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Schrödinger’s CATS: The Indeterminate Extent of Deemed Trade Fictions

The United Kingdom’s Upper Tribunal (UT) decision in *CATS North Sea Limited v. HMRC* provides an exploration of statutory deeming rules, in particular the extent to which a deemed trade fiction applies when interpreting other legislative provisions.

The case concerned a niche point around the interaction between “transfer of trade” rules in a capital allowances context and a deemed trade fiction created under the UK’s tax regime for upstream oil-related activities.

However, the UT’s decision may be of broader interest, given the increasing use of deemed trade fictions in UK tax law, including the UK’s new tax regime for carried interest. The UT’s application of the principles set out by the UK Supreme Court in *Fowler v. HMRC* for interpreting statutory deeming provisions in this context is of particular interest.

Background

The case revolved around capital allowances in relation to the CATS Pipeline — a pipeline which was originally built to transport hydrocarbons from the Everest and Lomond fields in the North Sea to mainland UK. BP p.l.c. Group and other companies used the pipeline to transport hydrocarbons.

Amoco, a BP-owned company, held a minority interest in the CATS Pipeline via a contractual joint venture with a third party. In July 2014, Kellas acquired that third party's majority interest in the joint venture and offered to acquire Amoco's minority stake. This occurred in a two-step transaction: (1) Amoco hived down its interest in the CATS Pipeline to a wholly owned subsidiary, CATS North Sea Limited (CNSL), for \$1 (the Hive-Down); (2) Amoco then sold the shares in CNSL to Kellas (the Share Sale).

Amoco was a "deemed participator" in the Everest field, so all of its CATS Pipeline activities were treated as oil-related activities and therefore fell entirely within a single (deemed) "Inside Ring Fence" (IRF) trade.

CNSL was not a "deemed participator" in the Everest field but was associated with Amoco (as members of the BP Group). This combination meant that, following the Hive-Down, CNSL was deemed to be carrying on an IRF trade with respect to its transportation of BP Group hydrocarbons as a result of its association with Amoco. However, its transportation of third-party hydrocarbons was an "Outside Ring Fence" (ORF) trade.

In other words, BP Group's activities in relation to the CATS Pipeline remained the same pre- and post-Hive-Down but were treated as two separate trades in CNSL, rather than the single IRF trade in Amoco, for corporation tax purposes.

Further, following the sale of CNSL to Kellas, CNSL ceased to be associated with Amoco. That meant that the entirety of CNSL's activities in relation to the CATS Pipeline comprised a single ORF trade from that point on.

The key question was the extent to which the deemed trade fiction applied when interpreting "transfers of trade" rules in a capital allowances context. This was critical to the amount of capital allowances balancing charge(s) incurred by CNSL in connection with the Hive-Down and Share Sale.

If Amoco had sold its interest directly to Kellas, Amoco would have suffered a capital allowances balancing charge of approximately £169m. HMRC's preferred analysis would result in the same amount balancing charge for CNSL following the Hive-Down. However, CNSL argued that the deemed trade fiction meant that, under various interpretation scenarios, its balancing charge was only about £23m.

Overview of Legal Framework and Issues

Part 22 of the UK's Corporation Act 2010 (CTA 2010) provides that a transfer of a trade between two companies without (broadly) a change in ownership does not trigger capital allowances balancing charges or allowances; instead, the transferee inherits the transferor's tax written down value of the relevant assets and is treated as having carried on the transferor's trade since it commenced.

The basic position requires that the transferor is transferring a whole trade, which the transferee then carries on. The legislation expands that by specifically providing that certain transfers are treated as a transfer of a trade – broadly, in any one of the following scenarios:

- **Whole-to-part:** The transferor ceases to carry on a whole trade (trade X) and the transferee begins to carry on the activities of trade X *as part of* the transferee's existing trade (part X), provided that there would have been a transfer of a trade had the transferee carried on part X as a separate trade;
- **Part-to-whole:** The transferor ceases to carry on *part of* a trade (part Y) and the transferee begins to carry on the activities of part Y as its trade, provided that there would have been a transfer of a trade had the transferor carried on part Y as a separate trade; or

- **Part-to-part:** The transferor ceases to carry on *part of* a trade (part Y) and the transferee begins to carry on the activities of part Y *as part of* the transferee’s existing trade, provided that there would have been a transfer of a trade had the transferor carried on part Y as a separate trade.

The difficulty in *CATS North Sea Limited* was how to interpret those provisions in light of the deeming rule in section 279 of CTA 2010, which provides that where a company carries on oil-related activities as part of a wider trade, those oil-related activities are “*treated for the purposes of the charge to corporation tax on income as a separate trade [i.e. an IRF trade], distinct from all other activities carried on by the company as part of the trade [i.e. an ORF trade].*”

It was common ground that Amoco, as transferor, had transferred *part of* its wholly IRF trade to CNSL and that CNSL was taxed on the basis of carrying on the same activities as two separate trades – one (deemed) IRF trade and one ORF trade. The dispute centred on whether, for Part 22 purposes, there was a part-to-whole or part-to-part transfer, or if Part 22 simply did not apply at all.

It was also common ground that the principles set out by the Supreme Court in *Fowler* (at [27]) were relevant to the analysis:

- “(1) the extent of the deeming is ‘primarily a matter of construction of the statute in which it appears’,
- (2) the court must identify so far as it can ‘the purposes for which, and the persons between whom the statutory fiction is to be resorted to’ and,
- (3) must not extend it beyond that rationale, particularly where doing so would yield ‘unjust, absurd or anomalous’ results unless compelled by clear language, but that
- (4) once, on a correct construction, the fiction is engaged, the court must not ‘shrink from applying the fiction created by the deeming provision to the consequences which would inevitably flow from the fiction being real...”

HMRC’s primary argument was that the deemed trade fiction under section 279 is limited to *computation* of IRF profits to which the higher rate of corporation tax applies and that the deemed IRF trade is not relevant to Part 22. Instead, HMRC argued, the Hive-Down should be treated as a part-to-whole transfer because (very broadly) CNSL carried on the same *activities* as Amoco had done for that part-trade.

CNSL’s primary argument was the converse: the deemed trade fiction was intended to apply for all corporation tax purposes – that included Part 22 and, by extension, the capital allowances regime. Since Amoco carried on a single IRF trade and CNSL carried on two trades (one IRF and one ORF), the same trade was not continued, so Part 22 should not apply at all as the legislation simply does not cater for a part-trade to two part-trades scenario. On that analysis, CNSL would not suffer a balancing charge until it ceased to carry on a (deemed) IRF trade following the Share Sale. Further, that balancing charge would be in relation to CNSL’s IRF trade only, based on a just and reasonable apportionment of its \$1 acquisition cost between its IRF and ORF trades at the time of the Hive-Down (by reference to anticipated split between its trades), so the balancing charge would be about. £23m (on the basis of 13.55% IRF).

HMRC argued (among other things) that CNSL’s interpretation would produce absurd consequences (in conflict with the *Fowler* principles) and was not in line with a purposive interpretation of the legislation.

The UT's Decision

The UT, reversing the First-tier Tribunal decision, comprehensively rejected HMRC's primary argument and many of its other arguments. However, the UT did not agree with CNSL's primary argument either.

Instead, the UT preferred CNSL's "Scenario D" analysis that, for Part 22 purposes, Amoco carried on two part-trades – Part Y1 (transportation of BP Group hydrocarbons) and Part Y2 (transportation of non-BP Group hydrocarbons) – and that there were two separate part-to-part transfers.

On that analysis, Part 22 applied the transfer of Part Y1 (i.e. IRF-to-IRF) but not to Part Y2, because the latter was a transfer by Amoco of an IRF trade which CNSL then carried on as a different (ORF) trade. The net result was that CNSL suffered a balancing charge of about £23m when it ceased its IRF trade following the Share Sale. It did not face any balancing charge in relation to the ORF trade.

The UT was not persuaded by HMRC's arguments in applying the *Fowler* principles on deeming provisions, in particular that the deeming fiction should be applied only so far as the purpose requires and not to produce unjust or anomalous results.

HMRC had highlighted that the CATS Pipeline ultimately moved from wholly IRF in Amoco to wholly ORF in CNSL (following the Share Sale) but, on this analysis, with a significantly lower balancing charge (c. £23m vs c. £169m) than if there had been a direct transfer from Amoco to Kellas. However, the UT was not persuaded that this justified a narrow interpretation of the deemed trade fiction, stating (at [93]):

In our view CNSL's interpretation does not lead to anomalous or perverse results, when the particular design of the statutory regime is taken into account – although it may suggest that there is some other lacuna in the code.

Takeaways

The UT's decision illustrates that purposive interpretation of legislation and the application of the *Fowler* principles on deeming provisions will not always save HMRC's arguments if the clear wording of the legislation points to a different result, even if that result appears odd or unusually beneficial to the taxpayer when viewed through a broader tax policy lens. It remains to be seen whether HMRC will appeal the decision.

The application of the *Fowler* principles to a deemed trade fiction is particularly interesting given the increasing use of deemed trade fictions across UK tax legislation, including the UK's new tax regime for carried interest.

Under that new tax regime, which applies from 6 April 2026, an individual carried interest holder is deemed to carry on a trade for UK income tax purposes. It is currently understood that there would be a separate trade per set of arrangements that gives rise to carry, which would mean a carry recipient could have multiple (deemed) trades. Among other things, the deemed trade fiction means that non-UK resident carry recipients with "UK workdays" may be subject to UK tax in certain circumstances, subject to potential tax treaty protection.

The extent to which the new carry regime's deemed trade fiction applies across UK tax legislation, and its relevance in the context of the UK's tax treaties, remains to be seen. Whilst the precise wording of the deeming provision differs from the one in the *CATS North Sea*, the UT's decision may still serve as a useful reference point as an approach to interpretation.

Perhaps the main takeaway, though, is that the “true” position of opposing interpretations of the extent of a particular deemed trade fiction cannot be known with much certainty until it is tested before the courts.

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