

Business tax update – September 2024 (B1451 25.14 minutes)

Budget & Business tax key announcements

On 29 July 2024, the Chancellor of the Exchequer confirmed that the Budget would be delivered on 30 October 2024.

<https://www.gov.uk/government/speeches/chancellor-statement-on-public-spending-inheritance>

<https://questions-statements.parliament.uk/written-statements/detail/2024-07-29/hcws32>

Carried interest

Carried interest is a form of performance-related reward received by fund managers, primarily within the private equity industry.

The government has published a call for evidence confirming its intention to take action as it believes that the current tax regime, whereby such interest can be taxed at capital gains tax rates, does not reflect its economic characteristics, nor the risk taken on by fund managers.

<https://www.gov.uk/government/calls-for-evidence/the-tax-treatment-of-carried-interest-call-for-evidence/b8a7b5ae-0fcd-49bc-bfd1-d5cf5f4a8599>

Pillar 2: new anti-arbitrage rule

The government is publishing draft legislation to translate an internationally agreed anti-avoidance rule into UK legislation.

The draft legislation seeks to prevent multinational enterprises avoiding Pillar 2 top-up tax by exploiting a temporary simplification in the rules.

The legislation will apply from 14 March 2024 and will prevent multinational enterprises that enter into certain avoidance transactions from accessing the simplification.

Further, to provide certainty, the government is confirming that the UK will introduce the Undertaxed Profits Rule of Pillar 2 for accounting periods beginning on or after 31 December 2024.

<https://www.gov.uk/government/publications/pillar-2-transitional-country-by-country-reporting-safe-harbour-anti-arbitrage-rule/07a36f83-b8e5-4d74-843a-fd5ab1b03a44>

Energy Profits Levy reform

The government has published a policy document confirming its intention to increase the rate of the Energy Profits Levy to 38% from 1 November 2024 and extend that levy from March 2029 to March 2030.

The government will also remove the main investment allowance for qualifying expenditure incurred on or after 1 November 2024 and reduce the extent to which capital allowances claims (including first year allowances) can be considered in calculating levy profits.

Further details will be announced at the Budget.

<https://www.gov.uk/government/publications/july-statement-2024-changes-to-the-energy-oil-and-gas-profits-levy/changes-to-the-energy-oil-and-gas-profits-levy>

Failure to notify after 15 years

Summary – HMRC had made valid discovery assessments but these were reduced to reflect additional deductible costs and the fact that the profits on the disposal of two properties were capital rather than trading profits.

In 2004, Kenneth Williams entered the property market buying four properties in April/ May 2004, followed by a further seven properties later in 2004 and in 2005. He renovated each of the properties before selling them on in 2004/05 and 2005/06.

On 22 June 2004, he wrote to HMRC enclosing his P60 for 2003/04, in which he claimed to have notified HMRC that he had commenced a property business as a sole trader. HMRC acknowledged receipt of the letter and their records showed that a Self Assessment return was issued for 2003/2004 as the P60 showed that he was a higher rate taxpayer. However, HMRC's records made no mention of a new sole trader property business. Once the tax return for that year had been received, his Self Assessment record was closed.

In October 2012, Kenneth Williams called HMRC asking for a UTR. This was followed in August 2013 by a request for a tax return for the year ended 5 April 2014. Kenneth Williams called HMRC to say that he had been receiving income from property since October 2013. At this point, HMRC re-opened his Self Assessment record.

In 2014, HMRC enquired into his property dealings, concluding in 2019, that he had made taxable trading profits in 2004/05 and 2005/06 on the disposal of nine of the properties; two of the properties qualified for principal private residence relief as they were, at some point, occupied as his main residence.

HMRC issued assessments totalling a little over £14,000 and penalties of around £8,000 on the basis that he had failed to notify HMRC that he was chargeable to tax for the relevant years. Following review, these numbers were reduced to £12,000 and £6,500 respectively.

Kenneth Williams appealed, claiming that he had notified HMRC that he was starting to carry out a property business in his letter dated 22 June 2004 so that there was no failure to notify. In any case, he claimed HMRC had not allowed all of the expenses he incurred as part of his business, which if deducted would mean no profit had been made.

Neither party had a copy of the letter dated 22 June 2004 but HMRC argued that had Kenneth Williams started to carry on a new property business as a sole trader, the self-assessment record would not have been closed as it would have been clear to HMRC that he would have needed to file a tax return for the year ended 5 April 2005. From their records, no tax returns were submitted for either 2004/05 or 2005/06, the years in question.

As well as considering whether the assessments were validly raised, the First Tier Tribunal needed to consider whether:

- certain expense deductions were in fact deductible; and
- two of the properties were bought as long-term investments with the intention of renting them out, such that any profit would be subject to capital gains tax.

Further, if the assessments were valid, the level of the penalties charged was also challenged.

Decision

The Tribunal accepted that HMRC made a discovery as a result of their compliance check which commenced in 2014 and that the relevant assessments were intended to make good the loss of tax which, in HMRC's opinion, had occurred.

The First Tier Tribunal found that while it was possible that HMRC simply overlooked the reference to the new property business in the June 2004 letter, this seemed unlikely. HMRC had clearly read the letter, reviewed the P60s and sent out a tax return for 2003/04. This letter did not notify HMRC of Kenneth William's chargeability going forward. Further, there was no evidence that returns had actually been submitted for either 2004/05 or 2005/06. The First Tier Tribunal found that Kenneth Williams was negligent by failing to notify HMRC of his chargeability to tax for 2004/05 and 2005/06, meaning that the 20-year time limit applied to the issue of the discovery assessments.

The expense costs under dispute related to property redevelopment and the renovation costs incurred totalling approximately £150,000; HMRC had allowed only £62,000. The First Tier Tribunal concluded that the taxpayer's claim was likely to represent a significant overestimate of the expenses incurred, as little evidence was forthcoming. However, the First Tier Tribunal accepted that, on the balance of probabilities, there were likely to be some expenses which HMRC had rejected arising as a result of not taking into account the cash withdrawals, to pay expenses, made in the branches rather than through cash machines. There were likely to be further deductible expenses arising as a result of HMRC's methodology relating to some contractors being paid by way of staged payments rather than the entirety of a particular project being paid in one go. From the lack of evidence supplied, the First Tier Tribunal was unable to quantify precisely which renovation costs should be allowed. Instead, the First Tier Tribunal adopted a "rough and ready approach looking at the evidence in the round and applying the balance of probabilities". They allowed a further deduction of £20,500 allocated across all of the properties in proportion to the expenses which had already been allowed in respect of those properties.

The First Tier Tribunal accepted that two of the properties purchased by Kenneth Williams were intended to be kept on a longer-term basis to rent out. The only reason they were sold was because he could not obtain buy-to-let mortgages. These were not trading transactions, meaning the profit on sale was subject to capital gains tax. The First Tier Tribunal stated that the parties would need to agree which expenses are deductible in these circumstances, as different principles now applied.

Finally, the First Tier Tribunal agreed that there should be a small, 5% reduction in the penalties as Kenneth Williams had made a voluntary disclosure of certain matters such as an additional four properties which HMRC had not included in their original list.

Kenneth Williams v HMRC (TC09171)

Artificial Intelligence to 'know your client

Summary – The company was entitled to claim R&D credit for costs incurred in developing an artificial intelligence analysis process for verification and risk profiling

Get Onbord Limited was a Small or Medium-Sized Enterprise for the purposes of the R&D legislation that sought to develop a novel, automated artificial intelligence analysis process for 'know your client' verification and risk profiling. The analysis tool was to be used during a financial services customer onboarding process that would achieve a superior outcome to human analysis, while meeting all regulatory and legislative requirements.

The company submitted an R&D surrenderable loss claim, with significant supporting evidence, seeking a repayable tax credit from HMRC. However, HMRC rejected the claim as it considered that the company did not incur expenditure on qualifying "research and development". Broadly, the project did not advance overall knowledge or capability. The taxpayer submitted more information and, although HMRC said the work was 'impressive', it still maintained that it did not constitute R&D.

The company appealed.

Decision

The First Tier Tribunal noted that the HMRC officer dealing with the case had little to no knowledge of software technology. Indeed, this was the first software claim that he had ever dealt with.

By contrast, the First Tier Tribunal was impressed with the company's supporting evidence and found that the:

- project had a clear aim to develop an artificial intelligence analysis process;
- technology was not already publicly available or readily deducible and amounted to more than simply copying or adapting an existing product.

Consequently, the project costs did constitute qualifying R&D expenditure and the company was entitled to make the claim. The appeal was allowed.

Procedural matter

Having heard the case, HMRC sought to have the case reheard by a different Tribunal, arguing that the company's former director was not authorised to give evidence on behalf of Get Onbord Limited, as the company was in liquidation. The Tribunal stated that, on the appointment of a liquidator all the powers of a director cease, and so agreed that the director had no capacity to represent the company at the hearing. However, the Tribunal dismissed HMRC's application, deciding that the liquidators had the power to endorse the submissions made by the former director and to ask that the hearing stand. This would be fair and just, and "doing so would not run the risk of creating a precedent which could be cynically exploited in the future."

Get Onbord Limited (in Liquidation) v HMRC (TC09238)

Advisers' fees on sale of company

Summary – Advisers' fees, incurred after the decision to sell its Dutch business was taken, were 'expenses of a capital nature' and therefore were not deductible as management expenses.

Centrica Overseas Holdings Ltd, an intermediate holding company in the Centrica plc group, owned the group's Dutch parent company, Oxxio BV, and its subsidiaries.

The Dutch business was persistently loss-making and the Centrica group decided to sell the business in June/July 2009.

The sale process proved difficult and it was only in February 2011 that the group approved in principle a sale to the buyer, with the final agreement signed in March 2011.

Between July 2009 and March 2011, Centrica Overseas Holdings Ltd incurred fees for professional services provided by Deutsche Bank, PwC and De Brauw Blackstone Westbroek in connection with the sale ('the disputed expenditure'):

- Deutsche Bank provided advice negotiating the disposal process and evaluating potential purchasers;
- PwC prepared a vendor due diligence report and a 'deep dive' report, which helped the group understand the difficulties in the Oxxio BV business; and
- De Drauw provided Dutch legal advice and prepared the sale and purchase agreements.

Centrica Overseas Holdings Ltd claimed a tax deduction under s.1219(1) CTA for the disputed expenditure as expenses of management. The company accepted that fees incurred after 22 February 2011 were not deductible as those fees related to implementing the sale of the Oxxio BV business and were therefore capital in nature.

HMRC disallowed the claim on the basis that the disputed expenditure did not constitute expenses of management or, if it did, it was capital in nature.

The First Tier Tribunal dismissed the appeal but the Upper Tribunal overturned it, finding in Centrica Overseas Holdings Ltd's favour. The decision was reversed again at the Court of Appeal finding that although the expenditure qualified as expenses of management, it was capital in nature. HMRC's appeal was allowed

Having accepted the expenditure was management expenses, the company appealed to the Supreme Court, with the only issue remaining being whether the disputed expenditure was capital in nature.

Decision

The Supreme Court agreed with the Court of Appeal that the test for determining if management expenses, incurred by a company with investment business, are expenses 'of a capital nature' is the same test as applies for determining whether a trading company's expenses are 'items of a capital nature' (within the meaning of s.53(1) CTA 2009). Accordingly, it followed that the established case law relating to the revenue/capital distinction that applies in the context of trading companies applies equally to investment companies.

Surveying the case law on the revenue/ capital distinction, the Supreme Court concluded that payments incurred in bringing about the disposal of a capital asset are capital in nature, irrespective of whether they are incurred by a trading company or a company with investment business. Here the disputed expenditure was incurred to assist with the disposal of an onerous capital asset and was therefore capital in nature. In reaching this conclusion, the Supreme Court highlighted that:

- the three firms were engaged specifically for the process of disposing of Oxxio BV - there was no evidence that they were engaged more generally in advising Centrica Overseas Holdings Ltd on its investment business; and
- the fact that there was no certainty that the Oxxio BV business would be sold did not make the disputed expenditure revenue in nature - the fact that there is uncertainty in most transactions does not prevent expenditure on professionals, rendered to enable an investment company to reach a decision as to whether or not to make an acquisition or disposal, from being capital expenditure.

The professional fees were incurred to bring about the disposal of Oxxio BV, a capital asset and so should be regarded as capital in nature and so not deductible as an expense of management for corporation tax purposes.

Centrica Overseas Holdings Ltd v HMRC [2024] UKSC 25
Adapted from the case summary in Taxation (26 July 2024)

No DTR for stapled entity

Summary - The company, which was stapled to a US company and so subject to worldwide taxation in the USA, was not entitled to double tax relief under the USA/UK treaty.

GE Financial Investments was a UK-resident member of the GE group and was the limited partner in a Delaware limited partnership. The general partner in the Delaware limited partnership was a USA-resident group member (GEFI Inc).

GE Financial Investments and GEFI Inc were 'stapled entities' for the purposes of US federal income tax as the shares in one could not be transferred without the shares in the other also being transferred to the same transferee. This resulted in *GE Financial Investments* being subject to US tax on its worldwide income. It claimed UK double tax relief in respect of the US tax for six consecutive accounting periods and HMRC rejected all of the claims.

The First Tier Tribunal had dismissed the company's appeal, holding that it was not resident in the USA under article 4 of the UK/USA double tax treaty and that it was not carrying on a business in the USA through a US permanent establishment within article 7 of the treaty.

The Upper Tribunal reversed this decision, allowing the company's appeal on the basis that it was resident in the USA under the treaty (although it held that the First Tier Tribunal was entitled to conclude that *GE Financial Investments* was not carrying on a business in the USA).

HMRC appealed and *GE Financial Investments* cross-appealed on the carrying on a business issue.

Decision

The Court of Appeal first considered whether *GE Financial Investments* was resident in the USA for the purposes of the treaty, finding that the Upper Tribunal had been wrong to conclude that the only criterion for residence in article 4 was worldwide taxation.

Article 4 required both the existence of a local connection falling within the enumerated criteria (domicile, residence, citizenship, place of management or place of incorporation) or of a similar nature and that the connection attracts worldwide taxation.

The Court of Appeal concluded that *GE Financial Investments* did not fall within any of the listed criteria, and it did not have a local connection 'of a similar nature' to those listed.

The US federal income tax law treating certain stapled entities as domestic corporations did not require any form of connection between the company itself and the USA, whether a formal legal one (such as incorporation) or a factual one (such as place of management).

The Court of Appeal said that 'the facts that the entity to which the company is stapled is itself US incorporated and that both entities are ultimately US owned cannot suffice'. *GE Financial Investments* was therefore not resident in the USA for treaty purposes.

The Court of Appeal went on to consider whether *GE Financial Investments* carried on a business in the USA. It agreed with the Upper Tribunal that the First Tier Tribunal had made no material error of law and that its conclusions were unsurprising.

The court therefore upheld the First Tier Tribunal's decision that the Delaware limited partnership (and therefore *GE Financial Investments* as limited partner) acted merely as a passive holding vehicle for some loan receivables and was not carrying on a business.

HMRC v GE Financial Investments [2024] EWCA Civ 797

Adapted from the case summary in Tax Journal (26 July 2024)

