Direct Tax Cases: Decisions from the Irish Courts and Tax Appeals Commission Determinations

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02	**Income Tax: *Buckley v The Revenue Commissioners***	High Court
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01 Capital Gains Tax: Hanrahan v The Revenue Commissioners [2024] IECA 113

The Court of Appeal (consisting of Donnelly J, Faherty J and Butler J) considered cross-appeals from a High Court judgment. In summary, the taxpayer had in 2004 entered into transactions with connected parties whereby a bond was sold subject to an option agreement. The overall result of the transactions was that a significant tax loss (for CGT purposes) was purportedly created owing to the operation of the connected-party rules (in particular, s549 TCA 1997), in respect of which relief was then claimed under s31 TCA 1997, even though no corresponding commercial loss had been suffered. Revenue challenged the taxpayer's claiming of that loss and sought to use s811 TCA 1997 (the general anti-avoidance rule, or GAAR) to reverse it.

The three questions before the Court of Appeal were:

(1) Did the taxpayer engage in a tax-avoidance transaction for the purposes of s811 TCA 1997 (the GAAR provision) ("the substantive question")?

(2) Did Revenue act within the time allowed?

(3) Was Revenue's Notice of Opinion invalid?

The High Court had ruled in favour of the taxpayer on the substantive question, which Revenue appealed to the Court of Appeal, and had ruled in favour of Revenue on the two procedural points, which the taxpayer cross-appealed.

The Court of Appeal decided all three questions, and thus the appeal, in favour of Revenue, holding the following:

(1) The fact that the tax treatment that the taxpayer sought to avail of was derived from an anti-avoidance provision (s549 TCA 1997) rather than a relieving provision did not preclude the operation of s811. "On the contrary this is a general provision which is intended to apply to **any** transaction undertaken or arranged to benefit from... **any** relief, allowance or abatement" (paragraph 115, original emphasis).

(2) Revenue was not precluded from raising the assessment beyond the four-year time limit provided by s955(2) TCA 1997 as the taxpayer had not made a full and true disclosure of all material facts on his return. Furthermore, even if the taxpayer had made a fully compliant disclosure, then s955(2) would still not apply given the effect of s811(5A).

(3) The court considered that an error in the description of the transaction by Revenue in its Notice of Opinion was not material. The court noted that the key factors that made the transaction a tax-avoidance transaction (which the court stated were the parties' connection and the consequent substitution of market value) had been sufficiently set out in the Notice of Opinion and the factual error that the taxpayer complained of had no bearing on the tax consequences of the transaction. It therefore decided that the Notice of Opinion was not invalid. Significantly, although the court found against the taxpayer on this point, it also rejected Revenue's argument that the taxpayer should be regarded as being on notice of the correct details of the transaction (on the basis that the taxpayer was a participant) and criticised that argument as Kafkaesque. The question of whether any omission from a Notice of Opinion could be cured by such details' having been included in prior Revenue correspondence to the taxpayer was looked on more favourably by the court but ultimately not considered further, given its finding that the notice was not invalid.

02 Income Tax: Buckley v The Revenue Commissioners [2024] IEHC 414

The High Court (Dignam J) considered an appeal by a taxpayer against a Tax Appeals Commission (TAC) determination that he had not been carrying on a trade of land development and thus was not entitled to claim losses against his other income (dental profession).

The taxpayer had purchased a site in 2005 with the intention of developing it, but owing to the economic downturn he did not proceed with the venture. He began claiming losses in respect of costs associated with the project (primarily borrowing costs) for the tax year 2008 and continued in the following years. Revenue subsequently raised assessments covering the years 2008 to 2015, reversing those loss relief claims on the basis that the taxpayer had not provided evidence of a trade. The taxpayer was unsuccessful before the TAC on the substantive point, concerning whether he was carrying on a trade, and on a procedural point, concerning the raising of the assessments beyond the four-year time limit.

The questions before the High Court were:

- whether the TAC was correct to find that the taxpayer was not conducting a trade of land development during the years in question and
- whether the TAC was correct to find that the taxpayer's returns did not contain a full and true disclosure of all material facts.

The High Court:

- Rejected the appellant's contention that the judgment of the High Court in *Revenue Commissioners v O'Farrell* [2018] IEHC 171

was authority for the proposition that an individual should be considered to have commenced a land development trade as soon as he purchased land with the intention of developing it, on the basis that such contention was an oversimplification of that decision. The court noted that the *O'Farrell* decision required that all of the mix of facts (and not merely the fact of purchase and intent) had to be considered.

- Noted that the Commissioner was entitled to treat the facts that planning permission had not been obtained, the zoning status had not changed and financing for the development had not been secured as relevant considerations, and could, as part of an examination of all of the facts, have reached a conclusion that the taxpayer was not trading.
- Found, however, that the Commissioner had erred when making her decision by not considering the fact (as found by her) that the taxpayer had incurred professional fees in respect of design fees and planning applications after purchase and had retained a planning agent. The court considered those facts to be relevant to the question of whether the taxpayer had commenced to trade and noted that those facts had not been referenced alongside the other facts in the "Analysis" section of the TAC's determination.
- Decided, accordingly, to remit the case back to the TAC, so that the Commissioner could reconsider the matter in light of all of the relevant facts.
- Determined, given its determination on the substantive point, that it was not appropriate to consider the second question.

03 Corporation Tax: Arlum Limited v The Revenue Commissioners [2024] IEHC 402

The High Court (Quinn J) considered an appeal by the taxpayer against a TAC determination that had upheld Revenue's decision to treat the release of a €6m debt as a trade receipt pursuant to s87(1) TCA 1997.

The taxpayer, a company, had in 2006 borrowed €9.5m to purchase land on which it intended to develop residential property. The value of that land decreased significantly after the collapse of the property market. The taxpayer had written down the value of the land in its accounts for tax purposes over a number of years. By 2016 the taxpayer had paid more than €5m in interest and capital payments to the bank, and at that time the bank agreed to write off the balance of the loan (€6m) in exchange for a payment of €250,000 (which sum was understood to be the estimated value of the land at that time).

The TAC had accepted Revenue's position that the deduction allowed for such asset value write-downs fell within the wording of s87(1) TCA 1997, i.e. that "a deduction has been allowed for any debt". It therefore upheld Revenue's assessment that the release of €6m of the original debt was a receipt of the trade pursuant to s87(1).

The principal question before the High Court was whether the TAC was correct in its determination that the writing down of the value of the land in the accounts of the taxpayer company meant that "a deduction ha[d] been allowed for any debt" within the meaning of s87(1).

Revenue also attempted to raise as an alternative argument before the High Court that s76A TCA 1997 ought also to apply to treat the amount of the debt written off as a trading receipt.

The court held the following in allowing the taxpayer's appeal:

- The TAC and Revenue were incorrect to apply s87(1) to the facts as "[t]he writing down of the value of the lands, and carrying forward losses as a result, does not equate to having a deduction allowed for a debt". The court noted that the language of the statute was clear and that no deduction had been allowed for the debt – "The lands purchased by the loan are not legally the same thing as the debt due by the Company to the bank".
- As regards the secondary argument, the court concluded that it had no jurisdiction to hear Revenue's s76A argument as it had not been raised in the case stated made to it. However, having allowed Revenue to make its s76A argument notwithstanding the court's jurisdictional concerns, the court further expressed the view that Revenue's s76A argument was without merit.

04 TAC's Jurisdiction: Browne v The Revenue Commissioners [2024] IEHC 258

The High Court (Quinn J) considered an appeal by a taxpayer against a decision of the TAC. As this case concerned VAT rather than direct taxes, the substantive questions are not considered here. However, as regards a procedural point, the High Court reiterated the position that the TAC has no inherent jurisdiction to hear arguments of a judicial review nature. Accordingly, the court held that the TAC was correct in finding that it had no jurisdiction to consider the taxpayer's complaints that Revenue's application of the Value-Added Tax Consolidation Act 2010 was *ultra vires* to the Constitution, fair procedures and the Charter of Human Rights.

05 Corporation Tax: TAC Determination 59TACD2024

In this appeal the TAC considered the application of transfer pricing rules (s835C(2)(b) TCA 1997). The appellant (a software development company) provided certain services to its parent company. The appellant charged a fee based on arm's-length principles – in this case using the transactional net margin method as the transfer pricing method and the net cost plus method as the profit level indicator – which amounted to a mark-up of 10% on its costs.

The dispute between the appellant and Revenue concerned the calculation of the appellant's net costs, in particular whether the value attributed to share-based awards (SBAs) granted by the appellant to its employees should be included. These SBAs were in respect of shares in the appellant's parent company. The appellant attributed an expense value to them in its financial statements in line with FRS 102 (being the "fair value" of the SBAs); however, it excluded their value from the calculation of its "costs" when determining its margin for transfer pricing purposes, on the basis that it did not incur any actual costs as a result of the issue of the SBAs by its parent.

The fundamental question before the TAC was whether the appellant was correct to exclude the value attributed to the SBAs from its cost base when calculating the inter-company services fees that it charged to the parent company.

The TAC held, in allowing the taxpayer's appeal, that it was correct to exclude the notional value attributed (by FRS 102) to the SBAs from the taxpayer's accounts as it found that (1) the costs of the SBAs were borne by the parent company (rather than the appellant) and (2) the OECD guidelines were concerned with the economic costs incurred by the appellant (rather than by its parent company).

06 Income Tax: TAC Determinations 62TACD2024 and 63TACD2024

In these joined appeals concerning the same matter, the TAC considered the disposal of goodwill by a sole trader to a company and the effect of the creating a director's loan account. The appellants were an individual and his company. The individual had transferred goodwill in his sole trader business to his company in exchange for the creation of a €250,000 director's loan account in his favour. He claimed retirement relief in respect of that disposal. He subsequently drew down the balance of the director's loan over a number of years (2013–2016). Four years after the transfer of the goodwill, the appellant sold the shares in the company to his children for €1.

Revenue raised a number of assessments against the individual and his company, subjecting the sums extracted to alternative assessments to PAYE and dividend withholding tax (DWT).

The questions that the TAC had to consider were:

- What was the appropriate value of the goodwill?
- What approach should the TAC take to the alternative assessments?
- How was the creation and draw-down of the director's loan account to be treated?

Valuation of goodwill

The TAC heard evidence from the appellants' and Revenue's expert witnesses on the valuation of the goodwill of the business, and the determination sets out their competing valuation methodologies in some detail. Expert 1 (appellants' expert) had valued the goodwill at €283,736. Expert 2 (Revenue's expert) had valued the goodwill at €41,225.

The two experts had agreed that the key issue in valuing the business was its future profits. Where they disagreed was in the appropriate number of years' profits to take into account when calculating future maintainable profits, with Expert 1 favouring 6.25 years and Expert 2 favouring 3 years. A further difference was that Expert 1 used a simple average of the profits whereas Expert 2 favoured a weighted average approach that placed most weight on the most recent year's profits (which was also the recommended approach in Des Peelo's book on valuation methods, *The Valuation of Businesses and Shares: A Practitioner's Guide*). A further difference arose between the experts concerned the multiple to apply (4.5 vs 2).

The TAC accepted that goodwill existed in the individual's business and that this had been transferred to the company. However, the TAC favoured Expert 2's approach, holding that, on the particular facts (a trend of declining sales), Expert 2's approach was more consistent with Mr Peelo's guidance, and accordingly found that the appropriate value of the goodwill was €41,225.

Alternative assessments

The Commissioner noted that there were no Irish judicial decisions on the issue of alternative assessments but there was a line of UK authority, which held that they were not an unfair practice. In any event, the Commissioner noted Irish judicial authorities to the effect that the jurisdiction of the TAC was to focus on the assessment and charge rather than any incidental questions. The Commissioner also noted that the case before her had been adjourned at an earlier stage to allow the appellants to take judicial review proceedings against Revenue but those judicial proceedings were not then taken. Therefore the Commissioner focused on the correct charge to tax.

Tax treatment of the director's loan transactions

The Commissioner had already found that the goodwill should be valued at €41,225 rather than €250,000. The question then was how the

difference of €208,775 was to be treated. Given the choice between confirming the assessments to Schedule E (emoluments/PAYE) or Schedule F (dividends/DWT), the Commissioner chose the PAYE assessments. Regarding whether the tax should be assessed when the amounts were credited to the director's loan account (i.e. the paper transaction when the loan balance was created in the company's books) or when the sums were actually drawn down, the Commissioner opted for the latter, taxing the amounts only as and when they were drawn down. It should be noted that Revenue stated that this was its preferred approach, and the Commissioner further noted that no arguments had been made during the proceedings to support the proposition that the creation of a director's loan in a company's financial accounts is an emolument under s112 TCA 1997.

Finally, having found that the amounts were assessable as emoluments under Schedule E, the Commissioner held that they could not also be assessed as dividends under Schedule F.

07 Capital Gains Tax: TAC Determination 70TACD2024

In this appeal the TAC considered the meaning of "debt on security" (s541 TCA 1997). In 2018 the appellant sold his company to a third-party purchaser at the par value of the shares. The following day he assigned a debt due to him from the company (documented by way of a convertible loan agreement (CLA), which had been entered into in 2013) to the same third party. The nominal outstanding balance of the CLA was €2,135,000 at that time, but it was assigned to the third party in consideration of the sum of €21,350. The appellant therefore made a loss of €2,113,650 on the disposal of the CLA.

The appellant then claimed that loss against a gain that he made on the disposal of shares in another company. Revenue disallowed that loss claim, and the appellant appealed to the TAC.

The TAC held the following, in allowing the taxpayer's appeal:

- *McSweeney v J.J. Mooney (Inspector of Taxes)* [1997] 3 IR 424 was authority for the proposition that it is not a requirement for a debt on a security that interest must actually be paid on the loan but merely that there is an entitlement to interest on the loan.
- Despite the fact that the company had insufficient authorised share capital to allow conversion of the loan to shares, the conversion rights were not thereby rendered merely theoretical, because the company was controlled by the appellant and his son, who operated it "in harmony", and so would have passed the necessary resolutions to increase the authorised share capital if they had been mandated to do so under the terms of the CLA.
- As regards the question of whether the loan had the potential to increase in value such that it would be marketable, the Commissioner noted that:
  - it was improbable that the appellant would have invested the sum of €2,135,191 if he had no realistic prospect of getting a return on his investment; and
  - the company held underlying assets at the time that the CLA was entered into, and since it was possible that those underlying assets "**could** have substantially increased in value at that time or thereafter, the Commissioner finds that the value of the underlying assets in [redacted] had the **potential to increase in value**. As that potential increase in value may have enabled the CLA to be marketable, the Commissioner finds as a material fact that the second test under *McSweeney* is satisfied and as such the CLA entered into by the Appellant is considered a 'debt on security' [emphasis in original]".

- The Commissioner further rejected Revenue's argument that s546A TCA 1997 should apply to disallow the loss, as he rejected its contention that it had arisen consequent upon an arrangement where the main purpose, or one of the main purposes, was to secure a tax advantage.
- The Commissioner further rejected Revenue's argument that the transaction between the appellant and the purchaser of the CLA was not at "arm's length" such that s547 TCA 1997 would deem them to be connected parties, noting that the purchaser had purchased the CLA for real monetary funds.