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The Supreme Court agrees with the taxpayers in *NCL* that they are entitled to a deduction as a trading expense in respect of their accounting debits recognised on the grant of share options to their respective employees by an employee benefit trust. The Court of Appeal rules that the Danish tax authority is entitled to bring claims in the UK courts to reclaim Danish withholding tax refunds made in error. Latest developments on the global minimum tax include the publication by the OECD/IF of commentary on the model rules and a one year delay to implementation in the EU, although the draft directive has yet to be unanimously agreed.

NCL Investments Ltd: deductions for accounting debits recognised on grant of share options

It may seem surprising that HMRC was granted leave to appeal to the Supreme Court when it lost every argument at each step of the way there. There are, however, several other cases standing behind *HMRC v NCL Investments Ltd and another* [2022] UKSC 9 and large sums are riding on the outcome from the Crown's perspective.

The Supreme Court unanimously dismissed HMRC's appeal. The Court of Appeal, the Upper Tribunal and the FTT had also rejected HMRC's arguments and concluded that the taxpayers (which were the employing companies) were entitled to a deduction as a trading expense in respect of the accounting debits recognised in their respective accounts on the grant of share options to their employees by an employee benefit trust (the EBT).

The taxpayers employ staff and, in return for a fee, make those staff available to other companies in the group. Whenever the EBT trustee granted employees of the taxpayers an option to acquire shares in the parent of the taxpayers, SWHL, the taxpayers agreed to pay SWHL an amount equal to the fair value of the options granted to their respective employees. The taxpayers then passed this cost on to other group companies by including it in the fee.

Under IFRS2, any grant of share options by the EBT Trustee to employees triggered an obligation on the taxpayers to recognise an expense in their income statements equal to the fair value of the options that the EBT Trustee had granted. IFRS2 also required the expense in the P&L to be matched by a balance sheet entry which was shown as a capital contribution from SWHL. No amounts were then recognised in the taxpayers' accounts in respect of the recharge payments.

HMRC argued (on several grounds) that the debits required by IFRS2 are not allowable as deductions for corporation tax purposes. The Supreme Court dismissed all of HMRC's arguments.

CTA 2009 s46(1): adjustment required or authorised by law

HMRC had argued that disregarding the debits is an 'adjustment required or authorised by law' within s46(1) CTA 2009. The Supreme Court disagreed. It considered that s46 gives statutory supremacy to generally accepted accounting practice (GAAP). To be 'required or authorised by law' adjustments are likely to be those specified by statute. Whereas the Supreme Court considered it is possible for a judge-made rule to require or authorise such an adjustment, the rule would have to be clear that it applies notwithstanding the company's profits have been calculated in accordance with GAAP.

HMRC had failed to show any convincing case law authority or statutory authority for such adjustments. The Supreme Court concluded (in paragraph 33) that 'There is no adjustment required or authorised by law to the effect that if profits in the P&L account are depressed because of an entry which is matching an entry in the balance sheet, then that is to be left out of account in calculating profits for corporation tax. Nor do we see any policy justification for drawing that distinction.'

Wholly and exclusively test

HMRC argued the deduction is disallowed as the expenses were not incurred wholly and exclusively for the purposes of the trade under CTA 2009 s54(1)(a). The FTT had found as a fact that the purpose requirement of s54(1)(a) was satisfied because the debits were required by IFRS2 to reflect the consumption by the taxpayers of the services provided by the employees, who were in part remunerated by the grant of the options. The taxpayers consumed those services wholly and exclusively for the purposes of their trades, being the provision of their employees' services to other group companies at a profit. The Supreme Court agreed that the deduction is not disallowed by s54(1)(a).

Capital in nature

HMRC further argued the items were capital in nature and so disallowed by s53 CTA 2009 but the Supreme Court held they were revenue for the reasons given by the FTT. The fact that the matching credit entry was a capital contribution does not change the character of the debits, these were revenue in nature, not capital.

Employee benefit contributions

The Supreme Court also dismissed HMRC's argument based on CTA 2009 s1290 and held this provision, as it was drafted at the time, did not apply to deny or defer allowance of the debits. The grant of share options by the EBT Trustee did not amount to an 'employee benefit contribution' within the meaning of s1291 and so the debit required by IFRS2 is not a deduction in respect of an employee benefit contribution.

Of course what really exercised HMRC here was the fact that the vast majority of the options lapsed unexercised and HMRC thought that the legislation at the time precluded a deduction for anything other than the provision of shares on exercise under the rules in Part 12 CTA 2009. Finance Act 2013 amended s1038 CTA 2009, and introduced s1038A CTA 2009, to remove the possibility of claiming a deduction for the IFRS2 debit from 20 March 2013 onwards. However, the decision is still an important one given the number of claims for periods prior to the law change sat behind it together with the fact that it deals with three key principles relevant to calculating trading profits more generally.

Admissibility of claims by Danish tax authority to recover WHT refunds

The case of *Skatteforvaltningen v Solo Capital Partners LLP* [2022] EWCA Civ 234 is important in terms of public profile, the amount of money at stake and the principle of the case. The case arises from the cum/ex scandal and concerns thousands of Danish withholding tax refund claims against more than 100 defendants over a three year period totalling around £1.5 billion which the Danish tax authority, SKAT for short, maintains were paid in error because misrepresentations had been made to SKAT inducing the approval and payment of the claims.

SKAT had brought civil litigation proceedings in the UK but the High Court held that SKAT's claims fell foul of Dicey Rule 3, which provides that 'English courts have no jurisdiction to entertain an action…for the enforcement, either directly or indirectly, of a penal, revenue or other public law of a foreign State'. This is a substantive rule of English law leading to the dismissal of claims where they involve an attempt to have the court enforce extra-territorially the exercise of sovereign authority.

As the High Court identified the central issue in the case as the Kingdom of Denmark's sovereign right to tax Danish company dividends, it accordingly dismissed the claims. The Danish Tax Authority appealed the decision.

The Court of Appeal unanimously held that (in the case of all but one of the defendants) the nature of SKAT's claim is not for tax, but for 'monies which had been abstracted from SKAT's general funds by fraud'. The Court concluded that, in bringing claims to recover monies of which it was defrauded, SKAT is not doing an act of sovereign character or enforcing a sovereign right or seeking to vindicate a sovereign power. Rather, SKAT was acting in the capacity of a victim of fraud seeking reimbursement in the same way as if it were a private citizen. Whilst exploitation of the Danish withholding tax regime may have been the mechanism by which the fraud was committed, it does not follow that the claim involves the enforcement of that regime. So, Dicey Rule 3 does not apply to render these claims inadmissible.

If the Court of Appeal had found that Dicey Rule 3 was in principle applicable, SKAT had argued in the alternative that it should be disapplied under the public policy exemption. Whilst it was not necessary for the Court of Appeal to decide the point, it agreed that Dicey Rule 3 is not absolute and that there is a public policy exemption to the wider sovereign powers rule. 'Whilst not deciding the point, I can see much force in [the] submission that the exception should apply here in a case of a major international fraud' (para 146).

This case shows that whether Dicey rule 3 will render a claim before the UK court inadmissible will depend on the facts. The fact that a claim is brought by a taxing authority will not necessarily make it inadmissible. The court will look, as the Court of Appeal did here, at the capacity in which the tax authority brings its claims to determine the nature of those claims.

Latest international tax reform developments

Another month, and many more pages published on the minimum tax rules which form part of pillar 2, but are we any closer to global implementation? The EU has failed to agree on the Directive at the two most recent ECOFIN meetings, held in March and April, and so it will be back on the agenda for the May meeting. In any event, the timing of implementation of the minimum tax rules in the EU has been delayed by a year so at the moment, it looks like the UK will be the first to implement the income inclusion rule from 1 April 2023. It will be confirmed when the draft legislation is published in the summer whether the UK still intends to keep to this timing.

One of the obstacles preventing unanimous agreement on the EU Directive is the view of some that pillars 1 and 2 should be tied together as a package rather than pillar 2 being implemented first. Pillar 1 includes a new taxing right for market jurisdiction over 25% of the residual profit of the largest and most profitable MNEs. A recent IFA conference, HMRC was asked what the UK's view is on this. The response was that the UK sees the 8 October 2021 agreement as a commitment to implement both pillars and that it is not concerned that the global minimum tax rules are progressing faster than the pillar 1 rules.

In March, the OECD/IF published commentary on the model minimum tax rules to promote a common and consistent interpretation and a call for evidence on the implementation framework. Further work is ongoing at the OECD/IF on the co-existence of model rules with US GILTI and how GILTI will be treated forms part of the implementation framework discussions. It all depends on whether the US is successful in amending the current GILTI rules to bring them into line with the model rules. The UK legislation will allow for further changes to take into account the agreement reached on GILTI co-existence.

What to look out for:

- The OECD's consultation on a new tax transparency framework for crypto-assets, the Crypto-Asset Reporting Framework and proposed amendments to the Common Reporting Standard is open for written comments until 29 April 2022, and a public consultation meeting will be held at the end of May 2022.
- The OECD's call for evidence on the implementation framework of the global minimum tax closes on 11 April.

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