Co. Ltd.***, where the Special Commissioner held that an indemnity payment made by the taxpayer was made as part of a larger transaction, namely the prepayment of a loan, which could not have been achieved without the indemnity payment. The indemnity payment was the cost of getting rid of an onerous capital liability, namely the loan, and was therefore a capital payment. I agree with the Respondent that the payment of the $518 million in the instant appeal was part of the total cost of discharging the Appellant's liabilities pursuant to the Original Loan Agreements.

178. The Respondent further referred me to the decision in ***New Zealand Forest Research Institute***, where the Privy Council noted that the Institute, pursuant to its agreement to acquire the Crown's research undertaking and as part of the consideration for the purchase of the assets, accepted a liability under its employment agreements with former Crown employees to discharge obligations, either vested or contingent, which were attributable to their previous service to the Crown. The Privy Council held that the payments were capital expenditure, being part of what was paid for the acquisition of the assets.

179. I agree with the Respondent's submission that the decision is apposite in the instant appeal. I have already found that the decision to refinance the Original Loan Agreements and the payments made in consequence of that decision were part and parcel of the agreement to purchase the Appellant from **GROUP B**; the payment of $518 million was therefore part of the consideration paid for the acquisition of the Appellant.

180. My views in this regard are further strengthened by the decision in ***Parnalls Solicitors***, where the UK First Tier Tax Tribunal held:-

> *"It is doubtless correct to say that both Royal Insurance Company and New Zealand Forest Research Institute Ltd were decided on their own facts. There is nevertheless a clear principle that can be derived from those cases. It is that where an obligation, whether vested or contingent, is assumed as part of the purchase price, or consideration, for the purchase of assets on a transfer of a business, payments in discharge of that obligation are capital expenditure, and not revenue expenditure. Whilst we agree with Mr Harvey that Royal Insurance Company concerned a lump sum payment, it is clear that, as New Zealand Forest Research Institute Ltd decided, the principle also extends to other obligations which, if paid by the vendor, would have been deductible revenue expenses."*

181. Having regard to the foregoing, I find that the payment of $518 million by the Appellant was not a payment of interest but was instead a repayment charge incurred by the Appellant on the optional prepayment of the Original Loan Agreements, which were prepaid as part of the completion of the global agreement for the purchase of the **GROUP B** [redacted] division by **GROUP A**. I therefore find that the payment of the $518 million was capital and not revenue in nature. Accordingly, the provisions of section 81(2)(f) of TCA 1997 mean that it cannot be a deductible expense.

182. The final issue to be considered is the correct quantum of the sum claimed by the Appellant as a deduction. The Appellant submits that of the $1.373 billion paid by the Appellant to discharge its liabilities under the Original Loan Agreements, $855 million represented the payment of principal and the balance of $518 million represented the interest component of the debt settlement. For ease of reference, I have thus far referred to the figure of $518 million claimed by the Appellant but the Respondent submits that, even if there was a deductible payment of interest, the deductible amount was some $385 million. It is worth recalling in this regard that section 76A(1) of TCA 1997 requires that "*the profits or gains of a trade or profession carried on by a company shall be computed in accordance with generally accepted accounting practice…*"

183. The Respondent relied in this regard on the evidence of Professor Ó hÓgartaigh, which is summarised in paragraphs 66 to 74 *supra*. In essence, his evidence was that there had been only one transaction, namely the early redemption of the loan, and that this should have been reported as such, and a figure of $385 million recorded as the loss resulting from that transaction. His expert opinion was that it was inappropriate to "*bifurcate*" the transaction into a gain on early loan redemption and interest payable on early loan redemption.

184. Counsel for the Appellant cross-examined Professor Ó hÓgartaigh at some length in relation to his views, and pointed out that the witness had declined to say that the accounts did not present a true and fair view of the state of the Appellant's affairs. Counsel further submitted that I would have to "*go behind*" the audited accounts if I was to accept the Respondent's arguments in relation to the issue of quantum. Counsel further submitted that the witness's expertise did not entitle him to challenge the accuracy of the Appellant's accounts, which had been audited by a firm of significant expertise and professional standing.

185. However, in this aspect of the appeal as in the others, the onus of proof lies upon the Appellant. It was clear from the Respondent's written submissions that the issue of the quantum of the amount claimed was very much in issue, and paragraph 81 thereof stated that the Respondent "*awaits the evidence that will sustain the Appellant's contention that the early redemption charge of $385m has been correctly accounted for, presented and disclosed in its financial statements.*"

186. Notwithstanding this, the Appellant elected not to call expert accounting or auditing or tax evidence in relation to the accounting treatment of the monies paid to discharge the Original Loan Agreements. It relied instead on the wording of the Original Loan Agreements, which it submitted resulted in the principal sums payable being discounted, on the audited financial statements and on the calculations prepared by **GROUP B**.

187. I believe it is also relevant to note that the resolution passed by **WITNESS 1** and **WITNESS 2** on 30 November 20██ recorded that the sum of $988,201,845 was to be

used to discharge the principal payable under the Original Loan Agreements and the sum of $385,599,990 was to be used to settle the early repayment charge arising from the prepayment of the Original Loan Agreements. I also note that there is no reference in any of the contemporaneous documents opened to me in the course of the hearing to the principal sums having been discounted by **GROUP B.** I also note that while the figure of $518 million appears to have been originally received by the Appellant from **GROUP B**, a different approach was adopted by **COMPANY B2**, and its treatment of the $1.373 billion payment it received was consistent with Professor Ó hÓgartaigh's view as to the correct accounting treatment.

188. Overall, on the evidence before me, I am not satisfied on the balance of probabilities that the Appellant has discharged the burden of proof in relation to this issue and I am not satisfied that the amount claimed as a deduction could, if deductible, amount to $518 million rather than the $385 million which the Respondent submits is the correct figure.

G. Determination

189. For the reasons outlined above, my findings and conclusions can be summarised as follows:-

- **(a)** While some of the objects of the Appellant in refinancing its obligations under the Original Loan Agreements may have been objects for the purposes of the Appellant's trade, the primary object of the refinancing was to implement and complete the SAPA entered into by **GROUP B** and **GROUP A** on 21 April 20██, as amended by the Agreement Letter of 30 November 20██.
- **(b)** The implementation and completion of the SAPA as amended in November 20██ was not an object for the purposes of the Appellant's trade.
- **(c)** Accordingly, the refinancing by the Appellant of its obligations under the Original Loan Agreements and the payments made in consequence thereof were not wholly and exclusively laid out or expended for the purposes of the Appellant's trade.

(d) Therefore, the payment of $518 million made by the Appellant cannot be deducted by virtue of the provisions of section 81(2)(a) of TCA 1997.

(e) In addition, the payment of $518 million made by the Appellant was not a payment of interest.

(f) The $518 million paid by the Appellant was instead a repayment charge incurred by the Appellant on the optional prepayment of the Original Loan Agreements, which were prepaid as part of the completion of the global agreement for the purchase of the **GROUP B** ████████ division by **GROUP A**.

(g) Accordingly, the payment was capital in nature, and not revenue.

(h) Therefore, the payment of $518 million made by the Appellant cannot be deducted by virtue of the provisions of section 81(2)(f) of TCA 1997.

(i) The Appellant has not discharged the burden of proof to satisfy me on the balance of probabilities that the amount sought to be deducted was correctly calculated as being $518 million rather than $385 million.

190. Having made the findings listed above, I find that the Appellant has not succeeded in its appeal.

191. I consider that the Appellant has been neither overcharged nor undercharged by the amended assessment to Corporation Tax issued to the Appellant by the Respondent on 25 July 20██, and therefore determine that the said amended assessment stand.

Dated the 13th of October 2022

MARK O'MAHONY

Appeal Commissioner