Main purpose tests

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1. What is a "main purpose" test?

A main purpose test is included in many sections of the taxing statutes, particularly in the anti-avoidance sections. For example:

- Many of the specific anti-avoidance provisions within the Tax Acts provide that certain reliefs or deductions will not be available if the main purpose, or one of the main purposes, of an arrangement is to secure a tax advantage.
- Section 811C applies to withdraw or deny a tax advantage that a person seeks to gain from entering into a tax avoidance transaction. A transaction is only a tax avoidance transaction, for the purposes of section 811C, if it would be reasonable to consider that it was not undertaken primarily for purposes other than to give rise to a tax advantage.
- A transaction is only disclosable under the Mandatory Reporting regime (Chapter 3 of Part 33) if the main benefit, or one of the main benefits, of the transaction is obtaining a tax advantage.
- Under the EU mandatory disclosure regime (Chapter 3A of Part 33), certain categories of cross-border arrangements will not be disclosable unless a main benefit test is satisfied.

This manual summarises the key case law in the area.

1.1. How to approach a "main purpose" test

Whilst it is true that tax considerations can form part of a commercial transaction without swamping its non-tax elements, it is also true that tax driven transactions can be covered with a veneer of commerciality in an attempt to disguise their main purpose[1].

1.2. Principles from case law

While it can be argued that there are slight differences between the three tests above, there are some general principles, having regard to established case law, which are helpful in applying these tests:

- There is a difference between something being the sole or main purpose of a transaction and being one of the main purposes of that transaction. That a transaction has a genuine commercial motive as **the main purpose** does not mean it does not have obtaining a tax advantage as **one of the main purposes**[2]

[1] TCO1800: **A.H. Field (Holdings) Ltd**

[2] **Loyds TSB Equipment Leasing (No 1) Ltd v Revenue and Customs** [2014] EWCA Civ 1062

- Where a tax advantage is simply 'the icing on the cake'[3] then it is not a primary purpose or main benefit of the transaction.
- It is often obvious whether or not a primary purpose or main benefit of a transaction was to give rise to a tax advantage[4].

1.3. A simple test

In simple terms, tax avoidance will be one of the main purposes or benefits of a transaction, where:

(i) there are a number of reasons for entering into, or potential benefits from, a transaction and

(ii) one of those reasons / benefits is to gain a tax advantage and

(iii) the person would not have entered into the transaction had the possibility of the tax advantage not been there.

1.4. Other indicators

Where a taxpayer has a commercial goal in mind, but something in the way the transaction is carried out has a tax avoidance purpose, then the transaction may also fail a 'main purpose' test. For example:

- the price paid may be set at an artificial level[5] or
- artificial, complicated and unnecessary steps may be introduced[6]

so as to gain a tax advantage. In these cases **the main purpose** of the transaction may be a genuine commercial purpose. However, the main purpose of structuring the transaction in an artificial way is to obtain a tax advantage. Therefore, **one of the main purposes** of the transaction, as a whole, is to obtain a tax advantage.

1.5. Other considerations

That the tax advantage is a consequence of the transaction (e.g. getting capital allowances as a normal feature of the Irish tax system) does not mean that it cannot also be one of the main purposes of the transaction (e.g. where there was artificial structuring to obtain capital allowances or an excessive amount was paid for the asset to artificially increase the amount of capital allowances available). The issue of whether achieving a normal consequence of something can also be a purpose of doing something was addressed by Budd J in the High Court[7]:

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[3] **Commissioners of Inland Revenue v Sema Group Pension Scheme Trustees** [2002] 74 TC 593

[4] **Snell v HMRC** [2006] 78 TC 294

[5] As seen, for example in the structures challenged in **HMRC v Tower MCashback LLP 1 & Ors [2011] UKSC 19** or **CIR v Challenge Corporation Ltd [1986] STC 548**

[6] As seen, for example in the structure challenged in **Revenue Commissioners v O'Flynn Construction & Ors** [2011] IESC 47

[7] In the case stated for the Supreme Court in **MacAonghus (Inspector of Taxes) v Ringmahon Company Ltd** [1999] IEHC 48, where he cited with approval **Millett L.J's** summary of the principles involved from **Vodafone Cellular Limited and Ors v Shaw (Inspector of Taxes)** [1997] STC 734

> **Some consequences are so inevitably and inextricably involved in the payment that unless merely incidental they must be taken to be a purpose for which the payment was made.**

2. Objective or subjective tests?

When applying a main purpose test, it is first necessary to determine if it is objective (what a reasonable man on the street would think) or subjective (what did the taxpayer actually have in mind).

2.1. Objective tests

Objective tests can be phrased in a number of ways. For example, they can require that something be reasonable, invoking the **bonus paterfamilias** or 'reasonable man' test. Two examples of objective 'main purpose' tests in the Tax Acts are:

(i) Disclosure of a transaction under the mandatory disclosure regime is, in some cases, linked to what an 'informed observer' would conclude. For example, a loss scheme[8] is disclosable if an informed observer could reasonably conclude that the creation of an income tax loss is a main outcome of the transaction. This test is objective in that what the taxpayer actually intended is irrelevant. What an informed observer would reasonably conclude, from the facts, is the test in law.

(ii) Section 811C provides that when determining whether or not a transaction is a tax avoidance transaction one must consider whether or not, having regard to a number of factors, it would be reasonable to consider that the transaction gives rise to a tax advantage and that the transaction was not arranged primarily for purposes other than giving rise to that tax advantage. Furthermore, the factors which one must consider are in themselves objective: for example, one must look to the form and substance of the transaction and to the results of the transaction. The subjective intention of the taxpayer is not something which can be considered or inferred. Therefore, this is also an objective test in that the results are used to determine motive, rather than trying to actually determine what was in the taxpayers mind at the time of the transaction.

2.2. Subjective tests

Many of reliefs within the Taxes Consolidation Act 1997 contain a provision to the effect that relief will not be available if part of what has to be done to claim that relief was 'not for **bona fide** commercial purposes and was part of a scheme or arrangement the main purpose, or one of the main purposes of which, was the avoidance of tax'. These tests are generally subjective in nature. See for example section 489(7).

[8] Mandatory Disclosure of Certain Transactions Regulations 2011, para 11

Subjective tests are, by their very nature, contentious. Rimer LJ[9] stated that:

> **I should say that I do not regard [this section] as a cleverly drafted piece of legislation. To make the availability of a capital allowance dependent on what is ultimately the subjective intention of a party to a transaction is a recipe for dispute and litigation…Neither LEL nor HMRC can be criticised for wanting to litigate the point, but that our tax legislation should be written like this appears to me to be unsatisfactory.**

The UK's First Tier Tribunal considered whether or not the purpose should be inferred from the consequences[10] and found that:

> **… it is legitimate to consider the consequences of the taxpayer's actions in order to determine his purpose. Consequences are the result of purposes which have been acted on. Consequences can, and will usually be, related to purpose, though we take on board the fact that purposes can be frustrated and consequences can be unexpected.**

They further considered that in determining the purpose of a taxpayer one should:

> **Tak[e] account of both the alleged purposes by reference to the available evidence and actual consequences of the Appellant's actions, this is the approach taken in Prudential[11], Sema[12] and Brebner[13]**

The Irish Courts considered what 'purpose' meant when looking at whether or not a taxpayer had incurred an expense wholly and exclusively for the purposes of the trade[14]. Budd J, in the case stated for the Supreme Court, cited with approval Millett L.J's summary of the principles involved from Vodafone Cellular Limited and Ors v Shaw (Inspector of Taxes)[15]:

2. To ascertain whether the payment was made for the purposes of the taxpayer's trade it is necessary to discover his object in making the payment. Save in obvious cases which speak for themselves, this involves an inquiry into the taxpayer's subjective intentions at the time of the payment.
3. The object of the taxpayer in making the payment must be distinguished from the effect of the payment. A payment may be made exclusively for the purposes of the trade even though it also secures a private benefit. This will be the case if the securing of the private benefit was not the object of the payment but merely a consequential and incidental effect of the payment.

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[9] Para 41, **Lloyds TSB Equipment Leasing (No 1) Ltd v Revenue and Customs Commissioners** [2014] EWCA Civ 1062
[10] TCO1800: **A.H. Field (Holdings) Ltd**
[11] **Prudential plc v T&C Comrs** [2008] STC (SCD) 239
[12] **Commissioners of Inland Revenue v Sema Group Pension Scheme Trustees** [2002] 74 TC 593
[13] **IRC v Brebner** 43 TC 705
[14] **MacAonghus (Inspector of Taxes) v Ringmahon Company Ltd** [1999] IEHC 48
[15] [1997] STC 734

4. Although the taxpayer's subjective intentions are determinative, these are not limited to the conscious motives which were in his mind at the time of the payment. Some consequences are so inevitably and inextricably involved in the payment that unless **merely incidental they must be taken to be a purpose for which the payment was made.**

In looking at subjective tests it is therefore necessary to determine what was in the mind of the taxpayer at the time the transaction was entered into. Consequences can be used to infer what the subjective purpose was, but care must be had as to whether they were inevitable consequences or unexpected ones. Evidence will include contemporaneous documents as well as testimony from the taxpayer and other parties.