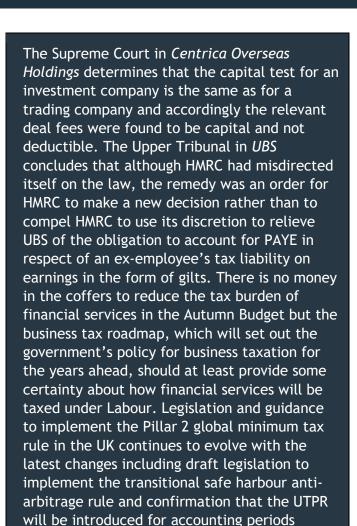
# SLAUGHTER AND MAY/

# TAX AND THE CITY

**CLIENT BRIEFING** 

September 2024



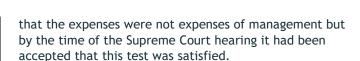
## Centrica: deductibility of deal fees

beginning on or after 31 December 2024.

The Supreme Court in Centrica Overseas Holdings Ltd v HMRC [2024] UKSC 25 concluded that the professional advisory fees incurred by Centrica in connection with the sale of a loss-making business (Oxxio) constituted capital, rather than revenue, expenditure and were not deductible by virtue of CTA 2009 s 1219(3)(a).

#### Two tests

In order for the professional fees to be deductible under s 1219, two tests had to be satisfied. The first is that the expenses are expenses of management. In the First-tier Tribunal (FTT) and Upper Tribunal (UT) HMRC had argued



The second test is whether the expenses were capital or revenue in nature. The taxpayer had argued that the capital test for an investment company was different to, and narrower than, the test for a trading company but the Supreme Court did not agree. The test is the same for both. The Supreme Court concluded that the words 'expenses of a capital nature' in s 1219(3)(a) and 'items of a capital nature' in s 53(1) must mean the same thing and there is nothing to support the taxpayer's view that the test in s 1219(3)(a) should be narrower. The wellestablished capital/revenue principles apply.

## Capital test

It is a question of law whether expenditure is capital or revenue and much depends on the circumstances. The case law provides factors regarded as relevant in a particular set of circumstances, but it must be recognised they cannot automatically be applied to a different fact pattern. A good starting point is to ask what the money is being spent on, which must be assessed objectively. Where a capital asset is identified, as it was in this case, expenditure on its acquisition or disposal should be regarded as capital. Professional fees then take their character from the commercial or business transaction for which they are incurred. On the facts, a decision was taken to dispose of the Oxxio business, and the professional fees were incurred for services to enable management to achieve that disposal and so were capital in nature.

## Implications for other cases

The conclusion that the capital test is the same for an investment company as for a trading company is unsurprising given the evidence of the parliamentary intention to align the capital expenditure position for investment companies with those of trading companies. But it is a significant limitation on the deductibility of management expenses in the context of the sale or acquisition of a capital asset. Two questions taxpayers and advisers may be thinking about in light of this decision are: how is the capital expenditure test different from the management expenses test, and what is the cut off point for deductibility?

The management expenses test (according to the UT and Court of Appeal) distinguishes between expenses incurred in deciding whether to acquire or dispose of an asset, which are management expenses, and those incurred on implementing such a decision, which are not. As the Centrica case shows, it may now make more sense to apply the capital test first and only if expenses are not excluded under that test, look at whether they are also management expenses as it is the capital test which is more likely to prevent the deduction.

Is everything deductible up to the time of the strategic decision to sell? It is clear that any expenses incurred after this decision, even if there is no particular buyer lined up, and there is uncertainty about whether a sale would in fact happen, would be capital if their clear objective purpose is to assist in bringing about the disposal. But in some cases, the line may be drawn even earlier. Lady Simler explains that advice to enable an investment company to decide whether or not to acquire or sell, payable regardless of whether the transaction takes place, is also capital expenditure. To maximise the possibility of recovery of management expenses, care should be taken to document exactly the purpose for which expenses are incurred.

## UBS: judicial review of HMRC's refusal to exercise discretion under ITEPA s 684(7A)

It is often difficult to make out the grounds for judicial review (JR) of HMRC's decision making but even if this is successfully achieved, the taxpayer may not get the remedy it wants and may appear to be no further forward as HMRC's new decision may be the same as the original one. This was the case in K (oao UBS AG) v HMRC and another [2024] UKUT 242 (TCC).

The remuneration arrangements for JW, a former senior employee of UBS, included gilt option agreements which he exercised some years after leaving his employment with UBS which meant that, at the time the gilts were delivered UBS was unable to deduct tax from an actual payment and so accounted to HMRC for an amount which was its 'best estimate' of the amount of income likely to be PAYE income. The amount of the tax liability was based on predictions of the future performance of the equity investment team led by JW. HMRC disagreed with the valuation on which UBS had based this estimate and issued a determination to UBS to recover a further £13.4m.

The person with the ultimate tax liability here is the exemployee, JW, and so HMRC could instead recover the tax from JW, rather than UBS. The legislation deals with this scenario by giving HMRC discretion under ITEPA 2003, s 684(7A)(b) to relieve an employer from the obligation to comply with the PAYE legislation if the HMRC officer was satisfied it was unnecessary or not appropriate for UBS to do so. UBS requested HMRC use this discretion and when HMRC declined to do so, UBS sought JR of the decision not to use the discretion and sought an order to compel HMRC to use its discretion.

By the time of the JR hearing, HMRC had committed to making a new decision and sought to withdraw its defence to the original claim, arguing that the JR claim was therefore academic and should be struck out. The UT concluded that the JR claim was not academic and needed to be resolved but UBS failed to meet the burden to show HMRC was bound to grant the discretion. Although UBS had provided reasons capable of sustaining an exercise of the discretion (including the inefficiency of litigating against UBS in respect of tax for which JW is liable and better placed to deal with the valuation question and the support of JW for UBS's position and JW's ability to pay), it did not compel the exercise of discretion in UBS's favour.

The UT found that HMRC had misdirected itself on the law in two ways which meant the decision not to exercise discretion was unlawful. Firstly, by regarding the lack of quantification of the tax liability as a bar to considering exercise of the discretion. Secondly, by assuming the fact UBS remained liable for employer's NICs detracted from UBS's argument that exercising the discretion would be more efficient. UBS would remain liable to the employer's NICs but this liability would be determined by the amount JW is ultimately taxed as employment income rather than based on the amount of income tax UBS accounted for or should have accounted for.

The remedy ordered by the UT was to mandate HMRC to consider whether to exercise the discretion, taking into account the misdirections of law, within two months of the release date of the decision. This case may be useful to other employer's seeking to get HMRC to exercise the s 684(7A)(b) discretion as it works through the relevant factors HMRC should consider when deciding whether an employer should be relieved of its PAYE obligations. On the other hand, the case shows how difficult it would be to get a tribunal to compel the exercise of discretion in an employer's favour.

## What does a Labour government mean for financial services?

According to the Labour Manifesto, the new government is committed to one major fiscal event a year, which the Chancellor has announced will, for 2024, be an Autumn Budget on 30 October. This is one way in which the government intends to provide more stability to taxpayers.

The Chancellor, in her speech on 29 July, highlighted what Labour identifies is a £22 billion hole in public finances. There is pressure on the government to raise additional revenue, and the long term plan is to increase the tax take through economic growth but in the short term revenue has to be raised to plug the funding gap. Promises not to raise rates of income tax, national insurance, VAT or corporation tax have been confirmed several times so attention is turning to other areas where taxes could be raised. The Prime Minister's rose garden speech on 27 August made it clear that 'those with the broadest shoulders should bear the heavier burden'

which includes the metaphorical shoulders of large businesses as well as those of wealthy individuals. This means it is unlikely that any reductions will be made to the bank surcharge or the bank levy and there are fears that taxes on banks could even be increased. It is hoped that the government will pay attention to the lobbying against any further industry specific 'windfall' taxes which are damaging to competitiveness and investment and would harm economic growth.

Plans for business (including the commitment to cap corporation tax at 25%) will be set out in the business tax roadmap which the government promised would be delivered within 6 months of gaining power. The roadmap should set out what the government policy is for the years ahead to give business more certainty about the business tax landscape. The Chancellor has confirmed that the government will be 'outlining' the business tax roadmap at the Autumn Budget.

### Pillar 2: an update

#### UK guidance on implementation

HMRC updated its short guidance note, How to prepare for the Multinational Top-up tax (MTT) and the Domestic Top-up Tax (DTT), which sets out the practical steps (including registration and filing requirements) needed to comply with MTT and DTT in the UK and with the adoption of Pillar 2 in other jurisdictions. HMRC is launching a new online service to include the ability to register, file returns and make payments. The first stage, which is already available, permits registration. In late 2024, the second stage will allow payments on account and authorise agents to carry out future tasks on their behalf. The final stage will enable submission of UK Pillar 2 returns using existing third-party software products.

In a new part of the guidance on common misconceptions, HMRC emphasises that, if a business is in scope of MTT or DTT, there are UK reporting obligations even if there is no tax liability. The group's filing member will need to submit a UK Pillar 2 self-assessment return and a GloBE Information Return (GIR) to HMRC for every accounting period that the group is within scope of MTT and DTT (or DTT only, if the group is a domestic-only group).

#### CBCR safe harbour: anti-arbitrage rule

The Country by Country Reporting (CBCR) safe harbour is a temporary rule to allow groups in the initial years after the MTT and DTT come into effect to limit the jurisdictions for which the group needs to submit full MTT and/or DTT calculations to higher risk jurisdictions. The financial information already gathered for CBCR (or which would have been included in a report for CBCR had such a report been required) is used to determine if one of three tests is satisfied. Shortly before the safe harbour could apply for the first time, the OECD/G20 agreed, in the third set of Administrative Guidance published by the OECD on 18 December 2023, that certain hybrid arbitrage arrangements designed to exploit differences between tax and accounting rules should be excluded from this safe harbour calculation.

Legislation to implement the agreed CBCR safe harbour anti-arbitrage rule in the UK was published on 29 July for consultation until 15 September. The draft legislation follows the OECD guidance in tackling three types of arrangement: deduction and non-inclusion, duplicate loss and duplicate tax recognition. In each case, it applies where the arrangements were entered into or amended on or after 16 December 2022 and has effect in relation to disqualified expense accruing on or after 14 March 2024 (when a written ministerial statement first announced the rule would be implemented in the UK) and to disqualified tax expense attributable to profits accruing on or after 14 March 2024.

When the Administrative Guidance came out, there were concerns about the breadth of the anti-avoidance provision and the impact it would have on affected groups. It is hoped that the consultation on the draft UK legislation will allow the Government to ensure the legislation operates as envisaged without unintended outcomes.

#### **UTPR**

Draft legislation to implement the Undertaxed Profits Rule (UTPR) was previously published in July 2023, and later revised in September 2023 but has not yet been enacted. The Government has confirmed that the UK will introduce the UTPR for accounting periods beginning on or after 31 December 2024 and will continue efforts to ensure the UK rules are effective and up to date.

#### What to look out for:

- The CJEU will hand down its judgment in the Apple case on fiscal state aid on 10 September.
- 15 September is the closing date for comments on the draft legislation published on 29 July (including on the CBCR safe harbour anti-arbitrage rule).
- The CJEU will hand down its decision in FCPE (on the UK CFC treatment of group finance companies) on 19 September.
- HMRC will be hosting Pillar 2 webinars this Autumn on the scope of the UK's legislation, reporting obligations and
  safe harbours. Dates are to be confirmed nearer the time. HMRC has also promised to publish further draft manual
  guidance in the coming months on other aspects of the legislation including a section on determining top-up tax
  amounts (covering chapters 6 to 8 of Part 3 of Finance (No. 2) Act 2023) and more guidance about particular types of
  entities and structures.

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