SDLT Sub-sale and Sharia-compliant Finance Leaseback Blues

UK Supreme Court's Decision in *Project Blue* Case

It has been over a decade since the Ministry of Defence (MoD) sold the Chelsea Barracks. Finally, on 13 June 2018, the stamp duty land tax (SDLT) consequences of that transaction have been resolved.

Perhaps unsurprisingly, the UK Supreme Court (UKSC) has ruled (by a majority of 4:1) to allow the appeal of HM Revenue and Customs (HMRC). The judgment of the Court of Appeal (CA) has been overturned.

The UKSC ruling brings to a close, finally, one of the most intricate and finely balanced disputes concerning SDLT since its introduction in 2003.

The case is instructive because it:

- Illustrates the complexities in the operation of the relief from SDLT for transactions involving a sub-sale (and, hence, the need for caution when encountering them in practice)
- Sheds light on the broad ability, and apparent willingness, of HMRC to invoke section 75A of Finance Act 2003 (ostensibly an anti-avoidance measure) in any circumstances, including those involving transactions that are entirely commercial and involve no avoidance motive – *caveat emptor*

One of the most interesting aspects of the decision is that the UKSC has concluded that SDLT is due on a greater amount than the MoD actually received. The decision has wide-ranging implications for property transactions that have yet to be completed and those where enquiries have been opened but were held pending the decision.

What Is the Case About?

The case relates to the acquisition of Chelsea Barracks by a special purpose vehicle (a company called Project Blue Limited [PBL] owned by the Sovereign Wealth Fund of Qatar) from the MoD.

The transaction was not entirely straightforward but was essentially a property acquisition financed by a contemporaneous, Sharia-compliant sub-sale and leaseback transaction. The overall scheme comprised a series of clearly identifiable steps:

1. The parties agreed the sale in April 2007. The purchase price was £959 million and PBL paid a 20% deposit (£191.8 million) at the time of exchange. The parties agreed to delay completion until January 2008.
2. In January 2008, PBL agreed to sell the barracks to a Qatari bank, Masraf al Rayan (MAR), also part owned by the Sovereign Wealth Fund of Qatar, for £1.25 billion.
3. On the same day, MAR agreed to lease the barracks back to PBL. The lease was a Sharia-compliant finance lease. In effect, the structure enabled PBL to borrow sufficient funds to purchase the barracks and provided MAR with security for that, but in a Sharia-compliant structure.

At this point, in the absence of substantial performance of the transactions, no liability to SDLT had arisen.

4. Two days later, PBL and MAR entered into a put option (entitling MAR to sell the barracks back to PBL at the end of the financing period) and a call option (entitling PBL to buy back the barracks from MAR).
5. On the same day, the sale by the MoD to PBL, the sub-sale by PBL to MAR, and the grant of the finance lease by MAR to PBL were completed.

PBL filed SDLT returns in relation to each step of the transaction on the basis that it was not liable for SDLT on any of the steps. It claimed it was entitled to SDLT sub-sale relief (in relation to the sale by the MoD to PBL) and SDLT relief for alternative finance arrangements (in relation to the sub-sale by PBL to MAR and finance leaseback by MAR to PBL). PBL disclosed the arrangements under the Disclosure of Tax Avoidance Scheme (DOTAS) rules.

How Has the Case Reached the Supreme Court?

After an enquiry, HMRC issued closure notices assessing PBL for £38.36 million of SDLT on the basis that section 75A applied, which gave rise to a "notional arrangement" for which the chargeable consideration was £959 million.

At the First-tier Tax Tribunal (FTT), HMRC changed its position, arguing that PBL's SDLT liability on the "notional arrangement" should be to £50 million (being 4% of the total of £1.25 billion paid by MAR). HMRC closed its enquiry into MAR's SDLT return without assessing it to any SDLT liability.

The central questions throughout the case have been whether PBL is liable for SDLT in respect of the purchase, and, if so, in respect of which particular transaction.

In the FTT, HMRC won, on its revised position (i.e. £50 million liability). The case was appealed to the Upper Tribunal (UT) where HMRC won again, but the UT revised the chargeable consideration back to £959 million.

Notably, the UT also agreed with the FTT that the absence of any "motive defence" under section 75A meant that PBL's motives were "not strictly relevant" in determining whether the anti-avoidance rule applied. In any event, the fact that PBL had made a DOTAS submission "strongly suggest[ed] that the avoidance of SDLT may have been a factor".

Both parties appealed to the CA, where PBL rather unexpectedly (but successfully) argued that MAR ought to be treated as the Purchaser for SDLT purposes and so it was MAR that ought to be liable to £50 million of SDLT on the £1.25 billion it had paid to PBL for the barracks. This was on the basis that the SDLT relief for alternative finance arrangements was, technically, unavailable because of the interaction with the sub-sale rules. The net result was:

- The freehold sale by the MoD to PBL should be disregarded (pursuant to the sub-sale rules and following the decision in *DV3 RS LP v. HMRC*), meaning that the relevant Purchaser for SDLT purposes was MAR with the chargeable consideration being £1.25 billion
- The Vendor was, therefore, the MoD (not PBL), meaning the exemption for alternative finance was not available (because it relied on the lessee, PBL, being treated as the Vendor)
- Crucially (despite the CA's obiter comments agreeing with the FTT and the UT that an avoidance motive is not necessary to trigger it), section 75A could not apply in this particular case because the amount of SDLT that would have been payable on the "notional transaction" was equal to the £50 million that was payable (albeit unpaid) by MAR

Since, however, HMRC had closed its enquiry into MAR's SDLT return (and was out of time to reopen it), one crucial practical consequence of the CA decision was that no further liability to SDLT arose. Unsurprisingly, considering the SDLT involved, HMRC appealed to the UKSC.

What Has the Supreme Court Decided?

The UKSC allowed HMRC's appeal (by a majority of 4:1). In essence, it has ruled that PBL's SDLT planning was ineffective.

The UKSC decided that the UT was correct in concluding that the sub-sale relief provisions did not prevent the application of the relief for alternative property finance. This the means that PBL (not the MoD) was the Vendor for SDLT purposes. As a result, looked at individually, PBL's purchase of the barracks from the MoD was exempt (under sub-sale relief) and MAR's purchase of the barracks from PBL was also exempt (under alternative property finance relief). The amount of SDLT payable in respect of each of the scheme transactions when considered separately was, therefore, £0.

That part of the ruling brings the anti-avoidance rule in section 75A back into play.

Following the *Barclays Mercantile Business Finance Ltd* case, the UKSC has adopted a broad, purposive approach to interpreting its application. It has held that the whole intention of section 75A is to tackle situations, such as the scheme in question, where the interaction of different rules applied at different steps result in a loss of tax. As the UKSC says:

> "the provision was introduced to counter avoidance schemes which have been developed to avoid payment of SDLT. It appears to be drafted in deliberately broad terms to catch a wide range of arrangements which result in tax loss." [44]

On that basis, looking at the whole scheme and the purpose of section 75A together, the UKSC concluded that the relevant "notional transaction" to be assessed involved the MoD as the Vendor and PBL as the Purchaser of its relevant chargeable interest in land, being the leasehold interest obtained from MAR. The series of transactions were all "involved in connection with" the disposal by MoD of its chargeable (freehold) interest in the barracks. The chargeable consideration (being the largest amount given by any one person under the scheme) was the £1.25 billion paid by MAR to PBL. Since the SDLT payable in respect of the actual scheme (£0) was less than the amount that would have be payable on the notional transaction, SDLT of £50 million was due under section 75A.

Importantly, the UKSC has also reinforced the position of both the UT and the CA on the potentially broad application of section 75A. In a short (but crystal-clear) passage, it concludes that taxpayer motive is indeed irrelevant (emphasis added):

> "The heading of the section, 'Anti-avoidance', is … relevant to assist an understanding as to the mischief which the provision addresses, but it **says nothing as to the motives of the parties** to the scheme transactions. There is nothing in the body of the section which expressly or inferentially refers to motivation. The provision was enacted to counter tax avoidance which resulted from the use of a number of transactions to effect the disposal and acquisition of a chargeable interest. It is sufficient for the operation of the section that tax avoidance, **in the sense of a reduced liability or no liability to SDLT**, resulted from the series of transactions which the parties put in place, whatever their motive for transacting in that manner." [42]

The stark alignment of tax avoidance with a simple reduction or elimination of SDLT, irrespective of motive or intent, is cause for concern (even if it is not entirely surprising).

Why Is the Case Important?

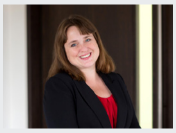
The SDLT planning at the heart of this particular case has already been blocked by changes made to the sub-sale relief rules, but the case remains instructive for the light it sheds on HMRC's ability to use section 75A whenever a series of transactions combine to produce less SDLT than would otherwise have been payable on a notional simple transaction. The UKSC judgment is only likely to embolden HMRC further in seeking to invoke section 75A.

This rather unsatisfactory state of affairs allows HMRC to apply a provision that is widely (but now wrongly) understood to be a "normal" anti-avoidance rule, in any given set of circumstances where more SDLT could have been charged. Avoidance motive or not, deliberate or not, if HMRC can postulate a "notional arrangement" where the chargeable consideration "payable" exceeds the amount that would otherwise be payable, it could trigger section 75A.

Project Blue, therefore, is a case that necessitates a further recalibration in our understanding of where the boundary between acceptable tax planning and unacceptable tax avoidance lies. Despite reassurances in its published guidance that it will not apply section 75A if the "right" result of SDLT has been paid, the question remains on who decides (and how) what the "right" amount of SDLT is.

A cautionary tale indeed but, given HMRC's need to raise as much tax revenue as possible, as Bob Dylan once wrote, "You don't need a weather man, To know which way the wind blows."

Contact



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