UK Tax Disputes Digest

Spring 2025

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Introduction

Welcome to the spring 2025 edition of our UK Tax Disputes Digest: a high-level summary of key developments in contentious tax over the last few months for tax and legal in-house professionals.

As with previous editions, we have seen a continued increase in HMRC activity across various areas. Both individual and corporate taxpayers would be well-advised to check their tax position as soon as possible to prepare for any potential HMRC investigation into their tax affairs.

In this edition, we look at just a few of these developments, including the latest in relation to BEPS Pillar Two and potential disputes, plus the latest series of HMRC nudge campaigns.

We also cover a number of notable tax cases and other interesting procedural decisions. This includes the most recent case law development on deductibility of payments, allocation of taxing rights under a double tax treaty and an interim decision on partial closure notices.

About the team

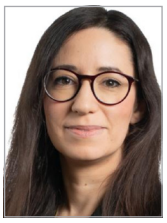
The CMS Tax Disputes and Investigations team provides a full-service contentious tax offering. This includes advising both corporate and private clients on all areas of direct and indirect tax covering tax dispute prevention, management and resolution. We seek to protect against tax risk, manage interaction with HMRC and conduct litigation at all stages of the courts and tribunals system including the Supreme Court.

With 17 partners, the CMS tax team is one of the largest in the City and advises high-profile clients across a wide range of sectors and all areas of tax. The UK team works alongside the CMS global network which has tax capability in over 70 offices to assist clients with international issues.

The CMS tax team has recently expanded its disputes capabilities with the appointment of Nicola Hine as partner, to lead the tax disputes practice. Nicola has a depth and breadth of experience in complex tax litigation at every stage of the courts and tribunal system including the First-tier Tribunal, Upper Tribunal, High Court (restitution and judicial review hearings), Court of Appeal, Supreme Court, Privy Council and Court of Justice of the European Union. Her practice covers the full disputes lifecycle and includes both domestic and international matters.

For more information on our team and the type of work we undertake, please see here.

Key contacts



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In focus: Managing Tax Dispute Risk: Pillar Two

Pillar Two seems set to increase the likelihood of tax disputes and action should be taken now to manage that risk.

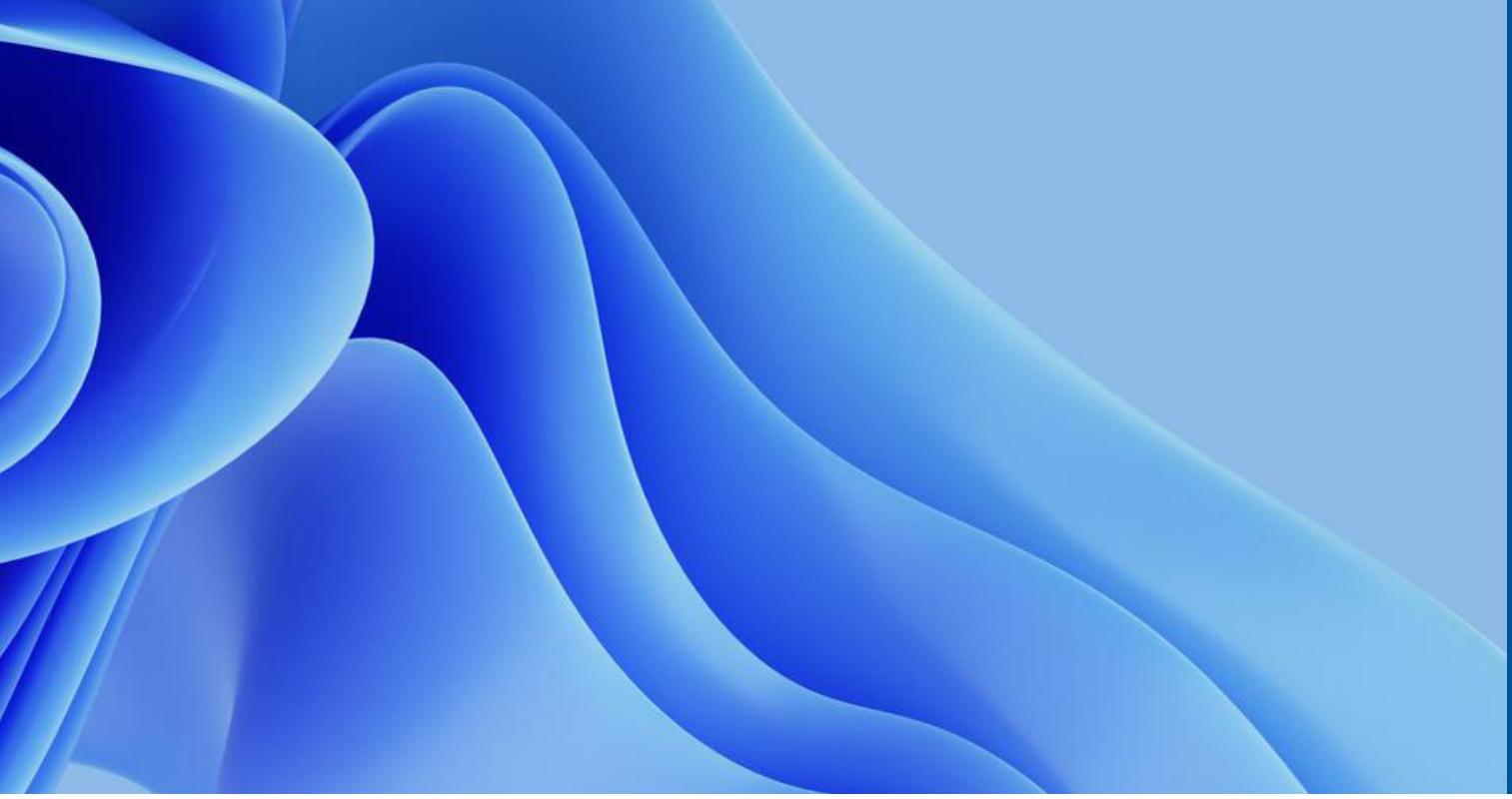
What is Pillar Two?
Pillar Two is an OECD-led initiative, resulting in a global minimum tax regime, applicable to groups with revenues of over 750m Euros. For the UK, and many other jurisdictions, it first had effect for 2024.

Now is therefore a key time to consider tax dispute risk in relation to Pillar Two. For many groups this will be of relevance from an audit perspective and technical issues may be emerging as a result of auditor engagement, or more generally as groups engage with the granular detail of Pillar Two.

Even where material Pillar Two tax exposures are not anticipated, the compliance and information-gathering processes required are often very significant. Data may be required which has never previously been required for tax purposes.

Registration processes and timeframes differ between jurisdictions, with registration deadlines in some key jurisdictions already having passed and in others about to fall due. The technical complexity of the rules is such that filing positions will need to be considered well in advance of the deadline for submitting returns.

The detail of the rules, and their application in particular contexts, remains the subject of much lobbying, including by industry bodies in various sectors, and discussions with tax authorities. In the UK, HMRC's draft guidance on Pillar Two is currently the subject of a consultation process, with further changes anticipated. Meanwhile individual taxpayers are discussing their own positions with tax authorities, in order to attempt to arrive at filing positions which are both technically compliant and, from a data perspective, feasible to comply with. Particular context-specific pockets of uncertainty (for example relating to opaque consolidated entities of insurers) are emerging and are currently the subject of much lobbying.



An extensive regime of elections will need to be considered in detail by groups, with complex points of interaction between elections. Rules which were enacted in haste are, in many cases, only now being tested against real-life fact patterns.

All of this technical complexity and compliance burden arises against a backdrop of what might be argued to be existential challenge. President Trump has decided to remove the US from the OECD global tax deal. This is a response to how an element of Pillar Two (the under-taxed profit rule) would affect the US.

Though many would argue that a compromise position might be reached, permitting Pillar Two to exist alongside US tax policy in a broadly mutually acceptable manner, it is unusual to see such fundamental uncertainty at a time when so much resource is being expended upon the minutiae of the rules.

The global context

Tax is increasingly a global issue. Tax collection is important where inflation and debt rises, alongside the economic challenges represented by the cost of living crisis.

Similarly, allocation of taxing rights, including transfer pricing, continues to be a hot topic for tax authorities across the globe. This is illustrated by the number of transfer pricing enquiries, alongside an increase in international issues in dispute. As of 31 March 2024, c£14bn of the tax under consideration in enquiries by HMRC's Large Business Directorate related to international matters. UK transfer pricing yield stood at £1.8bn in 2023-24 with 128 transfer pricing enquiries settled during the period.

Ensuring that appropriate action is taken by multinationals to protect against double taxation where there is competition between tax authorities for collection is key. This is likely to include taking advice to ensure that appropriate transfer pricing measures are applied, retention of advice and documentation in case of audit, considered implementation and regular review of policies (particularly where factual circumstances have changed).

In a Pillar Two context, careful consideration may be needed in order to determine which is the relevant taxing jurisdiction. Further, many of the technical complexities of the internal operation of the Pillar Two rules themselves give rise to potential areas of double taxation. Pillar Two legislation has been enacted in haste and there are a number of contexts in which it does not appear to operate as a cohesive whole. For example, a number of areas of potential double taxation arise for insurers holding opaque consolidated investment entities. Even where no Pillar Two exposure is ultimately anticipated, it may be necessary to consider the making of one or more elections in order to arrive at that result, with the potential interaction of several of the available elections being another area of uncertainty giving rise to concerns around potential double taxation.

Why might Pillar Two increase the likelihood of disputes?

Pillar Two is resulting in technical complexity and a significantly increased compliance burden. Novel rules, guidance and processes are likely to lead to an increase in tax authority audit activity. This is likely to involve tax authorities looking into consistency of approach and accuracy in implementation, arising from the need for each jurisdiction to enact its own implementing legislation for Pillar Two. Further, a number of potential areas of uncertainty are being resolved in guidance, both that issued by the OECD and that of individual jurisdictions, with significant potential for implementation differences to arise as between jurisdictions. As a general rule, where there is uncertainty, there is risk of challenge.

Although tax authorities may look into matters unilaterally, in a global setting a joint audit may be used to allocate taxing rights (see CMS article from an Italian and Swedish focus: https://cms.law/en/nld/publication/cms-international-disputes-digest-2024-winter-edition/joint-audits-the-route-to-tax-certainty-and-effective-dispute-avoidance).

How will Pillar Two disputes be resolved?

Parallels with the policy objectives of Pillar Two may usefully be drawn with those of the UK's diverted profits tax ("**DPT**") regime, which seeks to counteract contrived arrangements used by large groups (typically multinationals) that result in the erosion of the UK's tax base. This was a unilateral measure brought in with effect from 1 April 2015. It seeks to tax companies from a UK perspective and does not allocate profits between jurisdictions. Reform is expected to the DPT following consultation.

In a UK context there has been argument about whether DPT falls outside of the provisions of double tax treaties ("**DTT**"), which could risk double taxation. The uncertainty over whether DTT protection would be provided in a DPT context is illustrated by *Glencore Energy Ltd and another v HMRC* [2019] UKFTT 438 (TC) ("***Glencore***") following which legislation was introduced to allow relief against diverted profits tax as a result of the mutual agreement procedure (s114A Finance Act 2015) to provide certainty on the matter. This illustrates the challenge of managing double taxation globally alongside unilateral measures intended to impact on domestic tax take.

As *Glencore* illustrates, it is important that provisions are explicit to protect against double taxation in circumstances beyond the norm, or where the usual taxes are not applicable, to ensure that all parties have clarity and certainty about dispute resolution mechanisms.

Given the likelihood of multi-jurisdictional disputes arising in a Pillar Two context, the topic of dispute resolution in this context has been on the OECD's agenda for some time. On 20 December 2022 the OECD issued its Public Consultation Document on Pillar Two – Tax Certainty for the GloBE Rules.

The OECD's Public Consultation Document concludes that the following specific mechanisms might be employed by multinationals involved in Pillar Two disputes: (i) reliance on the provisions of the Convention on Mutual Administrative Assistance in Tax Matters (MAAC) to facilitate the exchange of information between States' respective competent authorities with respect to interpretation of the rules; and (ii) initiation of the mutual agreement procedure ("**MAP**") in place in the applicable double tax treaty with the aim of removing any double taxation by agreement.

Additionally, the OECD proposes incorporating new alternative dispute resolution provisions into domestic law and potentially adopting a multilateral convention to address Pillar Two disputes.

On its most recent Tax Certainty Day (15 November 2024) the OECD referred to ongoing work on a multilateral convention, with discussion focussing upon a common legal basis and scope. The possibility of expanding the OECD's International Compliance Assurance Programme was also discussed.

Of these mechanisms, the MAP in place in many double tax treaties provides access to dispute resolution to allocate taxing rights between states. However, this mechanism is arguably poorly equipped to deal with Pillar Two disputes. Article 25(1) of the OECD Model Convention does not provide a route to bringing Pillar Two disputes, principally because the requirement that there is "taxation not in accordance with a tax treaty" would typically not be met. An alternative route is the consultation procedure under Article 25(3), "The competent authorities of the Contracting States […] may also consult together for the elimination of double taxation in cases not provided for in the Convention." However, this does not provide a right for the taxpayer to initiate the process and would not assist in any context not involving double taxation. Further, any interaction with domestic laws would require consideration in this context.

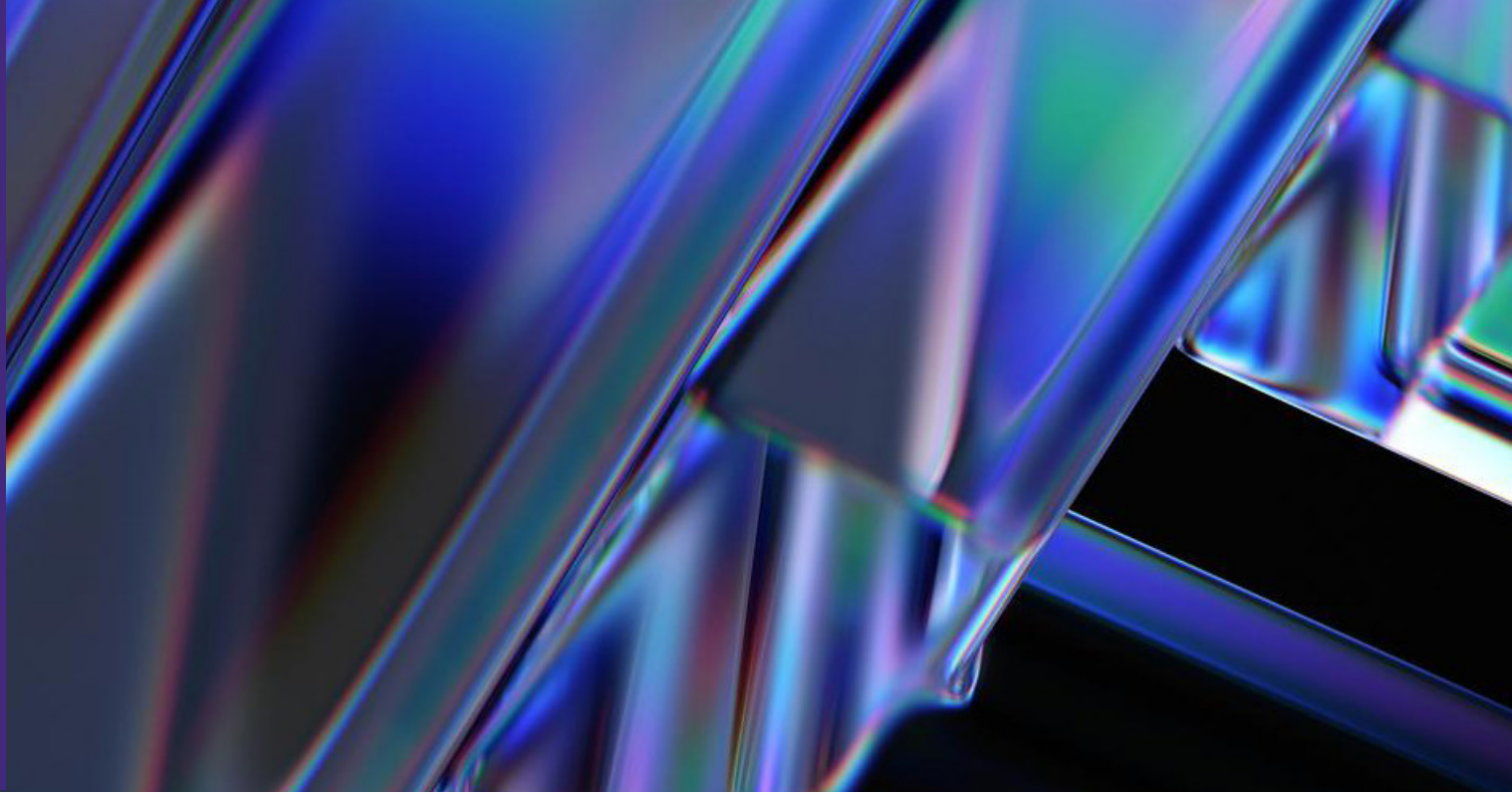
In addition, the process provides limited opportunities for taxpayers to be involved, rather relying on competent authorities to reach agreement between themselves. Similarly, not all taxes may be covered. Even where cases are within MAP not all result in resolution; a number of competent authorities are unable to reach agreement. BEPS action 14 seeks to make dispute resolution measures more effective. This includes addressing obstacles to MAP and the absence of arbitration procedures in treaties.

It will be important to ensure that domestic remedies work alongside MAP (or arbitration or other dispute resolution methods). Similarly, any bilateral processes should provide an effective resolution mechanism. This includes accessibility, timely resolution and a clear understanding of domestic tax authorities on the interaction of bilateral measures with their domestic resolution procedures. The authors consider that transparency between tax authorities and taxpayers, plus a commitment to engagement, will be key.

Action now to manage risk

Where there is uncertainty, risk management becomes key. Consideration should be given to technical analysis to assess the position and to seek to apply new provisions accurately across the globe. Identification of potential issues at an early stage, which could be discussed with a tax authority proactively, may be important. Similarly, ensuring appropriate implementation of policies and ensuring robust documentary records are held may be helpful. Records should be retained both in respect of tax technical positions taken, and as regards underlying data and compliance. A clear internal audit trail will enable clarity of discussion with tax authorities, and should provide the ability to respond to any tax audits in a considered manner (noting that disclosure should be considered carefully to ensure accuracy and appropriate information is provided). Retention of records for a time period that covers the risk of tax authority audits or assessments may be critical.

As part of the CMS global network with tax capability in over 70 offices, the CMS UK Tax Disputes & Investigations team is well-placed to advise on all forms of contentious tax matters. We advise taxpayers on technical issues in relation to Pillar Two as part of our tax advisory services. We can assist with all aspects of tax dispute prevention, management and resolution. Please get in touch with the team to find out more.



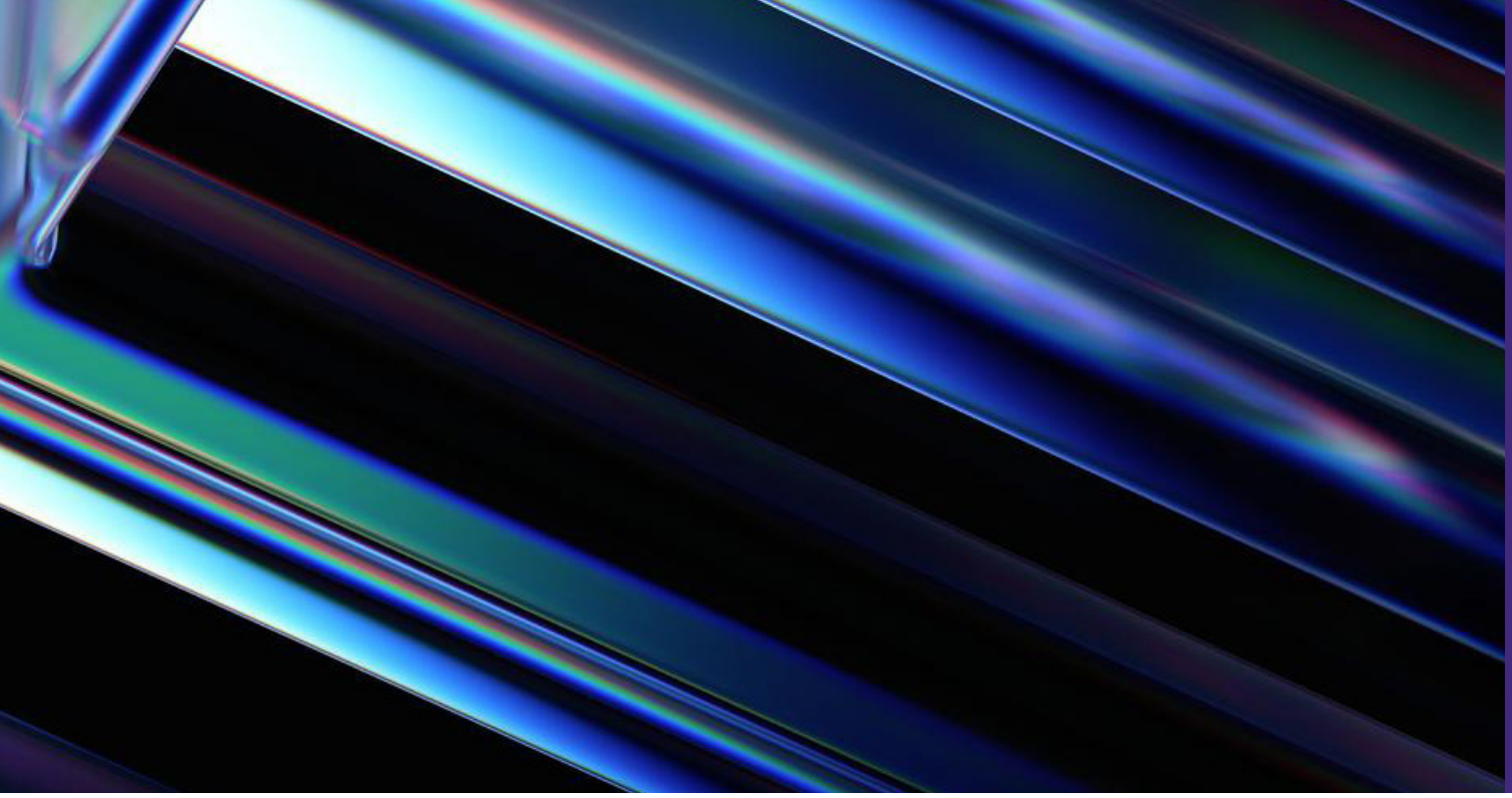
In focus: Deductibility of redress payments

The Court of Appeal has recently handed down its judgment in *ScottishPower (SCPL) Limited and other companies v HMRC* [2025] EWCA Civ 3 on 17 January 2025. The case provides an interesting development on the deductibility of redress payments. Overturning the Upper Tribunal's decision, the Court decided that payments made to settle regulatory investigations were not penalty payments and were deductible. This approach diverges from the approach taken in the tribunals below and taxpayers may wish to give careful consideration to whether any similar payments have been appropriately treated.

Background

ScottishPower (SCPL) Limited ("**ScottishPower**") operates in a regulated sector and generates and supplies gas and electricity. This case relates to four Ofgem investigations which were settled between October 2013 and April 2016 in relation to certain regulatory issues. As part of settlement discussions, penalties were proposed by Ofgem. However, it was agreed that ScottishPower would pay sums to customers, charities and an energy consumer campaign instead under contract settlements amounting to approximately £28m. Nominal penalties of £1 were paid also. It was found as a fact by the First-tier Tribunal (the "**FTT**") that ScottishPower agreed to the settlements in the expectation that if they did not, a penalty greater than £1 would be imposed.

Relevantly, corporation tax is charged on profits of a trade, in accordance with GAAP with no deduction for expenses not incurred wholly and exclusively for the purposes of the trade.



ScottishPower sought to deduct the £28m of redress payments from their profits for corporation tax purposes. HMRC disagreed with this approach. The FTT found that most of the payments were not deductible, save for one to consumers which they considered was made as compensation, wholly and exclusively for the purposes of the trade.

On appeal to the Upper Tribunal, it was found that all of the payments were non-deductible.

Judgment

Case law has developed to create a rule that penalties incurred in the course of a trade may not be deducted in computing taxable profits (*see McKnight (HM Inspector of Taxes) v Sheppard* [1999] 1 WLR 1333) ("**McKnight**").

HMRC argued that the rule in McKnight existed and applied to the payments here, as they were made in lieu of penalties. ScottishPower's view was that McKnight did not cover this scenario and that the payments should be deductible under general principles by reference to the purpose of the expenditure. The Court of Appeal considered there to be no support for a general proposition that deductibility is determined by the nature of the payment it replaces. Instead, the question was whether the actual payment was deductible under s54 Corporation Tax Act 2009 taking into account whether it was incurred wholly and exclusively for the purposes of the trade.

The FTT had decided that the payments were made in the course of the trade, deducted in accordance with GAAP and made wholly and exclusively for the purposes of the trade (leaving aside the penalty issue). In light of this, and as the payments were not in fact penalty payments, the Court of Appeal allowed the appeal finding nothing that prevented deductibility.

Comment

The Court of Appeal's judgment represents a development in the case law on the deductibility of payments. The usual trading deduction rules must be considered in and of themselves, rather than focusing on whether a payment is replacing a penalty or otherwise punitive in nature. In light of the potential difference in tax treatment between penalties and other redress payments, taxpayers should consider carefully if the appropriate treatment has been taken.

The judgment notes that the availability of beneficial tax treatment for an alternative form of redress payment to a penalty or fine does not undermine a regulator's power to penalise those it regulates. More specifically, the law must be followed and judges should not be expected to influence policy. Therefore there was no requirement that considerations of public policy should require a conclusion that a principle which prohibits a deduction for fines or penalties must extend to payments which are not in fact fines or penalties. Further, such a conclusion might be seen as going beyond the proper role of the judiciary. Instead, it would be for Parliament to develop a rule to manage any policy points if necessary.

Other notable tax cases

HMRC v Bluecrest Capital Management (UK) LLP [2025] EWCA Civ 23

The Court of Appeal has found in favour of HMRC in a case concerning the application of the salaried member rules, in a decision which narrows the circumstances in which partners will be able to take the position that they exert significant influence over the affairs of an LLP.

The taxpayer sought to claim that a number of its members should not be taxed as employees, though HMRC took an opposed position, invoking the salaried member rules. For the salaried member rules to apply, *inter alia* Condition B ("The member does not have significant influence over the affairs of the LLP") of the salaried member rules must be met.

Both the FTT and the Upper Tribunal ("**UT**") had found that some members of the LLP met condition B, whilst others did not. HMRC had argued that 'significant influence' meant an ability to influence the affairs of the whole LLP. However it was decided in the tribunals that a member may have significant influence if they could significantly influence particular, albeit important, aspects of the LLP's affairs.

The Court has concluded that the FTT and UT erred on a point of law and the case has been remitted to the FTT, so further developments may be expected. The Court held that only influence deriving from legally enforceable rights and duties of the members is to be taken into account in assessing whether they have 'significant influence'; de facto influence does not count.

Royal Bank of Canada v HMRC [2025] UKSC 2

The Supreme Court has handed down judgment in an appeal concerning the allocation of taxing rights between the UK and Canada. The case relates to income earned from the sale of oil found in the UK Continental Shelf in the North Sea. The appeal concerned the application of the UK/Canada double taxation treaty (the "**DTT**") and whether the UK had a right to charge to tax payments made by BP Petroleum Development Ltd ("**BP**") to Sulpetro and Royal Bank of Canada ("**RBC**"). The majority found in favour of RBC that the relevant payments were not subject to corporation tax.

Sulpetro Ltd ("**Sulpetro**") was an international company involved in exploiting North Sea oil and resident for tax purposes in Canada. Sulpetro set up a UK subsidiary ("**Sulpetro (UK)**") which was granted a licence by the UK to explore the Buchan Field in the North Sea Continental Shelf.

It was agreed that Sulpetro would fund and provide expertise for the exploration and in return would receive Sulpetro (UK)'s share of the oil found. In 1986 BP acquired the share capital in Sulpetro (UK) and the oil rights that Sulpetro had under its agreement with Sulpetro (UK). In return, BP agreed to make payments to Sulpetro calculated by reference to the volume of oil BP acquired once the price rose above a certain level (the "**Payments**").

Separately, Sulpetro was indebted to RBC and unable to repay its loan. By court order in 1993, the right to receive the Payments was assigned to RBC as a result of Sulpetro's continued indebtedness. The Supreme Court considered whether the UK had a right to charge to tax the Payments made by BP to Sulpetro and subsequently to RBC. This required consideration of Article 6 of the DTT. This provides that income from immovable property may be taxed in the Contracting State in which such property is situated. "Immovable property" includes rights to variable payments "as consideration for the working of, or the right to work, … natural resources".

There were three issues considered by the Supreme Court in the appeal:

1. What does the phrase "the working of, or the right to work" the Buchan Field mean and does it encompass the rights that BP was paying for when making the Payments first to Sulpetro and later to RBC?
2. If BP did acquire and so was making the Payments to Sulpetro for "the working of, or the right to work" the Buchan Field, are those Payments to be regarded as "as consideration for" the right to work the Buchan Field within the meaning of Article 6(2)?
3. If the Payments are covered by Article 6(2) so that the UK/Canada Convention conferred taxing rights on the UK in respect of the Payments, has the UK in fact exercised those rights and imposed a charge to tax in the domestic legislation? That turns on the proper interpretation of section 1313 of the Corporation Tax Act 2009 ("section 1313") and whether it catches the Payments.

The FTT and the UT held that the Payments were within Article 6 of the DTT and caught by section 1313, resulting in taxation by the UK. The Court of Appeal allowed RBC's appeal and held that the UK did not have the right to tax the Payments under the DTT. HMRC appealed to the Supreme Court.

In respect of issue 1, concerning the right to work, HMRC's case was rejected. HMRC argued that the agreement between the Sulpetro entities governing offshore activities (the "**Agreement**") gave Sulpetro the "right to work" the Buchan Field, which was then acquired by BP. The Supreme Court in its leading judgment considered it was Sulpetro (UK) which held the licence and was responsible for working the field. It was noted that there is a legal difference between someone having a right to work natural resources and someone having a right to require another person to work those natural resources, with the conclusion being that Sulpetro had the latter but not the former.

As it was decided that Sulpetro did not acquire the right to work the Buchan Field, did not transfer that right to BP and did not receive the Payments in consideration of the right to work, issue 2 was dealt with briefly. It was concluded that the Payments could not have been consideration for the right to work the Buchan Field. The Court's view was that even if the bundle of rights that Sulpetro acquired under the Agreement, which were effectively surrendered to BP in return for the Payments, had amounted to the right to work, those rights would still have been too remote to fall within the definition of immovable property for DTT purposes.

On issue 2, the majority judgment considered that what is caught by Article 6(2) and treated as immovable property is the contractual right to variable or fixed payments. This is different from the right to be paid for the sale of the oil itself, which is not caught by Article 6 because the oil is a movable (and not deemed to be immovable) property. The reach of Article 6(2) is not extended in the way that HMRC had sought to argue.

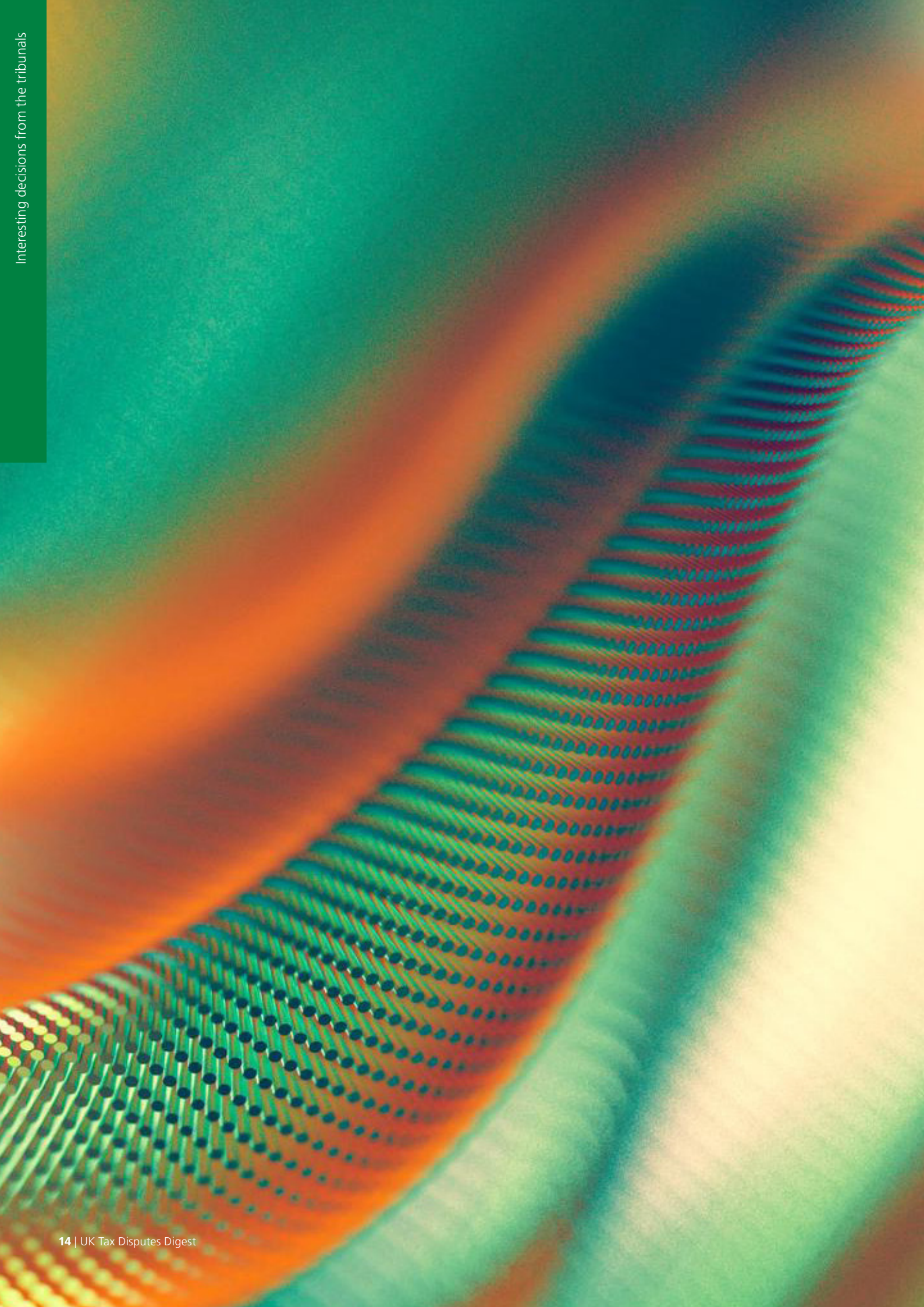
As the Court decided that the UK does not have the right under the DTT to tax RBC, the question whether the income would be taxable under section 1313 did not arise. However, the majority judgment states that if the Payments had fallen within Article 6(2) of the DTT they would have held that the UK had exercised its taxing rights in respect of those Payments and that they fell within the charge to corporation tax by virtue of section 1313. It was noted that this should not have the effect that any payments made to those financing oil-related projects are caught, simply because they are computed by reference to the price of oil or because the money used to make payments has been earned from the sale of oil. Here the Payments were much more closely related to the extraction of oil.

Orsted West of Duddon Sands (UK) Ltd v HMRC [2025] EWCA Civ 279

The Court of Appeal has concluded that pre-construction expenditure on surveys and studies relating to offshore windfarms qualified for capital allowances under section 11 of the Capital Allowances Act 2001 ("CAA 2001").

The appellants, Orsted West of Duddon Sands (UK) Limited and others are all members of a group of companies which the ultimate parent is Ørsted A/S ("**Orsted**"). Orsted was successful in winning a bid from the Crown Estate to develop certain areas of seabed as windfarms (Gunfleet Sands Phase 1, Gunfleet Sands Phase 2, Walney Offshore Windfarm and West of Duddon Sands Offshore Windfarm). Following the successful bid Orsted obtained various statutory consents to carry out various environmental impact assessments (including Landscape, seascape and visual assessments; Ornithology and collision risk studies; Fish and shellfish studies; and others) (the "Studies"). In February 2018, HMRC issued a closure notices denying Orsted capital allowances in respect of expenditure on the Studies.

The principal issue before the Court of Appeal was whether expenditure on the Studies fell within section 11 CAA 2001, on the basis that it was expenditure, "on the provision of plant and machinery". The Court of Appeal, disagreeing with the Upper Tribunal, has concluded that a three-part test should be applied, as follows. Expenditure should qualify where, "(a) the taxpayer can demonstrate that, looking at matters objectively and with the benefit of hindsight, expenditure informed the design of plant or machinery or how it was to be installed, (b) the expenditure related to plant or machinery which was in fact acquired or constructed and (c) the expenditure did not arise from characteristics or circumstances particular to the specific taxpayer." On this basis, the majority of the relevant expenditure was found to qualify for capital allowances.



Interesting decisions from the tribunals

FTT considers whether redress payments include an element of "interest"

In *NHS Mid & South Essex ICB and others v HMRC* [2024] UKFTT 1117 (TC), the FTT considered whether the inflationary element of a compensation payment is yearly interest, within the meaning of section 874(1) Income Tax Act 2007 ("**ITA 2007**"). The compensation payments were redress payments made by Integrated Care Boards ("**ICBs**") to individuals who were wrongly treated as being ineligible for NHS Continuing Healthcare ("**CHC**"). The redress payments included an inflationary element, based upon the retail price index, which were intended to put the individual in the position they would have been in had CHC payments been made at the appropriate time.

Background

Redress payments were made by the ICBs to make restitution for patients having been wrongly refused continuing care full funding at the appropriate time. The redress payments were to compensate the patient for not having received the CHC payment sooner, with the result that they had to pay for their care in the meantime. An interest element was included to ensure that the redress payment placed individuals in the position they would have been in, had CHC payments been awarded at the appropriate time. The interest element reflected the fact that the patients had been deprived of that money for a period.

HMRC argued that the ICBs had a duty to make such payments under deduction of tax, on the basis that they constituted yearly interest for the purposes of section 874 ITA 2007.

The three issues to be determined by the FTT were whether the payments were "interest arising", constituting "yearly interest" and whether they were "payable to an individual in respect of compensation".

Decision

Given that there is no statutory definition of "interest", an analysis of case law was undertaken by the FTT. The FTT agreed with the ICBs' submissions that the label attached to a payment is not definitive for tax purposes and that a sum is not interest merely because there is another sum of money from which the so-called interest will be ascertained.

However the FTT disagreed with the ICBs' submission that the amounts were not interest, because there was no principal sum to which they related. This argument had been made by the ICBs on the basis that there was no entitlement or debt due to an individual throughout the period of time during which they had to pay for their care. Instead, the FTT concluded that the correct tax treatment is determined by considering the true nature of the payment. On this basis, the sums were held to be "interest arising". The FTT further concluded, on the basis of settled caselaw, that the amounts were "yearly interest".

Alternatively, the FTT found that if the sums are not yearly interest, they would be treated as such (pursuant to the deeming provision in section 874(5A) ITA 2007), because the interest element of the redress payments was interest payable in respect of compensation. The taxpayers' appeal was therefore dismissed.

Comment

The FTT looked to establish the substance of the inflationary element of the redress payments, by reference to case law. This case therefore highlights the need to consider whether an obligation to withhold arises in any context where a composite payment includes an element based on the passage of time.

FTT rejects taxpayer's appeal in a case concerning the application of the loss-refreshing targeted anti-avoidance rule

In *Blackfriars Hotel (UK) Holdings Limited v HMRC* [2024] UKFTT 1095 (TC), the FTT rejected the taxpayer's appeal against HMRC's denial of the taxpayer's use of its pre-2017 carried forward non-trading loan relationship deficits ("**NTLRDs**") on the basis that the targeted anti-avoidance rule at section 730G of the Taxation of Chargeable Gains Act 1992 ("**TCGA 1992**") applied to prevent such use.

Background

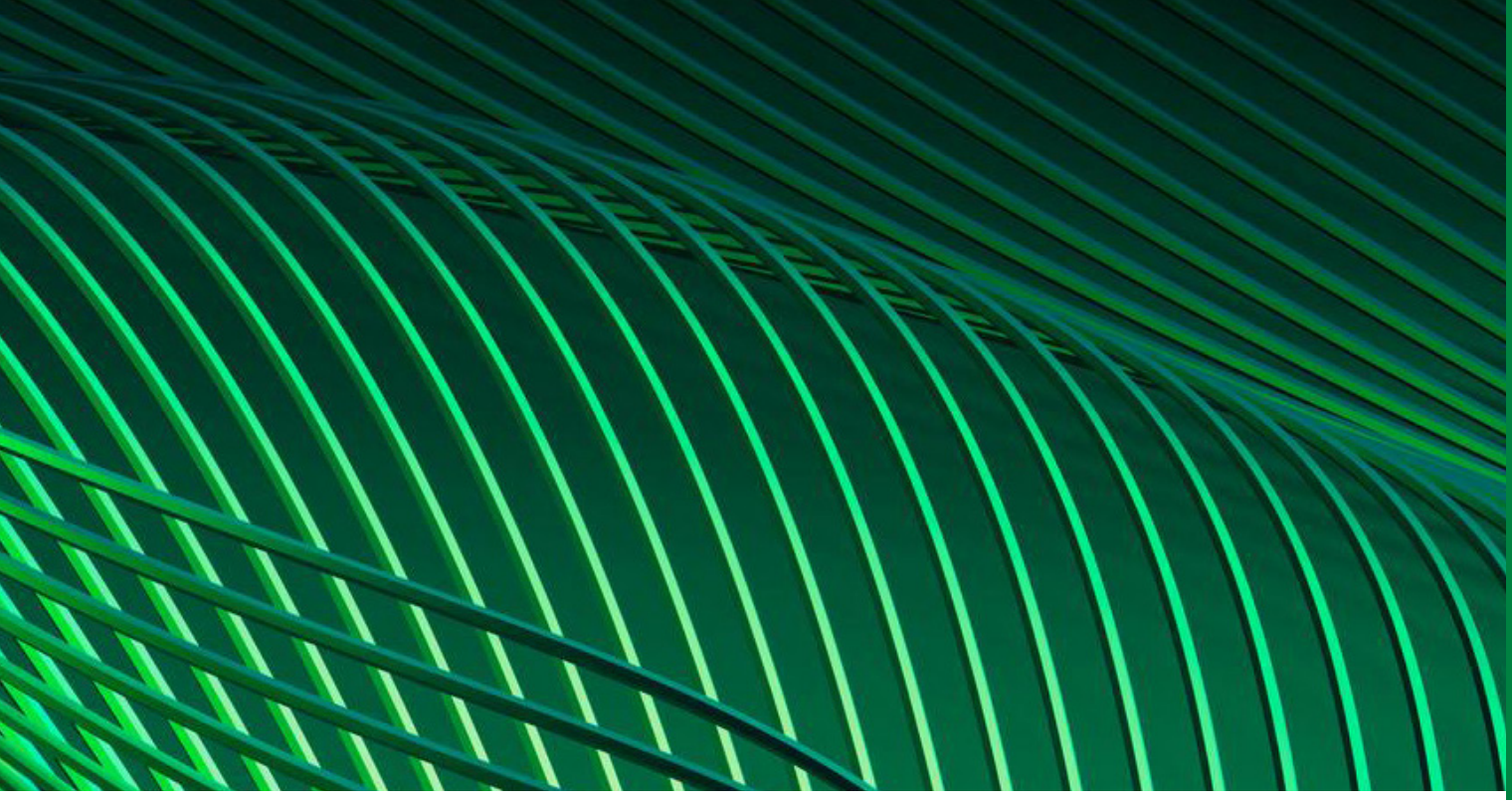
This case concerned a taxpayer (Blackfriars Hotel (UK) Holdings Limited) which, by virtue of the fact that its payments of interest on third-party bank debt exceeded its receipts of interest earned on a loan made to a subsidiary, had accumulated carried-forward NTLRDs. It had been unable to use those NTLRDs (as it did not have profits) and unable to surrender them as group relief (as NTLRDs arising pre-1 April 2017 could not be surrendered by way of group relief).

In December 2015, the taxpayer had sought to create profits by making another loan (of approximately £20 million) to the same subsidiary (the "tax arrangements" for the purposes of section 730G TCGA 1992), funded through reinvesting a dividend (itself funded through a capital reduction) received from that subsidiary. The taxpayer did also create a loan to another subsidiary at the same time, however, it was agreed that that loan was not relevant to the case.

Decision

In its decision, the FTT, which ultimately found against the taxpayer, cited a number of cases confirming that the correct approach to be taken to analysing anti-avoidance provisions, such as section 730G TCGA 1992, which prohibits a company from deducting carried-forward losses from "relevant profits" where all of the conditions are satisfied, is a purposive (and wide) one.

Accordingly, it found that, contrary to the submissions of the taxpayer, Condition A under section 730G TCGA 1992 can be satisfied in circumstances where a company has profits in an accounting period which arise as a result of the tax arrangements (i.e. relevant profits), whether or not it also has other profits. The FTT stated that this is both the more natural reading of the section and one which it considers accords with Parliament's intention that companies engaging in tax arrangements should be unable to improve their tax position as a result.



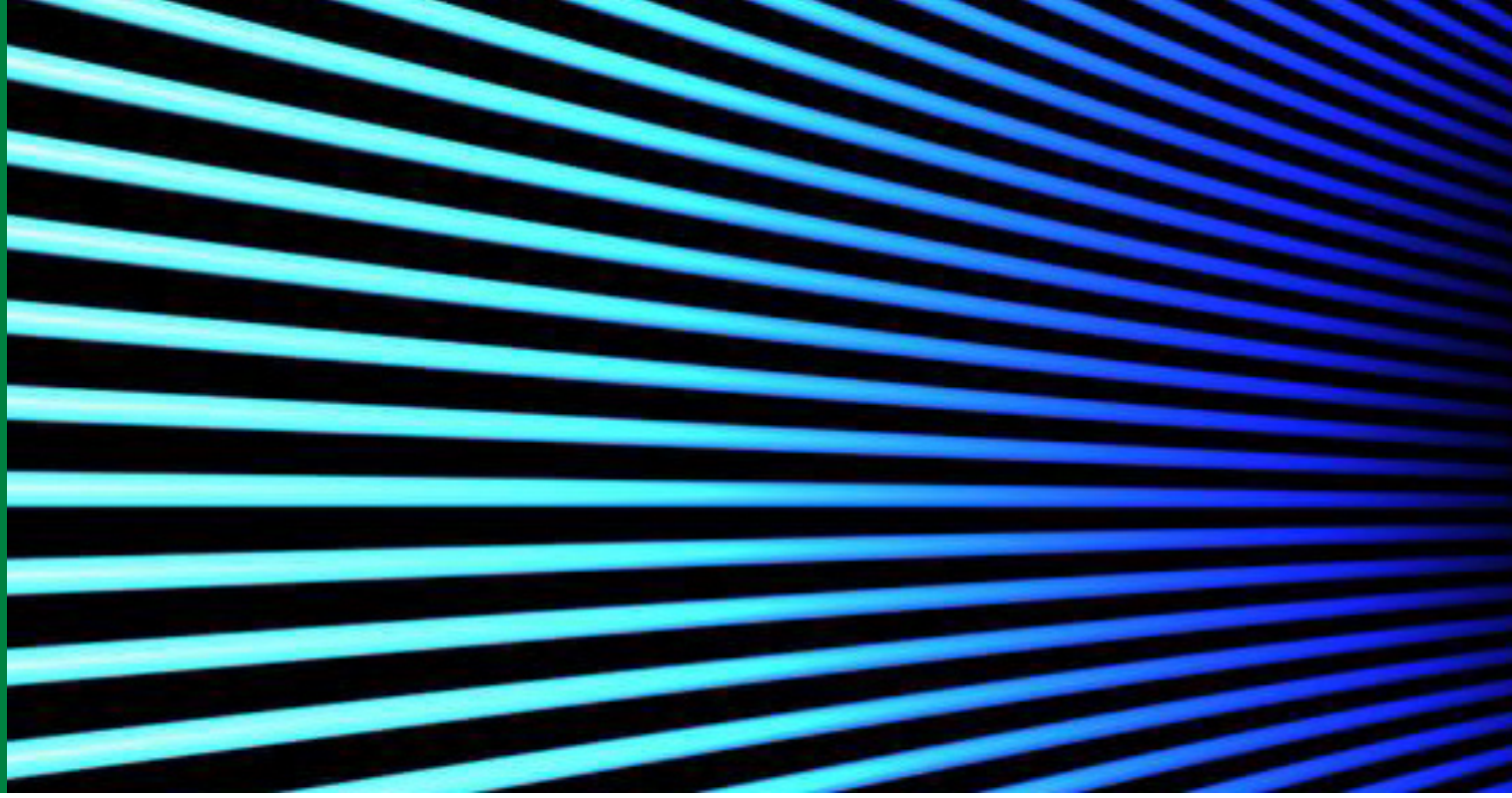
Additionally, in respect of Condition A, the FTT held that for profits to be relevant profits, tax arrangements must be an "efficient cause of the profits, but they need not be the sole or even the dominant cause". This conclusion was reached, again, on the basis of both a purposive interpretation of section 730G TCGA 1992 and an assumption that when legislating, Parliament should understand (from both a common law and common sense perspective) and recognise the existence of concurrent causation.

It then fell to be determined how much of any profits were, in fact, relevant profits. The FTT held that the correct approach to take was not to try to isolate individual items in the profit calculation "from the bottom up", but instead to consider what the taxpayer's profits would have been absent the tax arrangements, and compare that sum with the actual profits for the same period. Accordingly, as the taxpayer would have made a loss without the tax arrangements being in place, all of the taxpayer's profits in that period were considered to be as "as a result of" the tax arrangements, and hence were all "relevant profits".

Comment

This case is a reminder of the wide-ranging scope of section 730 TCGA 1992 as well as confirmation of the correct interpretation of several aspects in relation to Condition A. It provides helpful instruction on the method of calculating relevant profits, notwithstanding the fact that the relaxation of the rules in respect of NTLRDs arising after 1 April 2017 means that these concerns are perhaps of less significance than was the case some years ago.

More broadly, this provides a clear illustration as to the application of the purposive approach to anti-avoidance legislation. The FTT noted that, "It is hard to see why Parliament would want a company which engaged in arrangements within the scope of the [anti-avoidance provision] to be able to improve its position in any way at all". However there was no suggestion that the intended effect was "to punish a company for engaging in tax arrangements, as it could end up in a worse position than if it had not done so". It will be interesting to see whether this approach, involving counteraction of the arrangements being targeted, but no more and no less, is adopted in other disputes.



FTT considers whether part of a building was suitable for use as a dwelling

In *Tretyakov v HMRC* [2024] UKFTT 1144 (TC), the FTT gave detailed consideration to whether the taxpayer's property was of mixed use and therefore, whether the higher rates of stamp duty land tax ("**SDLT**").

Background

A building known as the Bacon Factory was purchased by the Appellant, Mr Tretyakov in June 2021 for £5.75 million. The appeal turned on whether, for SDLT purposes, this property was entirely residential or whether, as Mr Tretyakov contended, part of it was not residential.

Mr Tretyakov submitted his SDLT return on the basis that the building was mixed use which resulted in an SDLT liability of £277,000. However, HMRC contended that the building was entirely residential, resulting in an SDLT liability of £761,250.

The Bacon Factory comprises three floors. The upper two floors are residential accommodation whilst the ground floor was designated for planning purposes as light industrial. The ground floor has also been subject to non-domestic rates (business rates) from at least 1990 and that continued to be the case.

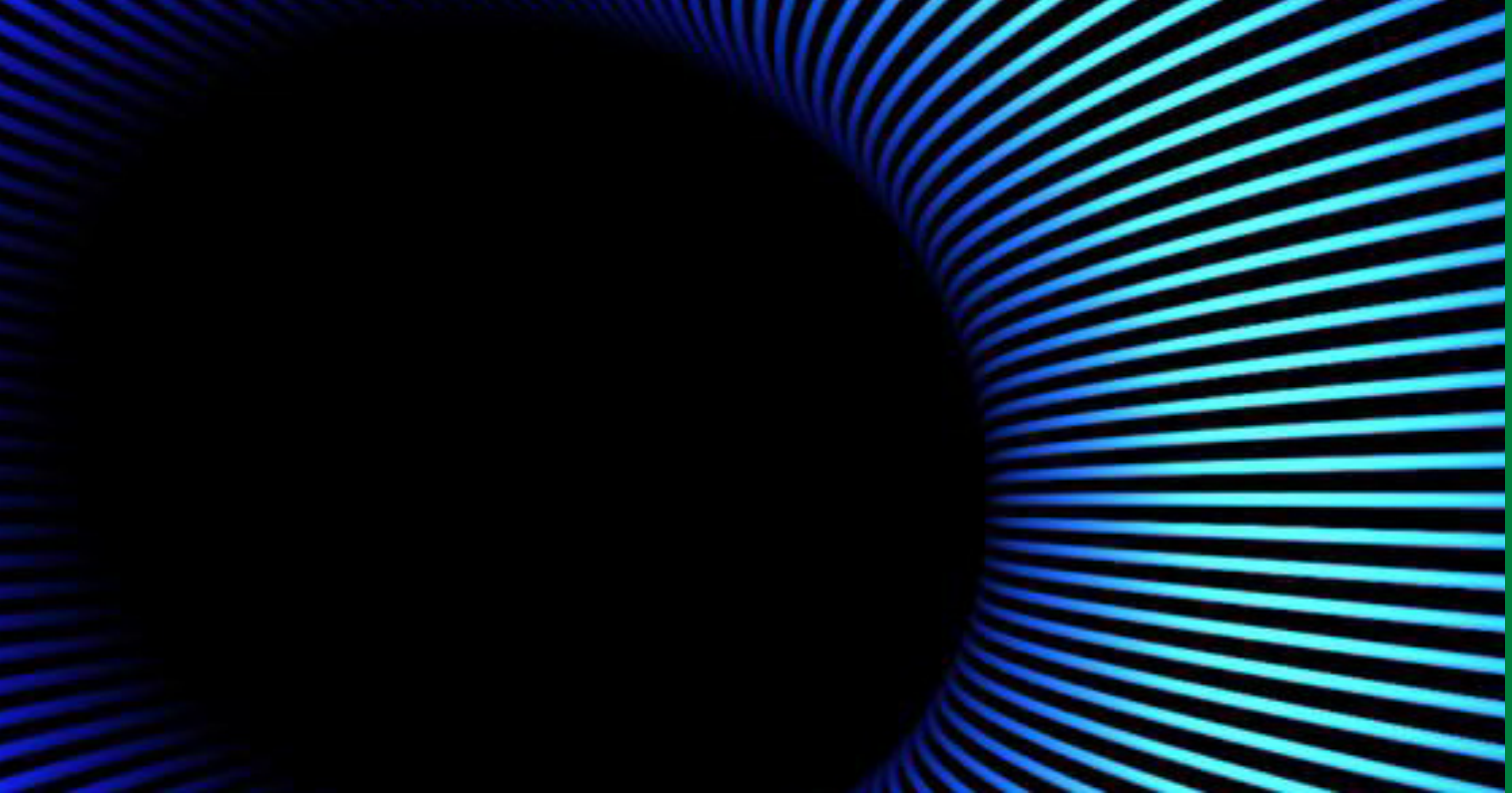
The ground floor had been intended for use by the original owner as a gin distillery, but for commercial reasons that business activity had not gone ahead. The ground floor was split into two parts. The front area consisted of a garage space with storage including an area which was walled off with fireproof glass. The rear area of the ground floor contained a large bar area and games room, a wine cellar, sauna and further storage.

The previous owner had in fact used part of the ground floor to carry out business operations of a home accessories business, but that did not involve the installation of any plant or machinery.

The taxpayer submitted his SDLT return on the basis that the ground floor was used as a factory. However HMRC opened an enquiry, which concluded that the property was entirely residential.

Decision

The amount of SDLT payable on a purchase of land depends on whether that land "consists entirely of residential property" or whether it "consists of or includes land that is not residential property" (s 55(1B) Finance Act 2003). Under s116(1) Finance Act 2003, residential property is defined as "a building that is used or suitable for use as a dwelling or is in the process of being constructed or adapted for such use" and non-residential property is any property that is not residential property.



The tribunal had to consider whether the ground floor was "suitable for use as a dwelling" at the date of completion. Following the Upper Tribunal's guidance in Mudan v HMRC [2024] UKUT 307, the question involves a multi-factorial assessment which takes into account all the facts and circumstances on whether a property is suitable for residential purposes.

It was agreed that a purchaser's intentions as to the future use of the property are irrelevant to the determination as to whether that property was residential at the time of completion. The Tribunal also said that the mere fact that a property has been used for commercial purposes of itself does not mean it is not suitable for use as a dwelling. Further, it was accepted by both parties that planning restrictions are a relevant factor, but not determinative. Weight was given to there being no separation between the ground floor and two upper floors as well as the fact that no modification or adaptation at all would have been needed for the ground floor to be used in its entirety as part of the dwelling. All that would be needed is for the stock that was being stored there to be removed.

Ultimately, although a part of the ground floor of the Bacon Factory was used for commercial purposes at the relevant date, the Tribunal concluded that the property, taken as a whole, was either used as a dwelling or suitable for use as a dwelling and therefore comprised residential property in its entirety. The higher rates of SDLT applied by HMRC in its closure notice were therefore due and the appeal was dismissed.

Comment

This case forms part of a series of HMRC victories in this area. However what is interesting is that the actual use of the property was regarded as significantly more important than its permitted use. Therefore a part of the property which was subject to business rates was nevertheless held to be "suitable for use" as part of the residential property.

Amendments to pleadings and interaction with partial closure notices

In *Barclays Bank PLC and othersv HMRC* [2025] UKFTT 27 (TC) the FTT has considered amendments to pleadings and interaction with partial closure notices ("**PCNs**").

Background

PCNs were introduced relatively recently by Finance (No.2) Act 2017. As such, procedural discussion of their operation is welcomed. The FTT considered whether HMRC could amend its statement of case issued in Barclays Bank PLC's ("**Barclays**") appeal against PCNs issued by HMRC, or whether the PCNs properly construed would prevent HMRC from doing so.

The dispute concerned the tax treatment of transactions which were part of a broader arrangement and which involved, amongst other issues, the transfer by Barclays of senior notes at their par value plus accrued but unpaid interest to two Luxembourg subsidiaries acting in partnership. HMRC opened an enquiry into the returns for 2014 and 2015, with one of the matters subject to the enquiry being whether the arrangements were on arm's length terms and whether a transfer pricing adjustment should be made.

PCNs were issued on 22 August 2022 under paragraph 32(1) Schedule 18 Finance Act 1988. As part of the tribunal process, HMRC then sought to amend its statement of case to include the possibility of a transfer pricing adjustment under section 147 of Taxation (International and Other Provisions) Act 2010 other than a complete disregard of the transaction and to expand the arrangements to include prior arrangements in 2008.

HMRC argued that the proposed amendments were within the FTT's jurisdiction, were clarificatory in nature and that allowing HMRC to make them would further the FTT's overriding objective of dealing with the cases fairly and justly.

Barclays argued that, following *Tower MCashback LLP and another v Revenue & Customs Commissioners* [2011] STC 1143 (SC), the scope and subject matter of an appeal are defined by the conclusions and amendments in the closure notice, except where the context of the closure notice and the surrounding circumstances demonstrate that the subject matter is broader (i.e. where it is clear that HMRC intend to advance further arguments). Barclays argued that was not the case here as there was no reference to any alternative argument in the correspondence in the two-year period prior to the closure notice being issued.

Decision

The FTT granted HMRC permission to make amendments to its statement of case, and therefore considered that they did not alter the scope of the appeal.

Comment

It is notable that Judge Heather Gething emphasised the fact that closure notices ought not to be construed like statutes, and that the tribunal could be flexible in interpreting them within their context. She highlighted the importance of ensuring the correct amount of tax is collected while ensuring that the taxpayer is not ambushed by late admissions of new arguments.

Other developments

Voluntary disclosure service for research & development ("R&D") claims launched

On 31 December 2024 HMRC's new voluntary disclosure service for overclaimed R&D tax relief went live, applicable to overclaims which have been made in error and that are out of time to be amended on a self-assessment corporation tax return.

New OECD Pillar Two administrative guidance

On 15 January 2025 the OECD published administrative guidance which covers: (i) the central record of legislation with transitional qualified status for the purposes of the Global Minimum Tax; (ii) updates to the language in the commentary to Articles 8.1.4 and 8.1.5 following the publication of the standardised template for the GloBE Information Return and clarifies the basis that MNE groups shall rely on to complete the Return; and (iii) guidance to address the treatment of certain deferred tax assets that arose prior to the application of the global minimum tax as a result of certain governmental arrangements or following the introduction of a new corporate income tax. Limb (iii) has some key points of interaction with certain features of Bermuda's new corporate income tax regime and therefore this may be a key point of interest to reinsurers with activities in Bermuda.

Financial institution notice statistics

On 15 January 2025 HMRC issued a report on its use of financial institution notices during 2023/24. It showed that there had been a reduction in the average time taken to respond to international exchange of information requests, with the UK continuing to exceed the international standard. The greatest number of financial institution notices issued were for domestic purposes. The number issued for international exchange of information requests also increased in absolute terms, whilst being a smaller percentage than in the previous year.

Guidelines for Compliance – Labour supply chain assurance

On 16 January 2025 HMRC published the latest in its series of Guidelines for Compliance, which are intended to assist taxpayers with understanding HMRC's position on various issues and to highlight common errors that HMRC sees arising: Help with labour supply chain assurance (GfC12). It aims to help businesses strengthen their assurance practices and identify, mitigate and reduce labour supply chain risks. The guidelines include HMRC's approach to labour supply chain risks, and recommendations for taxpayers on assurance and contractual processes. The guidelines should be read alongside the existing HMRC guidance for specific tax risks.

Transfer pricing and diverted profits tax statistics

On 27 January 2025 HMRC released its transfer pricing and diverted profits tax statistics. These show that transfer pricing yield was higher for 2023/24 than for the two preceding years, but still significantly lower than the 2020/21 high. In 2023/24 128 transfer pricing enquiries were settled, significantly fewer than in the preceding two years, and the average age of settled enquiries was 33 months. Significantly more advance pricing agreements were agreed in 2023/24 than in previous years (though the total is only 27 – against 45 applications made during the year) and the average time to reach agreement was 53 months. As regards mutual agreement procedure cases, 86 were resolved during the year and the average time to resolution was 29 months. Ten advance thin capitalisation agreements were agreed in 2023/24, and the average time to reach agreement was 37 months. As regards the profit diversion compliance facility, 19 letters were issued, 10 registrations were made and 19 cases resolved. The number of diverted profits tax notifications decreased to 16, significantly fewer than in previous years.

Public Accounts Committee report on HMRC's customer service standards

A Public Accounts Committee report published on 22 January 2025 has concluded that HMRC's customer service standards have further deteriorated since the Public Accounts Committee last reported a year ago. In 2023/24 HMRC answered just 66.4% of customers' calls and average waiting times exceeded 23 minutes. HMRC is urged by the report to take responsibility for its own failing to offer sufficiently effective digital services to customers, with a concern being expressed in the report that it has sought to degrade its telephone services in order to drive customers to digital channels.

Public Accounts Committee reports on tax evasion in the retail sector

A Public Accounts Committee report published on 12 February 2025 has concluded that the true cost of tax evasion is likely being vastly underestimated, as loopholes in the current system make it all too easy for fraudulent behaviour to go unchecked. The report called for HMRC to set out a clear strategy for tackling evasion and deliberate non-compliance, with specific, measurable and timetabled objectives. Specific joint working initiatives (as between Companies House, the Insolvency Service and the Department for Business and Trade) are also recommended.

Independent review of the loan charge

It was announced on 24 January 2025 that an independent review of the loan charge has been commissioned. In addition, HMRC has published a policy paper setting out the operational activity that HMRC will undertake during the period of the review.

Supplementary draft HMRC guidance on Pillar Two

On 28 January 2025 HMRC published supplementary draft guidance on Pillar Two for consultation. Of particular note is the content on the joint venture rules, which apply where no investor consolidates the joint venture results in its accounts, in circumstances where the ultimate parent uses equity method accounting and owns 50% or more of the joint venture. It also includes draft guidance for the insurance sector, covering issues of relevance to insurers' treatment of investments and also to the computational treatment of policyholder taxes.

Oil and gas price mechanism consultation

At Autumn Budget 2024, the Government confirmed that the Energy Profits Levy ("**EPL**") will end in 2030 or earlier if the EPL's price floor, the energy security investment mechanism, is triggered. Once the EPL has ended, a new permanent mechanism will be in place to respond to future oil and gas price shocks. On 5 March 2025, the Government issued a consultation setting out the Government's policymaking objectives and design options for a new mechanism. Stakeholder feedback is sought and the consultation closes on 28 May 2025.

Latest HMRC nudge letter campaigns

The behavioural science of "nudge theory" has become an increasingly used weapon in HMRC's arsenal over the last decade or so – i.e. the idea that people can be better directed towards a desired course of action through suggestion rather than obligation. UK taxpayers may have noticed the same concept at work when completing their online tax returns, where certain information is now pre-populated based on figures held by HMRC (the idea being that the taxpayer will likely accept those figures by default).

Over the last few months, HMRC has launched several new nudge letter campaigns on various issues, as summarised below.

Business asset disposal relief – lifetime limit (December 2024)
HMRC's Wealthy Team is sending letters to taxpayers who are believed to have either exceeded the £1 million Business Asset Disposal Relief by making a claim in 2023/24 or have already exceeded the limit prior to then.

Delivery drivers – declaration of income (January 2025)
HMRC is sending letters to individuals who have carried out deliveries during the tax year 2023/24 and who are not registered for self-assessment or paid via PAYE for this work. The letter als refers to the need to make a disclosure if they have not declared their income for previous years.

Small VAT-registered charities (January 2025)
HMRC is sending emails to selected small (up to £2 m registered turnover) VAT-registered charities, aimed at raising awareness of the need to complete business / non-business apportionment calculations. The email contains links to existing guidance and also highlights the possibility of overclaimed input tax relating to non-business activities.

ATED Avoidance Qualifying Property Business Relief (January 2025)
HMRC is sending letters directed at offshore companies which owned UK residential property over £500,000 but were registered and reported consecutive losses on their self-assessment tax return from their property rental income from 2017/18 to 2019/20. The letters encourage companies to file outstanding ATED returns for anything they own and have not already paid / reported and to correct their position going forward. HMRC wants the companies and representatives to reassess their loss-making UK rental business and register for ATED and file all applicable ATED liability returns.

Online marketplace sales (February 2025)
HMRC is sending letters to individuals who it suspects have not fully reported their income to HMRC in relation to online marketplace sales, up to tax year ending 5 April 2023. This is based on information which HMRC receives from online marketplaces concerning sellers using the platforms. The letters state that HMRC holds such data on the recipient, and encourages the taxpayer to declare their income or contact HMRC within 30 days of the date of the letter, or risk a compliance check and penalties.

Any taxpayers who receive nudge letters, even those confident of their tax position, should seek professional advice as soon as possible. Whilst nudge letters do not make specific accusations, they are generally based on actual data held by HMRC (although this may be sectoral and non-specific). Taxpayers who ignore these letters do so at their peril – failure to take action or respond is likely to mean that there is an imminent risk of HMRC starting an investigation (either under civil procedures or, in cases of suspected fraud, using their criminal powers). Early disclosure may also mitigate penalties.

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