



Neutral Citation: [2026] UKUT 00090 (TCC)

Case Number: UT/2024/000120

**UPPER TRIBUNAL
Tax and Chancery Chamber**

Rolls Building, Fetter Lane London EC4A 1NL

Corporation Tax – loan relationships – section 327 Corporation Tax Act 2009 – disallowance of imported losses – non-resident company becoming UK resident prior to early redemption of loan notes – whether “loss” for the purposes of section 327 includes expenses incurred for the purposes of a loan relationship – whether sums paid on early redemption were expenses – whether a loss arising in connection with the loan relationship was referable to the pre-migration period

Heard on 25 and 26 November 2025

Judgment date: 24 February 2026

Before

**JUDGE JONATHAN CANNAN
JUDGE JENNIFER DEAN**

Between

UK CARE No. 1 LIMITED

and

**THE COMMISSIONERS FOR HIS MAJESTY’S
REVENUE AND CUSTOMS**

Appellant

Respondents

Representation:

For the Appellant: Kevin Prosser KC and Zizhen Yang of counsel, instructed by Slaughter and May

For the Respondents: Mark Fell KC and Harry Winter of counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. This is an appeal against a decision of the First-tier Tribunal Tax Chamber (“the FTT”) released on 13 June 2024 (“the Decision”). It concerns the amount of debit or loss arising from a loan relationship which the appellant (“UKC1”) is entitled to bring into account for corporation tax purposes. In its corporation tax return for the period ending 31 December 2016, UKC1 brought into account a loan relationship debit of £150,749,046 together with accrued interest of £1,752,675.

2. The FTT briefly described the circumstances in which UKC1 incurred a loss on its loan relationship at [3] and [4] of the Decision. UKC1 is a Guernsey company which acted as the issuer of certain loan notes secured by the UK care home business of the group headed by the British United Providence Association Limited (the “BUPA Group”).

3. In 2016, UKC1 was not part of the BUPA Group. BUPA wanted to sell a number of the care homes which formed part of the security package for the loan notes. UKC1 was therefore acquired by the BUPA Group, became UK resident and then redeemed the loan notes. The redemption gave rise to an accounting loss of just over £150m, being the difference between the amount UKC1 had to pay to redeem the loan notes and the carrying value of its liability under the loan notes in its accounts. UKC1 brought into account a loan relationship debit in respect of this loss in its corporation tax return for the period ending 31 December 2016.

4. HMRC opened an enquiry into UKC1’s corporation tax return and in a closure notice it originally disallowed the whole of the debit and the accrued interest. By the time of the FTT hearing, HMRC’s position had changed and it contended that £93,903,841 of the debit should be disallowed. It accepted that relief for all the accrued interest should be allowed. The FTT allowed UKC1’s appeal but only to the extent that HMRC had already agreed to allow part of the sums brought into account by UKC1. The FTT confirmed that £93,903,841 of the debit could not be brought into account and it is that debit which is in dispute between the parties on this appeal.

5. Part 5 Corporation Tax Act 2009 (“CTA 2009”) deals with loan relationships and how profits and losses arising from a company’s loan relationships are brought into account for corporation tax purposes. We are concerned principally with section 327 and section 306A CTA 2009.

6. We set out these provisions below. At this stage, we simply note that section 327 concerns the disallowance of “imported losses”. Essentially, it restricts the amount of a loss that can be brought into account. A loss arising in connection with a loan relationship cannot be brought into account if it is wholly or partly referable to a time when the company claiming the loss would not have been subject to UK taxation had there been a profit.

7. Section 306A sets out the matters in respect of which amounts may be brought into account as credits or debits in respect of a loan relationship. This includes profits and losses of the company arising from its loan relationships and, separately, expenses incurred by the company under or for the purposes of those loan relationships. For this purpose, “expenses incurred” are defined in section 306A(2).

8. It is UKC1’s case that section 327 does not apply to disallow any part of the debit which it has claimed on redemption of the loan notes for two reasons:

- (1) because the loss was made up entirely of expenses, and section 327 applies only to losses and not to expenses, alternatively

(2) because no part of the loss was referable to a time when UKC1 and hence its loan relationship was not subject to UK taxation.

9. We are grateful to all counsel for their clear and concise written and oral submissions on what are difficult points of statutory interpretation and the application of the relevant test under section 327.

THE FTT'S FINDINGS OF FACT

10. There was little dispute about the facts before the FTT and the following summary is taken from the FTT's helpful findings at [11] – [29] of the Decision.

11. UKC1 was incorporated in 1999. The BUPA Group held some non-voting shares but the voting shares and equity interests in UKC1 were held by Guernsey trustees for the benefit of two charities. The directors of UKC1 were Guernsey residents, unconnected with the BUPA Group. UKC1 was, at this time, tax resident in Guernsey.

12. In February 2000, UKC1 issued two tranches of loan notes with a total face value of £235m. The loan notes were secured on some of BUPA's care homes. The two tranches had different fixed rates of interest of 6.3% and 7.5% and different maturity dates in 2029 and 2031. The notes were issued at a discount of £492,700 to their face value and so the gross amount raised by UKC1 was £234,507,300. There were also transaction costs of £5,369,247 so the net proceeds available to UKC1 was £229,138,053.

13. The terms of the loan notes provided that UKC1 could redeem them early on any interest payment date. However, in order to make the loan notes attractive to investors, the loan notes contained what is known as a "Spens" clause (also known as a "make whole" clause). The effect of the Spens clause was that, in order to redeem the loan notes, UKC1 would have to pay the higher of:

- (1) the outstanding principal under the loan notes (i.e. £235m); and
- (2) the present value of future cashflows using a discount rate equivalent to the gross redemption yield applicable to a specified "reference gilt", being 6% Treasury Stock 2028.

14. In order to understand the impact of this, the FTT looked at how corporate loan notes carrying a fixed rate of interest are priced in the market.

15. The market values a loan note by calculating all the future cashflows under the loan note, both principal and interest, and then discounting the total cashflows using a discount rate to arrive at a present value for the future cashflows.

16. There are two elements to the discount rate. The first element is called the "risk free rate" which is a hypothetical rate of return which the market would expect to receive on an equivalent loan note where there is no material risk of default by the debtor. This varies over time as global interest rates change but is also affected by currency expectations and market dynamics such as supply and demand. Broadly speaking, if global interest rates fall, the risk free rate will also fall which will in turn reduce the discount rate. The lower the discount rate, the higher the present value of the future cashflows under the loan note.

17. The second element of the discount rate is known as the "credit spread". The credit spread reflects the perceived credit risk, compared to a loan note issued by the UK Government, that the loan notes in question will not pay out on time and in full. It is the addition of the credit spread to the discount rate which results in a corporate loan note being worth less than a UK gilt which is issued on equivalent terms as the discount rate for a corporate bond is higher.

18. If the financial strength of the borrower improves, the credit spread will reduce. This will in turn reduce the discount rate and so will increase the value of the future cashflows under the loan note. The market value of the loan note will therefore increase.

19. The effect of the Spens clause was that the amount payable by UKC1 on early redemption of the loan notes would always be higher than the market value of the loan notes. That is because the discount rate used is set by reference solely to the risk free rate and takes no account of any credit spread. The discount rate is therefore lower than that used by the market in valuing the loan notes so the value of the future cashflows under the loan notes is higher. The purpose of a Spens clause is to ensure that investors are “over-compensated” for the value of their investment (see *Canary Wharf Finance Plc v Deutsche Trustee Company Limited & Ors* [2016] EWHC 100 (Comm) at [35]).

20. The payment to be made by UKC1 on early redemption of the loan notes can be viewed as being split into two parts. The first part, equal to the market value of the loan notes, compensates investors for the future cashflows of principal and interest which they would have received under the terms of the loan notes had they remained in existence until maturity. The second part, being the balance of the redemption payment, is effectively a penalty for early redemption.

21. It is important to note that under the terms of the loan notes, the payment made on early redemption is split differently. Where, as here, the redemption payment exceeds the outstanding principal, the payment is treated as a payment of the outstanding principal (in this case, £235m) with the balance being treated as a “premium”. The premium can then be viewed as comprising two elements. First, the difference between the principal of the loan notes and their market value which is compensation for the loss of future cashflows. Second, the balance of the sum payable which is a penalty for early redemption.

22. Early redemption of the loan notes was triggered because the BUPA Group wanted to sell some of the care homes which formed part of the security for the loan notes. In January 2016, the BUPA Group decided that the best way of going about this would be to redeem the loan notes early. Bearing in mind that the BUPA Group did not own UKC1, it determined that the steps needed to do this were as follows:

(1) Acquisition of the shares in UKC1 so that it became part of the BUPA Group. This took place on 15 February 2016 in consideration of a payment of £850,000 made by the BUPA Group to the Guernsey trustees.

(2) On 18 February 2016, two of the three Guernsey directors of UKC1 resigned and three senior executives of the BUPA Group were appointed in their place.

(3) The following day, 19 February 2016, a UKC1 board meeting was held in London at which it was agreed that it made sense for UKC1 to be managed and controlled from the UK and that future board meetings would be held in the UK. It was common ground that UKC1 became resident in the UK for tax purposes from 19 February 2016 (“the Migration Date”).

(4) The board of UKC1 met again on 24 February 2016 and resolved to redeem the loan notes. This involved also agreeing to issue further shares in UKC1 to the BUPA Group in order to provide UKC1 with the necessary funds to redeem the loan notes. A redemption notice was given to noteholders on 29 February 2016 for redemption on 1 April 2016.

23. The redemption amount under the Spens clause was £381,618,848 representing £235m of principal and a premium of £146,618,848. By comparison, the market value of the loan notes immediately before the Migration Date was £324,805,450 which reflected the fact that

the fixed rates carried by the loan notes were substantially higher than market rates at that time. The difference of just under £57 million between the redemption amount and the market value was, in effect, the penalty paid by UKC1 for early redemption of the loan notes.

24. The accounting treatment of the loan notes is also relevant. The UK generally accepted accounting practice provides that a company can account for financial liabilities such as the loan notes either on a fair value basis or an amortised cost basis.

25. Fair value, in effect, reflects the market value of the loan notes. The fair value of the loan notes on issue was £234,507,300 (i.e. the face value less the initial discount). Immediately before the Migration Date, the fair value was £324,805,450. Had UKC1 used a fair value basis of accounting in respect of the loan notes, this would have been the carrying value for the loan notes at the time UKC1 became UK tax resident and so the loss on redemption would have been the difference between this figure and the redemption price of £381,618,848, which is approximately £57m.

26. In fact, UKC1 accounted for the loan notes on the amortised cost basis. The effect of this was that the liability represented by the loan notes was shown in the accounts of UKC1 at a figure which was based on their historic cost, namely the issue price less the initial discount and transaction costs, with the discount and the transaction costs being amortised over the expected life of the loan notes. Thus, ignoring interest, the carrying value of the liability represented by loan notes would increase over the life of the loan notes.

27. The result of this accounting treatment was that by the maturity date of the loan notes, the carrying value of the liability would be £235 million, which was the face value of the loan notes. Therefore, there would be neither a profit nor a loss when the principal of the loan notes was repaid on maturity.

28. The amortised cost at the time of issue was £229,138,053 which was the net proceeds. Immediately before the Migration Date, the amortised cost was £230,901,609. The accounts of UKC1 showed an amortised cost for the loan notes on 31 March 2016 (the day before redemption) of £230,869,802. The loan relationship debit claimed by UKC1 was the difference between this figure and the redemption payment of £381,618,848, being £150,749,046.

29. The carrying value of the loan notes immediately before the redemption date was £4,130,198 less than the principal amount because part of the issue costs and part of the discount had not yet been recognised. Those unrecognised amounts may be described as the unamortised issue costs and the unamortised discount.

30. We understand that the loss claimed by UKC1 at the date of redemption was therefore made up as follows:

	£
Unamortised discount and unamortised issue costs	4,130,198
Compensatory element	89,773,643
Penalty element	56,845,205
Total	£150,749,046

31. The amount of the debit which HMRC said should be disallowed is the difference between the amortised cost of £230,901,609 at the Migration Date and the market value (or fair value) of the loan notes on that date which was £324,805,450, the difference being

£93,903,841. The amount of the debit which HMRC accepted should be allowed is the difference between this figure and the total claimed of £150,749,046 which comes to £56,845,205. HMRC says that is because when UKC1 migrated to the UK, the fair value of the liability under the loan notes was already £93,903,841 above its carrying value in the accounts. If UKC1 had used fair value accounting, that part of the loss would already have been recognised by the time of migration and it would not have been imported into the UK.

LEGISLATIVE PROVISIONS

32. Part 5 CTA 2009 sets out how profits and deficits arising to a company from its loan relationships are brought into account for corporation tax purposes. All references in this decision are to CTA 2009 unless otherwise indicated. The general rule in section 295(1) is that all profits arising to a company from its loan relationships are chargeable to tax as income. Section 293 provides that the regime also applies to profits and losses of a capital nature and to profits and losses from related transactions. Related transactions are defined by section 304 as any disposal or acquisition of rights or liabilities under a loan relationship.

33. A loan relationship is defined in section 302 as follows:

302 “Loan relationship”, “creditor relationship”, “debtor relationship”

(1) For the purposes of the Corporation Tax Acts a company has a loan relationship if—

- (a) the company stands in the position of a creditor or debtor as respects any money debt (whether by reference to a security or otherwise), and
- (b) the debt arises from a transaction for the lending of money.

34. Chapter 3 Part 5 contains rules of general application about the credits and debits to be brought into account. Section 306 states that the Chapter provides for the application of generally accepted accounting practice in determining the debits and credits to be brought into account, and also sets out some general rules that differ from generally accepted accounting practice, including section 327:

306 Overview of Chapter

(1) This Chapter contains rules of general application about the credits and debits to be brought into account for the purposes of this Part.

(2) In particular, it:

...

(d) sets out some general rules that differ from generally accepted accounting practice (see sections 320 to 327) ...

35. Section 306A provides:

306A Matters in respect of which amounts to be brought into account

(1) The matters in respect of which amounts are to be brought into account for the purposes of this Part in respect of a company’s loan relationships are-

- (a) profits and losses of the company that arise to it from its loan relationships and related transactions (excluding interest and expenses),
- (b) interest under those relationships, and
- (c) expenses incurred by the company under or for the purposes of those relationships and transactions.

(2) Expenses are only treated as incurred as mentioned in subsection (1)(c) if they are incurred directly-

- (a) in bringing any of those loan relationships into existence,
- (b) ...
- (c) in making payments under any of those relationships or as a result of any of those transactions, or
- (d) in taking steps to ensure the receipt of payments under any of those relationships or in accordance with any of those transactions.

36. Section 307 provides that as a general rule the amounts to be brought into account are those recognised in accordance with generally accepted accounting practice:

307 General principles about the bringing into account of credits and debits

- (1) This Part operates by reference to the accounts of companies and amounts recognised for accounting purposes.
- (2) The general rule is that the amounts to be brought into account by a company as credits and debits for any period for the purposes of this Part in respect of the matters mentioned in section 306A(1) are those that are recognised in determining the company's profit or loss for the period in accordance with generally accepted accounting practice.

37. This form of section 307 was introduced by amendment in Finance (No 2) Act 2015. The original section 307 included the provisions that became section 306A. It is common ground that the reference to “profits and losses” in section 306A is a reference to accounting profits and losses (see the observations of David Richards LJ as he then was in *Union Castle Mail Steamship Co v HMRC* at [37]-[38], regarding the very similar derivative contracts legislation).

38. Section 327 is one of the provisions which override the general rule about following generally accepted accounting practice. It provides:

327 Disallowance of imported losses etc

- (1) This section applies for an accounting period of a company (“the loss period”) if—
 - (a) apart from this section, a loss arising in connection with a loan relationship of the company would fall to be brought into account for the purposes of this Part, and
 - (b) the loss is wholly or partly referable to a time when the relationship was not subject to United Kingdom taxation.
- (2) The amounts brought into account for the loss period for the purposes of this Part must be such as to secure that none of the loss referable to a time when the relationship was not so subject is treated for those purposes as arising in the loss period or any other accounting period of the company.
- (3) For the purposes of this section a loss is referable to a time when a relationship is not subject to United Kingdom taxation so far as, at the time to which the loss is referable, the company would not have been chargeable to corporation tax in the United Kingdom on any profits arising from the relationship.
- (4) If the company was not a party to the relationship at the time to which the loss is referable, subsection (3) applies as if the reference to the company were a reference to the person who at that time was in the same position as respects the relationship as is subsequently held by the company.
- (5) An amount which would be brought into account for the purposes of this Part in respect of any matter apart from this section is treated for the purposes of section 464(1) (amounts brought into account under this Part excluded from being otherwise brought into account) as if it were so brought into account.

(6) Accordingly, that amount must not be brought into account for corporation tax purposes as respects that matter either under this Part or otherwise.

(7) This section does not apply if fair value accounting is used.

39. Section 327 was introduced in this form in CTA 2009 and has not been amended since. It is common ground that the reference to “a loss” in section 327 refers to an accounting loss.

THE FTT’S DECISION IN OUTLINE

40. It was argued before the FTT that section 327 does not operate to disallow any part of the debit claimed by UKC1 for two reasons:

(1) because no part of the loss claimed was referable to the period prior to the Migration Date, alternatively

(2) because the loss was made up entirely of expenses and section 327 does not apply to expenses.

41. The FTT held that the part of the loss which represented the difference between the market value of the loan notes and the carrying value of the loan notes at the Migration Date had already arisen as a matter of commercial reality prior to the Migration Date and was referable to the pre-migration period. That part of the loss is what was described as the compensatory element of the premium. In particular, at [104] and [117], the FTT stated:

104. Looking at the matter objectively, in my view, an informed observer would therefore conclude that, with the exception of the element which related to the unamortised issue costs (as to which, see further below), the element of the loss representing the difference between the amortised cost carrying value of the loan notes and the market value at the Migration Date already existed or had arisen as a matter of commercial reality in the pre-migration period as it reflected changes in the market (such as interest rates and credit spreads) during that period. Whilst that loss had not been crystallised (as no decision to redeem the loan notes early had been taken by UKC1), it already existed as a matter of commercial reality.

117. ...it follows from what I have already said that the decision to redeem the loan notes early therefore simply crystallised losses which already existed as a matter of commercial reality at the date of migration with the exception of the penalty element of the premium (which only came into existence as a result of the decision to redeem early). The whole of the remaining amount (subject to what I say below about the unamortised issue expenses) is therefore referable to the pre-migration period.

42. The FTT went on to consider at [124] to [130] the other elements of the premium, apart from the penalty which HMRC had already agreed was allowable:

124. As I have said, Mr Prosser breaks down the part of the loss which HMRC seek to disallow into three separate elements, being the compensatory element of the premium, the unamortised issue costs and the unamortised discount on issue. Given what I have said, this can only assist UKC1 if any of those three elements of the loss is not referable to the changes in market conditions occurring during the pre-migration period.

125. I accept that this is the case in relation to the unamortised element of the initial transaction costs. The reason for this is that the fair value of the loan notes on issue was £234,507,300 (being the face value less the issue discount). Any change in market conditions giving rise to the existence of a loss in the pre-migration period does not therefore reflect any part of the loss referable to the issue expenses (although it does reflect the part of the loss referable to the unamortised issue discount).

126. Mr Prosser submits that this element of the loss is referable to the fact that these costs had not been fully amortised, something which would only happen in the future and only if the loan notes had not been redeemed early.

127. However, in my view, the element of the loss attributable to the unamortised issue costs existed from day one as reflected by the fact that the initial fair value of the loan notes took no account of those expenses. As a matter of commercial reality, there was therefore a loss on day one represented by the amount of those expenses.

128. Like the remainder of the loss, this element of the loss may have been triggered or crystallised by the decision to redeem but it was a loss that already existed as the expenses had been incurred. The expenses were incurred in the pre-migration period and so that part of the loss is referable to that time. As the question of referability must be approached with hindsight, the fact that those costs would have been amortised in the future had the loan notes not been redeemed is, in my view, irrelevant.

129. Applying the approach I have proposed, it can clearly be seen that it is the pre-migration change in market conditions together with the incurring of expenses in the pre-migration period which has given rise to the non-penalty element of the loss. Without those expenses and changes, no loss would have arisen despite the removal of the obligation to make the future payments of interest and principal.

130. For the reasons I have explained, my conclusion is that the part of the loss which does not relate to the penalty (£93,903,841) is referable to a time prior to UKC1's migration to the UK...

43. The FTT then went on to consider the alternative argument put forward by UKC1. It held at [131] to [152] that even if the redemption payment made by UKC1 was an expense, it was still a loss arising in connection with a loan relationship and the loss was restricted by section 327.

44. The result was that the FTT allowed the claim for credit in the sum of £56,845,205 but disallowed the claim for credit in the sum of £93,903,841.

THE GROUNDS OF APPEAL

45. UKC1 appeals with permission from the FTT. It alleges that the FTT erred in law in rejecting its claim for the full loss. There are three grounds of appeal which rehearse the same arguments rejected by the FTT:

Ground 1 – The Loss comprised three elements, all items of expense, and the FTT wrongly applied a test of causation in determining their referability. The three elements were financing costs, or payments in respect of financing costs, that related to and thus were “referable to” the remaining contractual term of the Loan Notes.

Ground 2 – Alternatively, if it is appropriate to regard the statutory concept of referability to a time as concerned with the cause of the Loss, the FTT erred in law in misapplying its own “but for” test of causation, and in any event should have looked for the effective cause of the Loss.

Ground 3 – The FTT erred in law in holding that section 327 could apply at all where, as in this case, the “matter” in respect of which the company is seeking to bring an amount into account for the purposes of section 306A CTA 2009 consists of expenses, not a loss.

46. The appeal is essentially concerned with two concepts in section 327. Ground 3 is concerned with the meaning of “loss arising in connection with a loan relationship” for the purposes of section 327(1)(a). Grounds 1 and 2 are concerned with the circumstances in which

a loss will be “referable to a time when a relationship is not subject to UK taxation”. The parties dealt with Ground 3 followed by Grounds 1 and 2 and we shall adopt the same approach.

GROUND 3

47. Ground 3 is that the loss on redemption was made up entirely of expenses falling within section 306A(1)(c), and that section 327 does not apply to expenses. It is said that the loss comprised three elements each of which amounted to expenses:

- (1) the unamortised issue costs,
- (2) the unamortised discount, and
- (3) the premium paid on redemption.

48. UKC1 submits that the issue costs were expenses incurred by UKC1 directly in bringing the loan notes into existence and fall within section 306A(2)(a). The discount was an expense incurred by UKC1 directly in making a payment under the loan notes on redemption and falls within section 306A(2)(c).

49. UKC1 submits that the whole premium payable on redemption, over and above the principal amount, was an expense incurred by UKC1 directly in making a payment under the loan notes and also falls within section 306A(2)(c). It acknowledges that repayment of the net proceeds received on issuing the loan notes was not an expense. It is not necessary for us to consider whether the penalty element of the premium is an expense because it is common ground that relief is available in respect of that element. For the purposes of Ground 3, we are concerned with the compensatory element of the premium.

50. The FTT was prepared to assume that all these sums were expenses for the purposes of section 306A. It did not expressly address the issue, but there is a suggestion in the FTT’s conclusion at [149] that it was not necessarily convinced that they were expenses:

149. Therefore, even if the redemption payment is an expense, in my view, it is still a loss arising in connection with a loan relationship as that expression is used in s 327(1).

51. HMRC submit that the redemption payment, ignoring the penalty element and the repayment of principal, was not wholly or partly made up of expenses for the purposes of section 306A.

52. This issue is effectively a preliminary issue within Ground 3 as to whether the unamortised issue costs, the unamortised discount and the compensatory element amount to expenses.

53. UKC1 submits that the term expenses in section 306A has its ordinary meaning of disbursements. The issue costs and the discount are plainly expenses. The compensatory element is also an expense in that it is a payment required to be made on redemption of the loan notes.

54. There is authority under the old schedular system of taxation that losses are distinct from expenses. In *Allen v Farquharson Bros & Co* (1932) 17 TC 59, a claim was made for a deduction in computing the profits of a business for legal costs in relation to an appeal to the Special Commissioners. Finlay J considered whether deduction of those costs was restricted by Rule 3(a) which applied to disbursements or expenses not wholly and exclusively laid out for the purposes of the trade. Alternatively by Rule 3(e) which restricted any losses not connected with or arising out of the trade. He stated at p64:

... I cannot help thinking that there is a distinction between (a) and (e). Now a case might be put in which it was not very easy to say whether a thing was a disbursement or expense or was a loss. It is conceivable - such things sometimes happen - that there may be cases in which a thing might

fall alternately - it might be either within (a) or within (e), but, none the less, I do think that there is a distinction to be drawn between the two. (a) relates to disbursements; that means something or other which the trader pays out; I think some sort of volition is indicated. He chooses to pay out some disbursement; it is an expense; it is something which comes out of his pocket. A loss is something different. That is not a thing which he expends or disburses. That is a thing which, so to speak, comes upon him ab extra. it is not very easy to formulate the thing, but it is easy enough to put illustrations falling on one side or the other of the line which may show what is, I think, the distinction, and the real distinction, between these things. Take the case of money being stolen from a till: I should say that that, quite plainly, was not a disbursement or an expense and, equally plainly, I should say it was a loss. Take, on the other hand,, a sum of money expended, let us say, for legal expenses. I am not, of course, on the immediate question in this case. A trader thinks that he requires legal advice, or he thinks he wants a conveyance, or something of that sort; that, I should say, could not possibly and properly be said to be a loss, but obviously was a disbursement or expense. Although, in some cases, there may be a difficulty in deciding under which head it comes and, although it is true to say that in most cases it does not particularly matter, and the things may be conveniently considered together ...

55. In *Bamford v ATA Advertising Ltd* [1972] 3 All ER 535, Brightman J was concerned with funds misappropriated by a director of the taxpayer. He quoted the passage from *Allen* and stated at p543h:

Counsel for the taxpayer company submitted in the case before me that a distinction is to be drawn between a case ... where the debt had arisen with the concurrence of those controlling the company, and a case such as the present, where the debtor was fraudulent and had robbed the company. In the former case, the loss is the result of an expenditure which the company must be regarded as having authorised. In the latter case, the company has expended nothing; the money has been taken from the company involuntarily. That distinction, I think, is a valid one, and is much what Finlay J said in the passage which I read.

56. Mr Prosser submitted that UKC1 voluntarily decided to redeem the loan notes early knowing that it would have to make the redemption payment. It is clear that the redemption payment was an expense.

57. It is clear to us that the issue costs when paid would properly be characterised as an expense. They were not voluntary in the sense that UKC1 could not realistically have issued the loan notes without incurring those costs. Similarly, the loan notes could not have been issued without granting the discount on issue. However, they were money laid out or to be laid out in due course for the purposes of the loan relationship and of UKC1's business. HMRC did not seriously challenge that characterisation of those payments. On the basis that those sums were expenses when they were incurred at the time of issue, in our view it is appropriate to characterise payments which reflect the unamortised issue costs and the unamortised discount as expenses at the time of redemption. We are satisfied that those elements of the redemption payment amount to expenses for the purposes of section 306A.

58. The compensatory element of the redemption payment is not as straightforward. It is a payment which is only required to be made because UKC1 decided to redeem the loan notes early. It might therefore be viewed as an expense associated with redeeming the loan notes.

59. HMRC submitted that whilst the compensation element was a contractual obligation and a payment, in commercial substance it represented the present value of the future cash flows under the loan notes. It was submitted that in the words of Finlay J it was not a voluntary payment but something which comes upon UKC1 "ab extra". Whilst UKC1 chose to redeem the loan notes, the need for the compensatory element was determined by market movements and was imposed on UKC1. As such, the payment was more akin to the scenario of an issuer who buys back loan notes they have issued for more than their carrying value. A loss would be

generated but it would not amount to an expense because the obligation to make the payment and the amount of the payment was the result of market movements outside the issuer's control.

60. We tend to the view, on balance, that the compensatory element is an expense of redeeming the loan notes and therefore falls within section 306A(1)(c). It is essentially part of the cost of choosing to redeem the loan notes early. We are fortified in that view by HMRC's Corporate Finance Manual at [33060] which gives "early redemption penalties" as an example of an expense falling within section 306A(2)(c).

61. We now turn to the question of whether a "loss" for the purposes of section 327 can include expenses falling within section 306A(1)(c). The FTT decided that a loss for those purposes does include expenses. The parties focussed their submissions on three aspects of section 327:

- (1) the language of section 327 in the context of section 306A and other provisions of CTA 2009;
- (2) the purpose of section 327; and
- (3) the legislative history of sections 327 and 306A

62. It is convenient for us to deal with the parties' submissions under these separate headings, acknowledging that it is necessary to consider all these aspects together in reaching a conclusion on what is an issue of statutory interpretation.

(i) The language of section 327

63. UKC1 submits that the language of section 327 in the context of section 306A indicates that it has no application in relation to expenses. In particular:

- (1) Profits and losses are one of the matters which section 306A(1) requires to be brought into account in respect of a company's loan relationships. However, section 306A(1)(a) provides that expenses are to be excluded from any loss. The excluded expenses are brought into account separately pursuant to section 306A(1)(c) but only if they fall within section 306A(2).
- (2) Section 327 applies "if apart from this section, a loss would fall to be brought into account for the purposes of this Part". The result of section 306A is that only a loss excluding expenses falls to be brought into account. The amount to be brought into account for the purposes of section 327(2) is therefore the accounting loss excluding expenses.

64. We do not accept those submissions. Whilst sections 306A and 327 both refer to something being "brought into account", they are concerned with different things. Section 306A is identifying "the matters" in respect of which amounts are to be brought into account in respect of a company's loan relationships. One of those matters is profits and losses, excluding expenses. Expenses are identified as a separate matter because it is only certain expenses satisfying the conditions in section 306A(2) that are matters in respect of which an amount is to be brought into account.

65. In contrast, section 327(1) is concerned with whether "a loss" arising in connection with a loan relationship would fall to be brought into account. There is no reference back to the matters being brought into account by virtue of section 306A(1). In our view, there is a clear distinction between matters in respect of which amounts are to be brought into account, and the amounts which are to be brought into account in respect of those matters. That is reflected in the language of section 327(2) which refers to "the amounts" brought into account. Further, the general rule in section 307(2) is that "the amounts" are brought into account as credits or debits in respect of the matters mentioned in section 306A(1).

66. We acknowledge that the predecessor to section 306A at the time section 327 was enacted did not include any reference to matters. We consider the legislative history below. At this stage, however we note that there is no reference in section 306A to a loss being brought into account.

67. UKC1 submitted that the expression falling to be interpreted is not just the word “loss”, but the expression “[if] a loss arising...would fall to be brought into account for the purposes of [Part 5]”. It says that that expression is almost identical to the expressions in section 306A that the “losses of the company that arise to it” which “are to be brought into account for the purposes of [Part 5]” are losses excluding expenses. UKC1 submits that it would be surprising if Parliament intended the same expressions to have different meanings.

68. Lord Sumption noted in *Plevin v Paragon Personal Finance Limited* [2017] UKSC 23 at [22]:

In the ordinary course, there is a presumption that the same expression used in different provisions of a statute has the same meaning wherever it appears. There is also a presumption that differences in the language used to describe comparable concepts are intended to reflect differences in meaning. But the latter presumption is generally weaker than the former, because the use of the same expression is more likely to be deliberate. It will readily be displaced if there is another plausible explanation of the difference.

69. Section 327 and section 306A actually use different expressions. Section 306A refers to the matters in respect of which amounts are to be brought into account and identifies losses as excluding expenses. Section 327 refers to a loss being brought into account without any exclusion for expenses. In our view, subject to the purpose and legislative history of section 327, the presumption that Parliament intends different expressions to have different meanings is not rebutted in relation to these provisions.

70. The FTT did note at [148] that section 327(5) also refers to an amount being brought into account “in respect of any matter”. It considered that supported HMRC’s interpretation and must be a reference to the matters referred to in section 306A(1) so as to include losses, interest and expenses. That cannot be right because when the original version of section 327 was enacted, section 306A had not yet been introduced. Sections 306 and 307(3) CTA 2009 were the predecessors to section 306A but did not contain any reference to matters. The matters being referred to in section 327(5) are the matters referred to in section 464 CTA 2009 which provides that “the amounts which are brought into account in accordance with Part 5 in respect of any matter are the only amounts which may be brought into account for corporation tax purposes in respect of it”.

71. UKC1 points out that section 446 CTA 2009 also distinguishes profits, losses, interest and expenses which are brought into account as a result of the transfer pricing regime in Part 4 Taxation (International and other provisions) Act 2010 (“TIOPA 2010”):

446 Bringing into account adjustments made under Part 4 of TIOPA 2010

(1) This section deals with the credits and debits which are to be brought into account for the purposes of this Part as a result of Part 4 of TIOPA 2010 (provision not at arm's length) applying in relation to a company's loan relationships or related transactions.

(2) Subsection (3) applies if under Part 4 of TIOPA 2010 an amount (“the imputed amount”) is treated as an amount of profits or losses arising to a company from any of its loan relationships or related transactions.

(3) Credits or debits relating to the imputed amount are to be brought into account for the purposes of this Part to the same extent as they would be in the case of an actual amount of such profits or losses.

...

(6) Subsection (7) applies if under Part 4 of TIOPA 2010 an amount is treated as expenses incurred by a company under or for the purposes of any of its loan relationships or related transactions.

(7) Debits relating to the amount are to be brought into account for the purposes of this Part to the same extent as they would be in the case of an actual amount of such expenses.

72. UKC1 says that section 446(3) does not bring into account losses excluding expenses and the reason it does not need to is that section 306A(1) makes clear that the relevant losses exclude expenses. We do not consider that the terms of section 446 support that argument. Indeed, section 446 itself deals separately with expenses in sub-sections (6) and (7) in contrast to section 327.

73. We agree with HMRC that a loss is generally a “compound concept”. In most cases it is the result of a computation involving the deduction of expenses, whether capital or income expenses. If Parliament intended the reference to an accounting loss in section 327 to exclude expenses then it would have made express provision to that effect. That was the conclusion of the FTT at [142] – [144] where the FTT stated that the clear inference from section 306A(1)(a) is that a loss can include an expense. Otherwise it would be unnecessary to exclude expenses from the scope of losses. If Parliament had been concerned to ensure that an expense did not fall within the term “loss” for the purposes of section 327, we would have expected it to say so specifically. We do not consider that Parliament would be expected to expressly include expenses in losses in section 327 if they were to be covered by the provision. Nor do we consider that the exclusionary words in section 306A(1)(a) are there merely for the avoidance of doubt because it is clear that losses could not include expenses given that expenses were being treated differently.

74. In this regard we take into account the cautionary words of Lord Hoffmann in *Walker v Centaur Clothes Group Limited* [2000] UKHL 23 at 805D that arguments from redundancy seldom carry great weight.

75. In short, subject to submissions in relation to the purpose of section 327 and the legislative history, it seems to us that the word “loss” in section 327 appears to have the same meaning as in section 306A(1) and in both sections it includes expenses.

(ii) The purpose of section 327

76. It is common ground that section 306A(1) distinguishes losses and expenses because it is only certain categories of expenses which are to be brought into account in respect of a company’s loan relationships.

77. UKC1 says that Parliament was not concerned to specifically exclude expenses from section 327 because expenses would be properly recognised in accordance with generally accepted accounting practice either in the pre-migration period or the post-migration period. There was therefore no need for section 327 to apply separately to expenses. That is the case whether they are recognised as part of an accounting loss or separately as expenses. It submitted that Parliament would not have intended expenses to be disallowed under section 327 merely because they happen to be recognised as part of an accounting loss rather than separately.

78. UKC1 also submits that the heading to section 327 refers to “imported losses”. That is a reference to losses which are accounted for in the post-migration period but which as a matter of commercial reality arose in the pre-migration period. It says that it is hard to think of a scenario where a loss made up of expenses could arise as a matter of commercial reality without being recognised as a matter of accounting in the same period. An authorised accruals basis requires expenses to be allocated to the period to which they relate.

79. We do not accept these submissions. Firstly, whilst section 327 is concerned with accounting losses, it is one of the provisions identified in section 306 which effectively overrides generally accepted accounting practice. Secondly, there was no accounting evidence before the FTT to support the submission and the FTT, understandably, does not deal with the submission. The submission also pre-supposes that UKC1’s arguments on Ground 1 in relation to referability are right. The effect of those arguments is that in relation to expenses the accounting treatment would be determinative of whether the expense was referable to the pre-migration period. That seems an unlikely result where Parliament has chosen the concept of referability rather than accounting treatment to determine whether relief is available.

80. UKC1 points out that prior to the loan relationship regime, tax relief was available under section 77 Income and Corporation Taxes Act 1988 (“ICTA 1988”) for expenses incurred by corporate debtors in obtaining or repaying loan finance:

77 Incidental costs of obtaining loan finance.

77(1) Subject to subsection (5) below, in computing the profits to be charged under Case I or II of Schedule D there may be deducted the incidental costs of obtaining finance by means of a qualifying loan or the issue of qualifying loan stock or a qualifying security.

...

(6) In this section “the incidental costs of obtaining finance” means expenditure on fees, commissions, advertising, printing and other incidental matters (but not including stamp duty), being expenditure wholly and exclusively incurred for the purpose of obtaining the finance (whether or not it is in fact obtained), or of providing security for it or of repaying it.

(7) This section shall not be construed as affording relief —

(a) for any sums paid in consequence of, or for obtaining protection against, losses resulting from changes in the rate of exchange between different currencies; or

(b) for the cost of repaying a loan or loan stock or a qualifying security so far as attributable to its being repayable at a premium or to its having been obtained or issued at a discount.

81. Relief under section 77 included relief for break payments, which were not treated as premiums within section 77(7)(b). That was the view of Special Commissioner Dr Avery Jones in *Kato Kagaku Co Ltd v HM Revenue and Customs* [2007] STC (SCD) 412 at [27]. It is also the view expressed in HMRC’s Business Income Manual at [45820]. Relief would therefore have been available for the premium paid by UKC1 on early redemption. UKC1 says that there was no reason for Parliament to restrict that pre-existing relief when the loan relationship regime was introduced. The restriction in section 327 was aimed at the new relief introduced by the loan relationship regime for corporate creditors suffering a loss if a loan went bad because the debtor was in financial difficulties. Parliament was no doubt concerned that corporate lenders in jurisdictions which disallowed relief for capital losses might become UK

resident in order to obtain relief. This is consistent with HMRC's Corporation Tax Manual in 1998 which stated as follows in relation to the predecessor to section 327:

[The provision] applies only to disallow part or all of a loss. It applies both to debtor and creditor relationships. Its application to debtor relationships is unlikely to arise in practice, although conceivable.

82. UKC1 submits that Parliament would also have been concerned that relief for losses caused by bad debts could be for the principal sum lent, whereas expenses would typically be smaller. It described the present case as a rare case where the expenses turn out to be very large.

83. We agree with HMRC that there is every reason to suppose that Parliament would want to block relief for imported losses comprising expenses where they are referable to a period when the company was not UK resident. UKC1's interpretation of section 327 undermines that purpose. The cogency of UKC1's interpretation can be tested by assuming that the loss claimed in the present case is partly referable to the pre-migration period. We cannot understand why Parliament would intend that section 327 should apply to a loss not comprising expenses but should not apply to a loss which did comprise expenses. In our view it is legitimate to give a purposive construction which avoids such an unlikely result (see Lord Hodge in *Project Blue v Revenue and Customs* [2018] UKSC 30 at [31]).

84. The importation of losses referable to a pre-migration period is just as objectionable whether those losses arise to a creditor from a bad debt, or to a creditor or debtor from other circumstances. Nothing in the language of section 327 suggests that expenses referable to a pre-migration period should be excluded from the restrictions on relief. Parliament's intention to give the restriction on relief a wide ambit is signalled by its reference to a loss arising "in connection with" a loan relationship. Those are wide words (see *Lessees and Management Co of Herons Court v Heronslea Ltd* [2019] EWCA Civ 1423 at [37]). In our view, Parliament would not use wide words to catch any loss in connection with a loan relationship whilst at the same time importing a narrow definition of loss.

85. UKC1 submitted that "in connection with" is simply a shorthand for all the losses which can fall within section 306A(1)(a). That is, losses arising from a loan relationship, from a related transaction or from both. We accept that the wide wording of section 327 was intended to cover losses arising from related transactions, because when the provisions were introduced there was no equivalent of section 293 covering related transactions. However, we consider the expression is also wide enough to cover expenses. We agree with HMRC that it is hard to see why an imported loss arising from an expense should fall outside section 327, whilst an imported loss arising from a related transaction should fall within it.

86. It is also significant that section 327 is wider than section 306A because it refers to a loss arising "in connection with" a loan relationship whereas 306A refers to a loss arising "from" a loan relationship. This serves to emphasise the wide ambit of section 327. A loss could fairly be said to arise in connection with a loan relationship even if it were not a loss from a loan relationship.

87. There is no basis on which to suggest that Parliament would have considered that expenses falling within section 306A(1)(c) would typically be relatively small given the level of expenses claimed in this case. The fact expenses in this context can be large is another reason why Parliament would have intended section 327 to apply to expenses.

88. In our view, the purpose of section 327 supports HMRC's case that the restriction on losses includes expenses incurred by a company.

(iii) The legislative history

89. UKC1 relies heavily on the legislative history to support its construction of section 327 as referring to losses excluding expenses.

90. HMRC accepted that we could have regard to the legislative history, including provisions contained in the Finance Bill 1996 and the Finance Act 1996 as originally enacted. However, it submitted that elaborate and time consuming archival and historical investigations of predecessor provisions were not persuasive in this case. We also have reservations as to the assistance that can be gained from the examination of Finance Bill clauses, especially when they are not enacted with precisely the same wording in the Finance Act. There is in our view a danger in reading too much into variations between what was proposed in the Finance Bill 1996 and what was eventually enacted in the Finance Act 1996.

91. Section 306A originated as clause 76 Finance Bill 1996 which became section 84 Finance Act 1996:

Clause 76 Finance Bill 1996:

(1) The credits and debits to be brought into account in the case of any company in respect of its loan relationships shall be the sums which, in accordance with an authorised accounting method, fairly represent, for the accounting period in question -

(a) all its profits, gains and losses (whether or not of a capital nature) arising from its loan relationships and related transactions; and

(b) all interest payments, charges and expenses incurred by the company under or for the purposes of its loan relationships and related transactions.

...

(3) The reference in subsection (1) above to charges and expenses incurred for the purposes of a company's loan relationships and related transactions does not include a reference to any charges or expenses other than those incurred directly -

(a) in bringing any of those relationships into existence;

(b) in entering into or giving effect to any of those transactions;

(c) in making payments under any of those relationships or in pursuance of any of those transactions; or

(d) in taking steps for ensuring the receipt of payments under any of those relationships or in accordance with any of those transactions.

(6) This section has effect subject to Schedule 8 to this Act (which contains provision disallowing certain debits and credits for the purposes of this Chapter and making assumptions about how an authorised accounting method is to be applied in certain cases).

Section 84 Finance Act 1996:

(1) The credits and debits to be brought into account in the case of any company in respect of its loan relationships shall be the sums which, in accordance with an authorised accounting method and when taken together, fairly represent, for the accounting period in question —

(a) all profits, gains and losses of the company, including those of a capital nature, which (disregarding interest and any charges or expenses) arise to the company from its loan relationships and related transactions; and

(b) all interest under the company's loan relationship and all charges and expenses incurred by the company under or for the purposes of its loan relationships and related transactions.

92. Clause 76(3) was enacted in the same terms by section 84(3).

93. Section 327 originated as paragraph 9 Schedule 8 Finance Bill 1996 which became paragraph 10 Schedule 9 Finance Act 1996. The Finance Bill provision was enacted without amendment in the Finance Act 1996:

Paragraph 9 Schedule 8 Finance Bill 1996 / Paragraph 10 Schedule 9 Finance Act 1996:

(1) This paragraph applies in the case of a company (“the chargeable company”) for an accounting period (“the loss period”) where –

(a) an authorised accruals basis of accounting is used as respects a loan relationship of that company for the loss period;

(b) in accordance with that basis of accounting there is an amount which would fall (apart from this paragraph) to be brought into account for the purposes of this Chapter in respect of that relationship;

(c) by the bringing into account of that amount in that period a loss incurred in connection with that loan relationship would be treated for the purposes of this Chapter as arising in that period; and

(d) that loss is referable in whole or in part to a time when the relationship was not subject to United Kingdom taxation.

(2) The amounts brought into account for the purposes of this Chapter in the loss period shall be such as to secure that no part of the loss that is referable to a time when the relationship was not subject to United Kingdom taxation shall be treated for the purposes of this Chapter as arising in the loss period or any other accounting period of the chargeable company.

94. UKC1 submits that clause 76 clearly distinguished “profits, gains and losses” and “interest payments, charges and expenses”.

95. It is also said that paragraph 9 Schedule 8 was intended to apply where an “authorised accruals basis of accounting” was used for a loss period. We were also referred to clauses 77(2)(b) and 77(3)(a) which provided as follows:

Clause 77 Authorised Accounting Methods

(1) Subject to the following provisions of this Chapter, the alternative accounting methods that are authorised for the purposes of this Chapter are .

(a) an accruals basis of accounting; and

(b) a mark to market basis of accounting under which any loan relationship to which that basis is applied is brought into account in each accounting period at a fair value.

(2) An accounting method applied in any case shall be treated as authorised for the purposes of this Chapter only if –

...

(b) it contains proper provision for allocating payments made under a loan relationship to accounting periods; ...

...

(3) In the case of an accruals basis of accounting, proper provision for allocating payments made under a loan relationship to accounting periods is provision which -

(a) allocates payments to the period to which they relate, without regard to the periods in which they are made or received or in which they become due and payable;

96. The Finance Bill therefore recognised that an authorised accruals basis of accounting would allocate payments to the period to which they relate.

97. The Explanatory Notes to Finance Bill 1996 described the imported loss rule as “prevent[ing] companies using an authorised accruals basis from obtaining tax relief on a loss on a loan relationship to the extent the loss relates to a period when the loan relationship was outside the scope of United Kingdom tax” (emphasis added). Given that an authorised accruals basis of accounting required expenses to be allocated “to the period to which they relate”, if a loss which related to a pre-migration period was made up of expenses, those expenses would be related to, and so brought into account in, the same pre-migration period. The result is that relief could never be obtained for that part of the loss in any event. UKC1 submitted that the drafter cannot have contemplated that the imported loss rule might apply to a loss made up of expenses.

98. We do not consider that this supports UKC1’s case. In particular, just because a loss related to a particular period applying an accounting method authorised by clause 77 does not mean that it would be referable to the same period for the purposes of paragraph 9 Schedule 8. Again, it is notable that the drafter of the Finance Bill used different terms in the two provisions.

99. UKC1 submits that the reference in paragraph 9(1)(c) Schedule 8 to the bringing into account of an amount whereby a loss “would be treated for the purposes of this Chapter as arising” made it clear that the imported loss rule was only dealing with “losses ... arising” as mentioned in clause 76(1)(a). That is, clause 76 was expressly subject to schedule 8, and the only reference to “losses arising” appeared in clause 76(1)(a). Paragraph 9(1)(c) must have been drafted with clause 76(1)(a) specifically in mind: it was asking whether the bringing into account of an amount in an accounting period meant that a loss was treated as arising in the pre-migration period.

100. We can see that if the Finance Bill had been enacted in these terms then it would have supported the arguments of UKC1 in relation to section 327. Whilst the imported loss rule in paragraph 9 was enacted without amendment as paragraph 10 Schedule 9 Finance Act 1996, changes were made to clause 76(1) Finance Bill 1996 before it became section 84(1) Finance Act 1996. In particular, the phrase “(disregarding interest and any charges or expenses)” was inserted in section 84(1)(a) so as to exclude expenses from the sums being brought into account as representing profits and losses for the accounting period in question.

101. UKC1 submits that one can reasonably speculate that, mindful of the fact that the new loan relationship rules were an accounts-based regime and of the broad concept of accounting loss, the drafter inserted those words to make it clear beyond any possible doubt that companies could not bring losses into account under clause 76(1)(a) insofar as they were made up of expenses. Further, there was no need to make any corresponding amendment to the imported loss rule because this had not been drafted with expenses in mind and the drafter would not have thought it could apply to them.

102. We have already addressed the relationship between section 84 Finance Act 1996 and paragraph 10 Schedule 9 in considering the relationship between section 306A and section 327. In our view, speculation as to why the Finance Bill was amended prior to enactment provides little support for UKC1’s arguments on section 84 and section 306A CTA 2009.

103. UKC1 submits that paragraph 9 Schedule 9 Finance Act 1996 gives further support to its interpretation. It applied to relevant overseas debts which are broadly sovereign debt and provided as follows:

9(1) This paragraph applies where—

(a) for an accounting period in which a company ceases to be a party to a loan relationship (“the loss period”) any amount falls for the purposes of this Chapter to be brought into account in respect of that relationship in accordance with an authorised accruals basis of accounting;

(b) by the bringing into account of that amount in that period a loss incurred in connection with a relevant overseas debt falling within sub-paragraph (2) below is treated for the purposes of this Chapter as arising in that period;

104. Paragraph 9 was a re-enactment of section 88C of ICTA 1988 and restricted the ability of a company to obtain a deduction, in computing the amount of its profits under Case I or Case II of Schedule D, for a “loss” incurred in respect of certain sovereign debts. UKC1 relies on the authorities referred to above (*Allen v Farquharson Bros* and *Bamford v ATA Advertising Ltd*) for a proposition that in the context of Schedule D Cases I and II, a loss does not include an expense.

105. It is not disputed that there is a distinction between losses and expenses. The authorities do not suggest that references to a loss in section 88C and paragraph 9 Schedule 9 are to losses only insofar as they do not arise from an expense. We do not consider that there is any basis to infer that the reference to losses in paragraph 9 Schedule 9 is a reference to losses excluding expenses.

GROUND 1

106. Ground 1 is essentially that the loss claimed by UKC1 was made up of expenses which were all referable to the remaining contractual term of the loan notes and therefore the post-migration period. It is said that the FTT erred in law in finding that each element of the expenses was referable to the pre-migration period and fell to be disallowed pursuant to section 327.

107. UKC1 submits that the expression “referable to” means “relatable to” and does not mean “caused by”. That is because a loss cannot be caused by a time. A loss which is referable to a time means a loss which relates to a particular period as a matter of commercial reality.

108. It was common ground before the FTT that a loss will be referable to a pre-migration period only if, at the time of migration, the loss already existed or had already arisen as a matter of commercial reality. This does not require the loss to have been triggered or crystallised prior to migration. An unrealised or unrecognised loss is sufficient, provided it already existed as a matter of commercial reality.

109. UKC1 accepts that questions of causation may be relevant in identifying the period to which a loss is referable. Similarly, HMRC accept that the question is not simply one of causation. It is common ground therefore that it is relevant to consider what events or factors caused the loss for which relief is being claimed. However, just because an event or factor which might be said to have caused the loss arose in a particular period does not mean that the loss is necessarily referable to that period.

110. The alleged errors of law made by the FTT and relied upon by UKC1 may be summarised as follows:

- (1) In relation to issue costs, the FTT failed to recognise commercial reality and wrongly focussed on the date the costs were incurred.
- (2) In relation to the discount, the FTT wrongly held that it was referable to pre-migration changes in market conditions.
- (3) In relation to the compensatory element, the FTT wrongly applied a causation test when it is not simply a causation test.

111. The overarching submission made by UKC1 is that where a loss is made up of expenses, it is necessary to identify the period to which the expenses are referable. On the present facts the answer is said to be straightforward. The expenses are all referable to the remaining term of the loan notes following the Migration Date. As such, the FTT ought to have found that the unamortised issue costs, the unamortised discount and the compensatory element were all referable to the post-migration period.

112. The FTT held at [77] – [79] that the question of referability and whether the loss existed as a matter of commercial reality, is an objective test. It must be answered with the benefit of hindsight. It is only once the loss has crystallised that the question as to whether it is referable to a pre-migration period falls to be addressed:

77. It is, in my view, clear from the wording of s 327, that the question of referability is an objective test. The question is whether an informed and independent third party would consider the loss to have arisen or existed in the pre-migration period and not whether the taxpayer had a subjective belief that a loss existed or had arisen. I accept Mr Fell’s submission that, given the purpose of s 327, it is unlikely that Parliament intended that the application of that provision should depend on whether the taxpayer in question considered a loss to exist or to have arisen prior to migration.

78. Contrary to Mr Prosser’s submission, I consider that the question as to whether the loss existed or had arisen in the pre-migration period must be answered with hindsight as it is only once the loss has been crystallised (and therefore identified) that the question as to whether that particular loss is referable to a time in the pre-migration period can be addressed.

79. It follows from this that the prior intention of the taxpayer company is irrelevant. By definition, the loss will have been crystallised and the task is to consider whether that particular loss is referable to a time in the pre-migration period in the sense that all or part of the loss existed or had arisen at that time as a matter of commercial reality. The fact that, absent a crystallisation event, the taxpayer company may not have considered a loss to have existed or arisen pre-migration cannot therefore be relevant.

113. We do not understand UKC1 to take issue with these passages. It was also common ground before the FTT and before us that a distinction must be drawn between “referability and computation”. The FTT described this distinction at [44] as follows:

44. The second point [on which the parties agree] is that there is a distinction between referability and computation. The fact that a particular factor (such as the fair value of the loan notes at a particular point in time) may be an essential ingredient in computing whether a loss has arisen does not mean that the loss is necessarily referable to that matter.

114. Whilst the FTT acknowledged that a loss is not “necessarily” referable to changes in a factor in the computation, it clearly proceeded on the basis that such changes may still be relevant in determining whether a loss is referable to a particular period. Indeed, UKC1 accepts that the computation may tell us something about the period to which a loss is referable.

115. HMRC suggested that UKC1’s challenge to the FTT’s findings under Ground 1 is a challenge to an evaluative decision of fact made by the FTT for which it did not have permission and in respect of which it did not satisfy the requirements of *Edwards v Bairstow* [1956] AC 14. We acknowledge that assessing whether something is commercially realistic sounds like an evaluative judgment with which an appellate tribunal should be slow to interfere. However, in this case the substance of the challenge in relation to unamortised issue costs and the unamortised discount, described in more detail below, is not to the weight the FTT gave to various factors in concluding that all the elements of the loss were referable to the pre-migration period. There was no range of factors being taken into account and no range of reasonable

views as to which period those elements of the loss were referable. We consider this issue further in relation to the compensatory element below.

116. We shall consider UKC1's challenge to the decision of the FTT in relation to issue costs and the discount, before considering the compensatory element.

Issue costs and discount

117. UKC1 says that when the loan notes were issued, it incurred three categories of expenses. The issue costs of £5,369,247, a liability to make a payment on redemption of £492,700 in excess of the principal amount raised by the loan notes which was the discount, and payments of interest for the term of the loan notes. Those were all financing costs incurred or to be incurred in order that UKC1 could have the use of the net proceeds of the loan notes over their contractual term. As a matter of commercial reality, it is said that these expenses were all referable to the entire term of the loan notes.

118. The issue costs were incurred at the time of issue but they were being amortised over what was expected to be the term of the loan notes. In *Cadbury Schweppes Plc v Williams* [2001] SpC 302, the Inland Revenue had argued that issue costs were an integral part of such funding and it would be artificial to attribute them to the period in which the instrument was issued. The Special Commissioner Dr Avery Jones acknowledged in his decision that it was "clearly economically sensible" to spread all expenses over the life of the loan.

119. The Special Commissioner also considered the nature of a discount on the issue of loan notes. He described a discount as performing exactly the same economic function as interest, which is why it was amortised over the term of the loan notes. He expressed the view that a discount on issue is "effectively the same" as interest.

120. In the present case, UKC1 had already recognised part of the issue costs and part of the discount through amortisation prior to the Migration Date. UKC1 says that those amortised costs were referable to the pre-migration period. In contrast, the unamortised costs were referable to the post-migration period. In particular, UKC1 relies on the fact that the unamortised issue costs were entirely unaffected by changes in market conditions. If the loan notes had not been redeemed early, UKC1 would have continued to amortise the costs and the resulting debit would have been deductible in accounting periods in the post-migration period. UKC1 submits that it would be perverse if the debit was not deductible simply because UKC1 decided to redeem the loan notes early. Parliament cannot have intended such a result.

121. HMRC submit that the observations in *Cadbury Schweppes* are not binding on us and do not assist in the present case where the loan was terminated early. They support the FTT's decision that the unamortised issue costs and the unamortised discount were both referable to the pre-migration period for the reasons it gave.

122. The FTT noted at [124] and [125] that changes in market conditions did not affect the loss referable to the unamortised issue costs but considered that those changes did affect the unamortised discount:

124. ... Mr Prosser breaks down the part of the loss which HMRC seek to disallow into three separate elements, being the compensatory element of the premium, the unamortised issue costs and the unamortised discount on issue. Given what I have said, this can only assist UKC1 if any of those three elements of the loss is not referable to the changes in market conditions occurring during the pre-migration period.

125. I accept that this is the case in relation to the unamortised element of the initial transaction costs. The reason for this is that the fair value of the loan notes on issue was £234,507,300 (being the face value less the issue discount). Any change in market conditions giving rise to

the existence of a loss in the pre-migration period does not therefore reflect any part of the loss referable to the issue expenses (although it does reflect the part of the loss referable to the unamortised issue discount).

123. The FTT went on to conclude that the unamortised issue costs were referable to the pre-migration period:

127. However, in my view, the element of the loss attributable to the unamortised issue costs existed from day one as reflected by the fact that the initial fair value of the loan notes took no account of those expenses. As a matter of commercial reality, there was therefore a loss on day one represented by the amount of those expenses.

128. Like the remainder of the loss, this element of the loss may have been triggered or crystallised by the decision to redeem but it was a loss that already existed as the expenses had been incurred. The expenses were incurred in the pre-migration period and so that part of the loss is referable to that time. As the question of referability must be approached with hindsight, the fact that those costs would have been amortised in the future had the loan notes not been redeemed is, in my view, irrelevant.

124. UKC1 submitted that the FTT was wrong insofar as it was saying that fair value accounting is determinative of referability. We would agree if that was indeed what the FTT was saying. However, we do not consider that the FTT was expressing a view that the accounting treatment was determinative of liability. The FTT was simply saying that because the issue costs were incurred on day one and the issue costs were not reflected in the fair value of the loan notes, the loss represented by the issue costs must be treated as being referable to the pre-migration period.

125. Having said that, we do not agree with the FTT that the fact the costs would have been amortised in the post-migration period if the loan notes had not been redeemed is irrelevant. It is at least a factor to be taken into account. Not just because the accounting treatment adopted by UKC1 allocated the issue costs to the lifetime of the loan notes, but because, as the Special Commissioner recognised in *Cadbury Schweppes*, it is “economically sensible” to spread the issue costs over the life of the loan. The accounting treatment gives a commercially realistic result.

126. We agree with UKC1 that the FTT was wrong to effectively treat the time when the issue costs were incurred as being determinative of the period to which they were referable. As a matter of commercial reality the costs did relate to the entire term of the loan notes. That is why they were amortised for accounting purposes over the entire term.

127. UKC1 also questioned the FTT’s reliance on hindsight. The FTT referred at [128] to the question of referability being approached with the benefit of hindsight. It had also referred to hindsight at [81] and [82]:

81. I accept that, looked at from the perspective of an issuer who has no intention of redeeming the loan notes early, this may be right. However, as I have said, the commercial realities do not, in my view, depend on the subjective perception or intention of the particular taxpayer but instead must be judged objectively and with hindsight from the point of view of an independent but informed observer.

82. In considering (objectively and with the benefit of hindsight) whether the loss (or part of it) existed or had arisen as a matter of commercial reality, it is in my view appropriate to ask the question whether the loss (or the relevant part) would have arisen but for an expense which was incurred during the pre-migration period or some change or event occurring after the loan relationship came into existence but during the pre-migration period.

83. This could be as a result of a change in the prospects of the borrower, a change in market conditions such as interest rates, credit spreads and discount rates or it may be something else. I see no reason in principle to distinguish between changes to the financial position of the borrower on the one hand and changes in market conditions such as interest rates on the other. Both of them are, in principle, capable of having an impact on whether a loss will be triggered when a crystallisation event occurs.

128. Clearly, section 327 is only engaged where a loss has actually arisen, and the section is only interested in the time to which that particular loss is referable. However, it is still necessary to consider when, as a matter of commercial reality, the loss arose. In our view, simply because the loan notes have been redeemed does not mean that one should ignore how an expense was treated prior to redemption.

129. HMRC says that the purpose of the referability test under section 327 is to assess whether the commercial reality as regards the timing of the loss differs from its treatment under amortised cost accounting. The period to which a loss is referable cannot simply turn on what the amortised cost treatment of the transaction costs would have been if the loan notes had run to term. The FTT's assessment of when the transaction costs were incurred is the correct way to identify the commercial reality and referability in the case of such expenses.

130. We agree that the accounting treatment of an expense, in this case an amortised cost basis of accounting, is not determinative. However, in this case the accounting treatment does reflect the commercial reality that the issue costs were an integral part of obtaining the funding and could properly be recognised over the expected term of the loan notes. No-one has suggested that this was an inappropriate accounting treatment.

131. We do not consider that the time the issue costs were incurred is irrelevant to the question of referability. However, we do consider that the FTT went wrong at [127] and [128] in not focussing on the commercial reality that the issue costs were part of the cost of obtaining the proceeds of the loan notes. It is relevant that the accounting treatment of the issue costs spread those costs over the lifetime of the loan. Obviously, when the loan notes were redeemed, the unamortised issue costs had to be written off as part of the loss on redemption.

132. We therefore set aside the decision of the FTT in relation to the unamortised issue costs and remake the decision. We are satisfied that as a matter of commercial reality the part of the loss attributable to the unamortised issue costs was referable to the post-migration period. Whilst they were paid at the time of issue, the unamortised issue costs were written off at the time of redemption and that reflected commercial reality.

133. In relation to the unamortised discount, UKC1 submits that it would always have to pay at least the principal amount of the loan notes on redemption. It would therefore always recognise any unamortised part of the discount as a loss, irrespective of market conditions. The unamortised discount was no different from the unamortised issue costs in this respect. Neither was a result of any change in market conditions. If the loan notes had not been redeemed early, then UKC1 would have obtained relief for the unamortised discount in the post-migration period.

134. It is not clear to us what the FTT was saying at [125]. What the FTT appears to be saying is that the part of the loss attributable to the unamortised discount was caused by a change in market conditions. We agree with UKC1 that the FTT was wrong to reach that conclusion. We cannot see that any change in market conditions affected UKC1's obligation to pay the discount, either at the end of the term or on early redemption. UKC1 committed to pay the discount at the time the loan notes were issued, but as the Special Commissioner in *Cadbury Schweppes* held, the discount was, in commercial reality, effectively the same as interest. It was being recognised as an expense over the lifetime of the loan notes.

135. It is true that the obligation to pay the discount was reflected in the fair value of the loan notes at the time of issue. In other words, the face value of the loan notes less the discount was the amount which the market was prepared to pay for the loan notes at the date of issue. However, that does not help to answer the question of whether the part of the loss represented by the unamortised discount was referable to the pre-migration period. The fact that market conditions changed and the fair value of the loan notes increased over time had no effect on the obligation of UKC1 to pay the discount at the end of the term or on early redemption. UKC1 was recognising that obligation by amortising the loan notes over their term and that reflected the commercial reality that the discount was a cost of obtaining the loan.

136. In the alternative, HMRC argued that the unamortised discount should be treated in the same way as the issue costs. The obligation to pay the discount arose at the date of issue and that was therefore the date on which the loss arose as a matter of commercial reality. We do not accept that argument for the same reasons that we did not accept the argument in relation to issue costs.

137. We therefore set aside the decision of the FTT in relation to the unamortised discount and remake the decision. We are satisfied that as a matter of commercial reality the part of the loss attributable to the unamortised discount was referable to the post-migration period. Whilst the obligation was entered into at the time of issue, the unamortised discount was written off at the time of redemption and that reflected commercial reality.

Compensatory element

138. The loss claimed by UKC1 was largely made up of the premium paid on redemption, comprising the compensatory element and the penalty element. It is common ground that the penalty element was referable to the decision of UKC1 to redeem the loan notes early and that decision was taken post-migration. That is the case even though it was computed by reference to pre-migration changes in interest rates.

139. HMRC accept that the penalty element was referable to the post-migration period because redemption of the loan notes did not just crystallise a pre-existing loss. It created an additional loss. The value of the loan notes at the Migration Date already reflected the compensatory element. In contrast, and it is not disputed, the value of the loan notes increased when the redemption notice was served on 29 February 2016 to reflect the obligation on UKC1 to pay the penalty element.

140. Ground 1 in relation to the compensatory element is that the FTT wrongly applied a test of causation in determining what period that part of the loss was referable to. UKC1 says that the FTT ought to have asked what part of the loss, if any, related to a pre-migration period as a matter of commercial reality.

141. There is a relatively short answer to that submission. We are satisfied that the FTT was applying the right test. It was seeking to identify when the loss attributable to the compensatory element arose as a matter of commercial reality. The FTT identified that this was the test and that it was a matter of common ground at [40] – [44] of the Decision. The FTT went on to reject a submission by UKC1 that commercial reality was to be viewed from the point of view of the particular taxpayer rather than as an abstract concept. It stated at [82] that the test was objective and that in considering whether a loss existed as a matter of commercial reality it was appropriate to ask the question whether the loss would have arisen “but for” some change or event in the pre-migration period.

142. The FTT applied the test at [93] – [130] under a heading “The loss and referability”. In the course of that section at [93] – [97], the FTT considered the circumstances in which the loss had arisen. In particular, that the compensatory element compensated noteholders for the

loss of future cashflows and when added to the principal sum outstanding was equal to the fair value of the loan notes.

143. The FTT then identified at [98] – [100] the arguments of UKC1 that none of the loss was referable to the pre-migration period. In particular that the compensatory element was referable to the decision to redeem or to the future interest payments which would otherwise have been made.

144. The FTT stated its conclusion in relation to the compensatory element at [104] and [117]. In the intervening paragraphs the FTT dealt with a number of submissions of UKC1 including a submission that it was necessary to look at the subjective intentions of the taxpayer. It rejected that submission at [108] – [116] and that argument is not pursued on this appeal. It is relevant to note how the FTT dealt with a submission by UKC1 that it was wrong to look at the fair value of the loan notes in determining when the loss arose as a matter of commercial reality:

105. Mr Prosser submits that it is wrong to look at the fair value of the loan notes in determining whether a loss had arisen or had existed as a matter of commercial reality prior to the Migration Date. This is because, as a practical matter, UKC1 could not acquire loan notes on the open market at fair value as, under the terms of the loan notes, UKC1 was prohibited from acquiring loan notes on the open market for a price in excess of the outstanding principal amount. At the relevant time (and for some years before that), the loan notes had been trading at a price significantly in excess of the outstanding principal amount. In practice, therefore, the only way of eliminating the loan notes was to redeem them early.

106. Whilst I accept all of this, it does not follow that market movements which affected the fair market value of the loan notes are irrelevant in determining whether, as a matter of commercial reality, a loss existed or had arisen in the pre-migration period. It seems to me that the fact that UKC1 could not crystallise that loss by acquiring loan notes on the market as opposed to redeeming them early makes no difference to this.

107. In principle, the situation is no different to that of a lender who migrates to the UK holding loan notes standing at a loss but which the lender has no immediate intention to sell. However, after coming to the UK, the lender decides to sell the loan notes and realises the loss. To the extent that the loss reflects factors (such as the creditworthiness of the borrower or movements in interest rates) resulting in the decrease in value of the loan notes up to the date of migration, that loss already existed as a matter of commercial reality.

145. The FTT then restated its conclusion at [117] and [118] as follows:

117. Leaving aside the question of intention which, as I have said, I do not consider to be relevant, it follows from what I have already said that the decision to redeem the loan notes early therefore simply crystallised losses which already existed as a matter of commercial reality at the date of migration with the exception of the penalty element of the premium (which only came into existence as a result of the decision to redeem early). The whole of the remaining amount (subject to what I say below about the unamortised issue expenses) is therefore referable to the pre-migration period.

118. As Mr Fell submits, it was the changes to market conditions including interest rates and credit spreads which gave rise to this element of the loss and to which the loss is referable. This is not to confuse calculation and referability. Of course, the changes to market conditions resulted in a change to the discount rate which is a key element in the calculation of the fair value of the loan notes and therefore the amount of the loss. However, just because something is part of the calculation of the loss does not mean that the loss cannot also be referable to that particular factor.

146. The FTT also expressed its conclusion in relation to all elements of the loss at [128] which is quoted above in the context of the unamortised issue costs. UKC1 submits that the decision to redeem early did not merely crystallise a pre-existing loss, which is how the FTT described it at [128]. It created a loss which did not previously exist as a matter of commercial reality and which there was no reason to believe would ever arise. At the Migration Date, UKC1 merely had expensive debt. If nothing changed, it would never suffer a loss. What changed, was the decision to redeem early. If the matter is looked at in terms of what caused the loss, this might be described as the immediate cause.

147. It is clear to us that the FTT was applying the right test, and in doing so was having regard to questions of causation, including “but for” causation. It was not simply applying a test of causation and focussing only on the cause of the loss. It plainly had in mind the nature and operation of the contractual clause pursuant to which the redemption payment was made, the way in which loan notes are valued in the market, the fair value of the loan notes at the time of issue and in the pre-migration period, changes in market conditions and how the payment was calculated, including by reference to future interest payments if the loan notes had not been redeemed. In our view that was the right approach. In particular, it is perfectly legitimate to consider questions of causation including “but for” causation as part of that analysis.

148. HMRC suggested that the challenge to the FTT’s finding that the compensatory element was referable to the pre-migration period was a challenge to the FTT’s evaluative judgment within the rule in *Edwards v Bairstow*. UKC1 does not have permission to make such a challenge and in any event would have to establish that no reasonable tribunal could reach such a finding. In our view there is some merit to HMRC’s objection. As we have said above, assessing what is commercially realistic sounds like an evaluative judgment. Indeed, as in this case there can be respectable arguments that a loss is referable to different periods and the question may be to which period is it most referable, although the arguments before us were not presented on that basis.

149. In any event, we are satisfied that the FTT was entitled to reach the conclusion that it did and indeed we would reach the same conclusion for the same reasons as the FTT. The compensatory element of the loss was referable to the pre-migration period. In particular, the fact that the compensatory element was calculated by reference to future interest payments for which relief would have been available if the loan notes had run to term does not mean that the loss is referable to the post-migration period. We do not accept UKC1’s submission that this is a perverse outcome.

150. The FTT noted at [119] the submission of UKC1 that the compensatory element was referable to the future interest payments it was liable to make and that it would be odd if the capitalisation of future interest payments was not deductible. It then stated at [120] – [122]:

120. However, even if Mr Prosser were right in this submission, the future interest payments are just as much part of the calculation of the loss as the discount rate and so would be vulnerable to the same objection.

121. As it is, I do not in any event accept that the compensatory element of the premium is referable to the future interest payments despite Mr Prosser’s suggestion that this part of the premium could be seen as an acceleration of the payment of interest.

122. The reason for this is that, as Mr Prosser accepted, whether or not any compensation was due depended entirely on the discount rate. If market conditions had not changed at all since the loan notes were issued, the compensatory element of the premium would have been nil even though the entitlement to future interest payments would have been removed as a result of the redemption of the loan notes.

123. Looked at in this way, it is even clearer that the loss is, as a matter of commercial reality, referable to the pre-migration changes in market conditions and not to the post-migration obligations which would have remained had the loan notes not been redeemed early.

151. We do not accept a submission by UKC1 that the FTT did not give any reasons for its conclusion at [118] that the compensatory element was referable to pre-migration changes in market conditions beyond the fact that those changes affected the calculation of its amount. It did give a reason at [122] and in any event the FTT's conclusion must be viewed in the context of the Decision as a whole.

152. UKC1 submitted that what is said at [121] is wrong because the future interest payments are much more than just part of the calculation. The obligation to make the future interest payments is the very basis of UKC1's obligation to pay the compensatory element, and therefore the reason for having to make the calculation. This itself has echoes of a "but for" test which both parties agree is not the right test. In any event, it is not simply the obligation to make future interest payments which is relevant, but also the rate at which those payments are calculated and how that rate compares to market rates at any particular time. For the same reason, we do not agree that the FTT was confusing computation and referability or that it failed to focus on the reason why UKC1 had an obligation to compensate the noteholders.

153. We acknowledge that it is important to take into account the nature of the compensatory element. It was paid to compensate noteholders for the loss of the right to future cashflows. There was no need to compensate the noteholders in respect of the principal amount, because that was paid to them on early redemption. Nor was there any need to compensate noteholders for future interest payments at current market rates because they would be able to reinvest the principal amount. The compensation was for the future interest carried by the loan notes insofar as the fixed rate exceeded current market rates. UKC1 was buying itself out of the obligation to make those payments of interest. We are satisfied that the FTT had the nature of the payment well in mind.

154. We should also deal with further submissions made by UKC1 in the course of argument although it does not appear to us that all of those submissions strictly fall within the ambit of Ground 1.

155. UKC1 submitted that the test of referability involves considering to what period the loss "relates" as a matter of commercial reality. In our view, this is simply another way of asking whether the loss is referable to a particular period. It does not help in answering the statutory question.

156. We do not consider that the FTT's finding is inconsistent with one object of the loan relationship regime which was to eliminate the distinction between capital and income payments. UKC1 submitted that there should be no difference in treatment between payments of interest on the one hand and a lump sum payment in replacement of those payments on the other hand. We acknowledge that the compensatory element was calculated by reference to the obligation to make future payments of interest and on one view it can be viewed as a lump sum payment replacing that obligation. However, the need to make that payment arose in commercial terms because of the pre-migration changes in market conditions.

157. During the course of submissions, both parties referred to the implications of the FTT's conclusion on the present facts for various hypothetical situations involving corporate borrowers and lenders. We consider these examples in principle below, but with the caveat that whether a loss is referable to a pre-migration period will depend on the specific facts of a particular case.

158. Some of the examples postulated by the parties were of lenders incurring losses. We agree with the FTT's observation at [90]:

90. In applying the approach I have proposed, I cannot see that there is, as a matter of principle, any reason to distinguish between a borrower and a lender. It may be less likely that a borrower will in fact realise a loss or that certain lenders (such as those who intend to hold their instruments to maturity) will realise a loss but that is not, in itself, a reason for applying a different approach in circumstances where a loss has, in fact, arisen.

159. UKC1 says that if the FTT is right, a corporate borrower migrating to the UK with a debt carrying interest above market rate could obtain deductions for the "excess" element of the interest for so long as the debt remains in place. In contrast, if the borrower were to pay a premium to re-finance the debt at a current market rate of interest, it would receive no deduction despite having incurred essentially the same financing cost. The fact that the expenditure is capital rather than income in nature should make no difference given that the loan relationship regime eliminates the distinction between capital and income payments.

160. We do not see why this result would not have been intended by Parliament. In the first case, no loss is realised so there is no reason to consider the question of imported losses. In the second case, a loss is realised at the time of refinancing and if it is referable to the pre-migration period then it is not surprising that it should be disallowed.

161. Both parties made submissions as to the relevance of fair value accounting and section 327(7) and gave examples of why fair value might or might not be relevant to the question of whether a loss was referable to a pre-migration period.

162. Section 327(7) provides that the imported loss restrictions in section 327 do not apply if the taxpayer uses fair value accounting. HMRC submitted that this exclusion from the operation of section 327 supported the proposition that changes to the factors which are used to calculate fair value may well have a significant, but not necessarily determinative, part to play in determining the period to which a loss is referable. The FTT accepted that submission at [88] and [89]:

88. In my view the fact that s 327(7) excludes the operation of s 327 where fair value accounting is used strongly supports the proposition that changes to the factors which are used to calculate fair value may well have a significant part to play in determining whether a loss is so referable as a matter of commercial reality.

89. However, as Mr Prosser's examples demonstrate, there will be circumstances where there is a loss based on fair value at the time of migration but, nonetheless, a subsequent loss realised by the relevant company post-migration is not referable to the loss which existed at the time of migration. It is no doubt for this reason that Parliament chose to use referability as the threshold for the application of s 327 rather than relying solely on fair value.

163. We were told that a corporate borrower such as UKC1 would not be expected to use fair value accounting for its liability because changes in interest rates could lead to significant increases in the liability even though there was no intention to redeem early. The company could as a result be rendered balance sheet insolvent. The borrower therefore simply recognises its obligations to pay the principal sum at the end of the term and payments of interest over the term. In contrast, a corporate lender might use fair value accounting because of the importance of recognising the market value or realisable value of a loan in its accounts.

164. UKC1 gave the example of a corporate lender with a fixed rate loan migrating to the UK. The borrower gets into financial difficulties post-migration and the lender writes off part of the loan recognising a loss in its accounts. UKC1 says that the loss is plainly not referable to the pre-migration period. The effective cause of the loss is the fact that the borrower got into financial difficulties. That is the case even if, immediately before migration, the fixed interest

rate carried by the loan was below current market rates such that if the lender had used fair value accounting a loss would have been recognised.

165. We do not see the difficulty with this example. When the loss is realised it would be necessary to consider on the facts whether any part of it was referable to the pre-migration period. That would include consideration of matters of causation, including what might be described as the effective cause of the loss.

166. UKC1 accepts that where a lender migrates to the UK and the fair value of the loan has fallen because the debtor got into financial difficulties prior to migration then a loss on subsequent sale would be referable to the pre-migration period. We cannot understand why it should make a difference if the loss arises as a result of other types of market changes.

167. Another example was a borrower getting into financial difficulties before the lender migrated to the UK. The borrower fully recovers in the post-migration period but then runs into financial difficulties again. If the lender realises a loss on the loan, the loss is clearly not referable to the pre-migration period. That is the case even though the fair value of the loan was less than par at the date of migration.

168. We agree that fair value in that case would not provide any assistance in assessing the period to which the actual loss incurred was referable. HMRC do not suggest that it would. The facts would have to be considered with a view to identifying to what period, as a matter of commercial reality, the actual loss was referable.

169. We agree with the FTT at [85] where it stated:

85. To that extent, I agree with Mr Prosser that fair value at the Migration Date is primarily relevant to the calculation of the amount of any loss. But that does not mean that changes in the elements which form part of that calculation cannot mean that the loss had arisen or existed as a matter of commercial reality in the pre-migration period.

170. HMRC maintains that the paradigm case in which section 327 would apply is where a lender migrates to the UK holding loan notes and the fair value of the loan notes has fallen prior to migration due to changes in market rates. If the loan notes were accounted for on the amortised cost basis then they would appear in the accounts at historic cost. If the lender crystallises the loss by selling the loan notes after migration, section 327 protects the revenue by disallowing any deduction referable to the pre-migration period. If UKC1 is right in its approach, the lender could argue that its loss was referable to future cashflows including interest receipts over the remaining term of the loan notes.

171. On the bare facts of HMRC's paradigm case, one might expect the imported loss rule to apply. This is essentially the same example as that given by UKC1 where the value of a loan is reduced by financial difficulties of the debtor but in this example it is changes in market conditions. In our view, there is nothing in section 327 which suggests a distinction between pre-migration losses caused by financial difficulties of the debtor and those caused by changes in market conditions.

172. Overall, we agree with the FTT that changes to the fair value of loan notes may assist in determining the period to which a loss is referable, although such changes will not be determinative. We consider that Parliament specifically chose the non-accounting concept of referability to ensure that the accounting treatment of a loan relationship was not determinative in the context of identifying imported losses save where fair value accounting was used. We do not accept the submission of UKC1 that whilst fair value accounting may be useful in determining the amount of an imported loss, it is not useful for determining whether there is an imported loss in the first place. Section 327(7) indicates that the policy concerns driving the imported loss restriction do not arise where fair value is used.

173. UKC1 contrasted section 327 with section 333 CTA 2009 which concerns the position of a company ceasing to be UK resident. In those circumstances, the loan relationship regime applies to certain loan relationships as if at the date of migration the company had assigned the assets and liabilities representing its loan relationships for a consideration equal to their fair value and had immediately reacquired them for the same consideration. We do not consider that this deemed disposal and reacquisition at fair value on ceasing to be UK resident throws any light on the significance of fair value in the context of section 327. The examples given above illustrate why a similar approach would not be appropriate in the context of imported losses.

GROUND 2

174. Ground 2 applies to the compensatory element. UKC1 submits that even if referability is concerned with the cause of the loss and the timing of that cause, it is not a “but for” test of causation. It is necessary to identify the effective cause of the loss. In the present case the effective cause of the loss was the decision to redeem the Notes early. The loss was not therefore referable to the pre-migration period.

175. Both parties acknowledge that the period to which a loss is referable does not involve a test of causation, although questions of causation may be relevant. We have already found that the FTT did not apply a “but for” test of causation. In those circumstances, it does not appear to us that Ground 2 adds anything to Ground 1 and it is not necessary for us to deal separately with Ground 2. To the extent that any arguments raised under Ground 2 are relevant to Ground 1 we have dealt with them under that ground.

CONCLUSION

176. For the reasons given above we allow the appeal in part. We consider the FTT did err in concluding that the unamortised issue costs and the unamortised discount were referable to the pre-migration period. We therefore set aside that part of the FTT’s decision and remake the decision with the result that UKC1’s appeal against the closure notice is allowed to that extent.

177. We are satisfied that the FTT was right to find that the compensatory element was referable to the pre-migration period and we therefore dismiss this aspect of the appeal.

JONATHAN CANNAN JENNIFER DEAN

UPPER TRIBUNAL JUDGES

Release date: 24 February 2026