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Do HMRC's allegations of fraud against GE signal a new era in tax investigations?

The background to **HMRC v IGE USA Investments Ltd & others** is whether HMRC should be allowed to rescind a settlement agreement reached with General Electric (***GE***). In this case, HMRC sought to amend its pleadings to introduce a claim that three representations, allegedly made by GE in the course of discussions leading up to the settlement, were made fraudulently. HMRC's allegations concerning two of these representations were dismissed; however, the High Court felt that the evidence in support of HMRC's third allegation - that GE deliberately failed to disclose the complete picture - was enough that it should be allowed to pursue that argument at trial. This creates an eye-catching headline but there is a long way to go yet. These allegations will no doubt be vigorously defended by GE once the case goes to trial, and it remains to be seen whether HMRC will ultimately succeed in establishing fraudulent behaviour. Nevertheless, the case is a useful reminder of the need to represent facts carefully and consistently in correspondence and negotiations with HMRC and other tax authorities. More generally, it reflects HMRC's hardened attitude towards cross-border hybrid and debt planning by multinationals.

What is the case about?

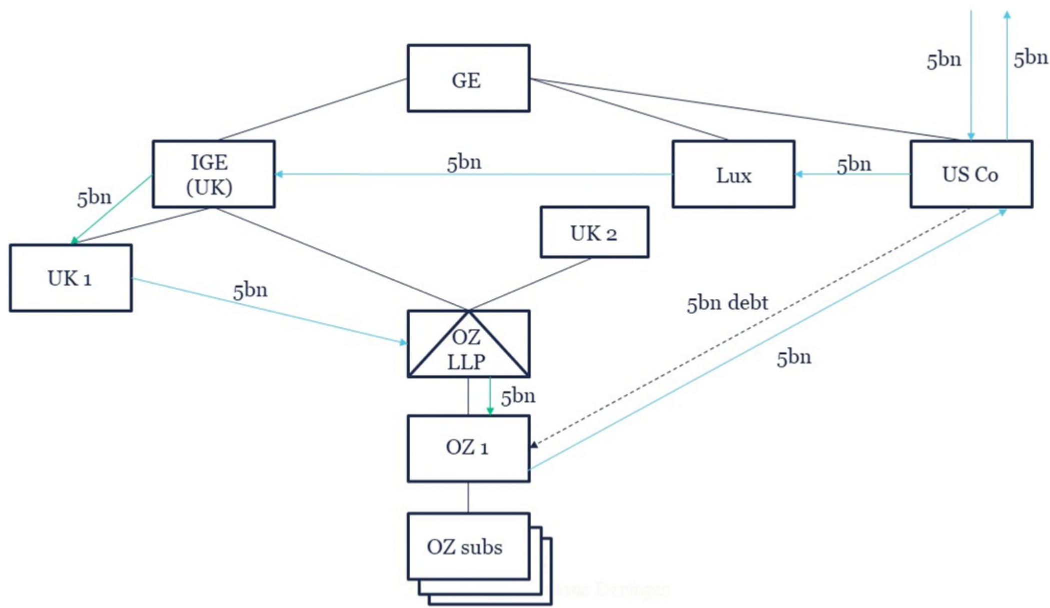
The UK High Court decision in **HMRC v IGE USA Investments Ltd & others** [2020] EWHC 2121 (Ch) is fundamentally about whether HMRC should be allowed to rescind a settlement agreement reached with General Electric (***GE***) in 2005, which included agreement as to the tax treatment of particular transactions. HMRC is arguing that it is not bound by the settlement agreement, including because the taxpayer made fraudulent representations in the course of discussions leading up to the settlement. It is obviously highly unusual to see such a serious accusation levelled at a multinational, professionally-advised taxpayer such as GE. However, the numbers are large (apparently around US$1bn of tax is at stake) and the transactions go back to 2004, so - unless the relevant corporation tax periods are still open - HMRC may need to show deliberate behaviour to recover the tax.

What was the underlying planning?

The GE group included an Australian subgroup which owed 5bn of debt (originally acquisition finance) to a GE US Treasury Co (***US Co***). In 2004, a transaction was implemented which (in very simplified terms) involved the US Co entering into a daylight borrowing of 5bn, passing those funds around the group through a series of intra-group loans and equity/capital subscriptions (including an equity investment into the Australian subgroup), and ultimately repaying both the existing debt owed to US Co and the daylight borrowing. The 5bn therefore flowed through the group in a circle, with the lasting effect of the steps seemingly being to transfer the Australian sub-group under a UK GE sub-group and to create several intragroup debts (see the simplified diagram below, showing debts/repayments in light blue and equity/capital subscriptions in green).

Importantly, these debts included a debt owed by an Australian LLP (***OZ LLP***) to a UK company (***UK 1***). The LLP was a hybrid entity, ie regarded as a taxable (opaque) entity in Australia, but a transparent entity in the UK. HMRC would say that this results in a net 'double dip' interest deduction, with a UK deduction being available to the UK companies which were members of the LLP, and an Australian deduction available to the LLP itself.

Shortly after these transactions were undertaken, the UK introduced its anti-arbitrage rules. These rules (now repealed and replaced by the anti-hybrid mismatch rules)



were an early attempt to combat tax avoidance through the use of hybrid entities. The rules applied to a taxpayer only if certain conditions were met, including (broadly) that the arrangements in question had a main purpose of achieving a UK tax advantage.

Existing transactions were not grandfathered under the regime, and HMRC seems initially to have been of the view that the anti-arbitrage rules could apply to the transactions described above with the effect of eliminating the UK interest deduction. GE disagreed and this led to extensive discussions between GE and HMRC, culminating in the signing of the settlement agreement in December 2005. The settlement agreement recorded, *inter alia*, that:

- GE did not consider that the anti-arbitrage rules applied in relation to these matters, and had represented that it had made disclosure of all relevant facts in connection with the application of the anti-arbitrage rules;
- HMRC, in reliance on the information provided by GE, agreed not to apply the anti-arbitrage rules to funding of the Australian investment;
- HMRC also agreed, on the basis of the information provided by GE, that it would raise no challenge under FA 1996 Sch 9 para 13 (the loan relationships unallowable purposes rule) - this in itself is quite unusual; and
- GE confirmed to HMRC that it had made adequate disclosure of the matters dealt with in the settlement agreement and the underlying facts and circumstances.

Why did HMRC rescind the settlement agreement?

From 2011 onwards, HMRC began to accumulate information which, it says, shows matters in a different light to that presented to them by GE. In particular, HMRC claims that it was not told during the settlement discussions of the circular nature of the transaction, nor in fact anything about the destination of the funding beyond its injection as equity funding into the Australian sub-group. HMRC's view is that the daylight borrowing and the transfer of funds in a circle indicates that at least one of the main purposes of the arrangements was to obtain a UK tax advantage.

After years of discussions with GE, HMRC purported to rescind the settlement agreement in October 2018, on grounds of material misstatements of fact and/or a failure to provide adequate disclosure. Shortly thereafter, HMRC issued proceedings in the High Court for a declaration that the rescission was valid.

The current High Court judgment concerns applications by HMRC to amend its pleadings, essentially to introduce three new representations that GE are alleged to have made, and to introduce a claim that those representations were made fraudulently. So this decision does not relate to a substantive hearing on the merits, but focuses on whether particular claims by HMRC should be allowed to go to full trial.

The judgment does not explain precisely what it is that caused HMRC to assert fraud, but it hints at a need to do so to overcome defences raised by GE (possibly statutory limitation defences). It may also be linked to the fact that, if HMRC succeeds in rescinding the settlement

agreement, it will have the benefit of a 20-year limitation period for deliberate misreporting of tax to raise discovery assessments on GE. Or it may be that HMRC wants to send a message to the taxpayer community; in particular, it seems that HMRC was frustrated that GE allegedly provided different (and inconsistent) information to HMRC and the Australian Tax Office.

HMRC now alleges that GE made the following representations:

- That the main purposes of the transactions at issue were all genuine commercial purposes, and/or that none of the main purposes of these transactions was to secure a UK tax advantage. This would obviously go to the question of whether the anti-arbitrage condition referred to above was met. This is referred to as the 'main purpose representation';
- That, absent the hybrid opportunity, the UK subgroup would nevertheless have effected the same investment in Australia (whether by borrowing in the UK to fund the acquisition of equity in an Australian company or otherwise). There is some disagreement as to the precise importance of this point, but it is thought to be relevant to the question of whether there is a main purpose of generating a tax advantage. This is referred to as the 'hybrid opportunity representation'; and
- That it had made disclosure of all relevant facts and matters in connection with the potential application of the anti-arbitrage rules and/or the legislation relating to unallowable purpose in connection with the funding of the Australian investment. This is referred to as the 'full disclosure representation'.

In each case, HMRC alleges that the relevant representation was made fraudulently, ie with knowledge of its falsity or recklessness as to its truth.

What were the legal tests to be applied at this stage?

In deciding whether to allow the various amendments to be made (and the claims to which they give rise to proceed), the test is whether the proposed amendments have a real, as opposed to a fanciful, prospect of success. It is clear from the discussion by the High Court that the allegation of fraud in particular requires some degree of particularisation, and that this caused some problems for HMRC.

Why were the main purpose and hybrid opportunity representations dismissed?

In relation to the main purpose representation and hybrid opportunity representation, GE successfully argued that HMRC has no prospect of establishing that they were made (or, if made, relied upon by HMRC) and therefore that HMRC's arguments on these points cannot proceed.

HMRC's essential problem here was a lack of clear evidence. HMRC was effectively trying to argue a combination of: (i) the points were vital to the analysis and so the representations must have been made at some point; and (ii) it could be inferred from the contemporaneous documentation that the representations had (more likely than not) been made.

However, the High Court was not convinced that the available evidence supported the inferences which HMRC sought to draw. In part, HMRC suffered because the discussions between GE and HMRC included some arguments where each side advanced a different legal interpretation of the anti-arbitrage rules. HMRC argued that it could be inferred from documents from this period that GE had made the alleged representations, but these representations were only relevant on HMRC's interpretation of the law. The High Court felt it was more likely that GE was advancing points on its own interpretation of the rules rather than trying to factually answer HMRC's interpretation.

As a result, the High Court was not required to consider the allegation of fraud in relation to either of these representations.

Why wasn't the full disclosure representation dismissed?

By contrast, GE did not argue that HMRC has no prospect of establishing that the full disclosure representation was made (presumably because the terms of the settlement agreement indicate that GE did make a representation along these lines, although GE does intend to dispute the point at trial).

The High Court therefore had to assume, for the purpose of these proceedings, that the full disclosure representation was made, was false, and induced HMRC to enter into the settlement agreement. The sole question then was whether the pleaded facts would justify the plea of fraud, or (putting it another way) whether on balance they pointed more towards fraud than negligence.

Here the High Court felt that the evidence in support of HMRC's position was enough that it should be allowed to pursue the argument at trial. This included:

- evidence that the relevant individuals at GE (who were very senior and experienced in relation to tax affairs generally) were aware (having discussed it with their legal advisers) of HMRC's draft anti-arbitrage guidance which included a requirement that details of any scheme provided for clearance should include a description of the flows of money and its final destination, and an explanation of the commercial purposes of the scheme; and

- evidence that those individuals had full knowledge of all material facts and matters relating to the Australian investment (and in particular the circular flow of funds) and that the same was not disclosed to HMRC.

In addition, HMRC was able to point to unhelpful facts such as:

- a diagram not disclosed by GE in the clearance discussions, which highlighted (with 'exploding star' shapes) the double-dip element of the transaction;
- an extract of a board minute of one of the UK companies involved which had been provided by GE to HMRC, which omitted details of the intra-group financing contained in the full minute;
- structure diagrams that were disclosed by GE, purporting to show an equity investment in Australia as the final step in the transaction, as compared to detailed step plans which revealed the circularity of funds and which were not disclosed to HMRC; and
- a 2013 description of the transaction by GE to the Australian Tax Office as having a purpose of 'gaining a tax advantage in the UK not Australia'.

The difference of legal opinion referred to above did not help GE here; in representing that it had disclosed all material facts the High Court considered that GE should (at least arguably) have included disclosure of facts relevant to HMRC's legal interpretation. If GE wanted to get clearance/agreement from HMRC, it was incumbent on them to give HMRC possession of those facts HMRC considered relevant.

HMRC's case on the full disclosure representation was therefore allowed to proceed and will be heard at trial, which is scheduled to take place in July 2021.

Was the settlement agreement a contract of 'utmost good faith'?

As an alternative ground, HMRC argued that the settlement agreement was a contract of utmost good faith and that a failure to give full disclosure should therefore entitle it to rescind. The High Court declined to answer this on an interlocutory application and left it for trial. However, this is potentially an important point to keep in mind when negotiating future settlement agreements.

HMRC was also allowed to proceed with an argument that the settlement agreement contained an implied term allowing it to terminate if the full disclosure obligation was breached.

Where does this leave us?

The case in effect represents the pilot episode for an upcoming courtroom drama that looks likely to run for some time. Even if HMRC succeeds in rescinding the settlement agreement, GE will doubtless dispute any tax assessments based on their legal arguments around the identification and application of comparator transactions. Key takeaways are:

- Although the allegations sound serious, at this stage, it seems unlikely that they will lead to any criminal proceedings for any of the individuals or entities involved. The press has suggested that a this is a 'new era' for HMRC alleging fraud against big business. However, it seems more likely that they have been raised strategically to avoid limitation defences and/or allow discovery assessments to be issued.
- The case demonstrates a significant hardening of HMRC's attitude to cross-border hybrid and debt planning, including more focus on main purpose tests. This reflects a continuing trend over the past few years and GE's case may eventually add to the body of case law in this area, albeit in the context of a set of rules that have now been repealed.
- The case is also a useful reminder of the importance of carefully (and consistently) representing and documenting facts in correspondence and negotiations with HMRC and other tax authorities. Global tax authorities are increasingly sharing information and taxpayers need to be mindful of this.

This briefing was originally published in Tax Journal on 11 September 2020.

Helen Buchanan

Partner

T +44 20 7716 4884
E helen.buchanan@freshfields.com

John Tolman

Senior Knowledge Lawyer

T +44 20 7785 2499
E john.tolman@freshfields.com

freshfields.com

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