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TAX AND THE CITY

CLIENT BRIEFING

NOVEMBER 2024

The Autumn Budget does not make any specific changes to bank taxes but the financial sector will experience, along with other large employers, a significant increase in the amount of employer's NICs they will pay from April 2025. Following the FTT's decision in the *GCH* case that members of an LLP successfully saved £2.7m in capital gains tax on a transfer of assets to an LLP, a change to the taxation of capital gains rules that apply to the liquidation of LLPs was announced with effect from 30 October. The taxpayer in *Visual Investments* fails to satisfy the FTT that the legal fees for which input tax recovery was claimed had a direct and immediate link to its management consultancy business or that it was the sole recipient of the legal services.

Budget measures affecting financial institutions

There are no specific bank tax measures in the Budget. The *Corporate Tax Roadmap* gives assurance that there are currently no planned changes to the bank levy or the bank corporation tax surcharge which together raise more than £2 billion a year. It provides, however, that the bank tax regime will be kept under review to ensure that the objectives of responsible fiscal policy and using the tax system to support the growth mission are appropriately balanced. Which could be taken either way. It might be read as the government suggesting that it would, at some point, consider lowering bank taxes to increase competitiveness and support growth, provided tax revenue for public services is maintained. Or it could be interpreted as a flag to banks that although there are no increases to bank specific taxes in this Budget, the government may consider it in future if that is what responsible fiscal policy requires!

Banks as employers with huge payroll costs will, however, be significantly impacted by the increase in employer's NICs by 1.2% to 15% from April 2025 and the reduction in the threshold at which this increased level of employer's NICs will become payable being reduced from £9,100 to £5,000 a year. Recent statistics published by HMRC showed banking sector PAYE receipts (which term includes employer's NICs) were £24.9 billion in financial year 2023 to 2024, an increase of £2.0 billion (8.7%) compared with the previous year.

The Corporate Tax Roadmap recognises and commits to maintaining key competitive features of the UK's corporate tax regime (such as the 25% rate of corporation tax, the Patent Box and generous capital allowances) but offers little in the way of additional incentives to invest in the UK. One such offering, however, is a consultation on a mechanism for providing investors in major projects with greater tax certainty in advance. Access to such pre-transaction clearance would be welcomed by investors but we will have to wait for the consultation in Spring 2025 to find out what will constitute a 'major project' and how the clearance process will work.

The aim of the Corporate Tax Roadmap is to provide business with a stable tax environment to encourage investment and growth, so, all things being equal, apart from the items flagged in the list of planned consultations at the end (which also includes further consultation on reforms to the UK's rules on transfer pricing, permanent establishment and diverted profits tax) business should feel reassured there will not be further changes in policy. However, the Roadmap also says '[the government] cannot rule out all changes to the corporate tax regime over the course of this Parliament' which keeps the options open for reaction to unforeseen developments.

It was confirmed at the Autumn Budget that the government is proceeding with the introduction of a new type of UK-based investment fund, the Reserved Investor Fund (Contractual Scheme). Secondary legislation to implement this and make minor changes to the tax rules in respect of Co-ownership Authorised Contractual Schemes is expected before the end of the year.

GCH: taxpayer succeeds in tax avoidance scheme using LLP

GCH Corporation Ltd and others v HMRC [2024] UKFTT 922 (TC) involved transactions notified under DOTAS which saved the taxpayers (three family trusts and a company which were all members of a limited liability partnership (LLP)) £2.7 million of tax on a transfer of loan notes to the LLP. The loan notes had been issued to the members as part of a takeover bid for a company they owned shares

in. The First-tier Tribunal (FTT) decided in favour of the taxpayers that the transactions gave them this tax saving. This was swiftly followed by a legislative change announced in the Budget, with effect from 30 October, to change the taxation of capital gains rules that apply to the liquidation of LLPs.

Although an LLP is a body corporate, it is treated as transparent, like other partnerships, for specified tax purposes according to statutory provisions. TCGA s 59A switches on tax transparency for capital gains purposes where an LLP carries on a trade or business with a view to profit. This tax transparency is then switched off, and the LLP becomes opaque, upon the appointment of a liquidator.

The transactions in this case broadly involved the members setting up an LLP and the LLP acquiring some shares and receiving some dividends (to satisfy the requirements of s 59A(1)). The members the sold the loan notes to the LLP at a 2% discount to face value (sale proceeds were left on loan account) at a time when the LLP was transparent (because it was carrying on a trade or business with a view to profit for the purposes of s 59A(1)) and so this was treated as capital contributions rather than disposals by the members. Less than a month after the LLP acquired the loan notes, a liquidator was appointed, thus causing the LLP to become opaque, and getting a step-up in base cost of the loan notes, effectively eliminating any gain pre-transfer to the LLP. The LLP then redeemed the loan notes and payments were made to the members pursuant to the member's voluntary liquidation.

Was there a trade or business with a view to profit?

The substantive issue in the case was whether the LLP was carrying on a trade or business with a view to profit for the purposes of s 59A(1). The FTT considered the badges of trade and concluded that the LLP's activities were not sufficient to amount to a trade (there was only one instance of buying and selling shares). The FTT then ran through the Upper Tribunal's decision in *GE Financial Investments v HMRC* [2023] UKUT00146 in some depth to extract the "key principles" relevant to the meaning of "business" under UK domestic tax law before considering whether the interpretation of the term in s 59A(1) should be coloured by its statutory context. Having done so, the FTT adopted a wide interpretation of 'business' and concluded that the engagement in passive investment by the LLP was enough to constitute carrying on a business with a view to profit and accordingly there was no tax to assess on the taxpayers because the transfers of the loan notes to the LLP were contributions of capital by the members of the LLP rather than disposals.

No scope for purposive approach to interpretation of s 59A(1)

Counsel for HMRC had argued that it was necessary to take a purposive approach to s59A(1) together with a realistic view of the facts in accordance with the *Ramsay* principle and that, if this principle were applied to the whole arrangements, the FTT should determine that the LLP was not carrying on a trade or business with a view to profit. But the FTT concluded, with little discussion, there is no scope for the *Ramsay* principle to apply to s 59A(1). On the facts, the FTT concluded the LLP was likely to have been established primarily for the purposes of implementing the tax mitigation scheme but it was also established as a vehicle for 'hedge fund' type business. S 59A(1) is not an anti-avoidance provision, it does not look at whether there is a tax purpose as well as a business purpose and so the wider arrangements were not relevant.

Preventing abuse of the legislation

The facts of this case illustrate an abuse of the rules treating an LLP as transparent (so no disposal by the taxpayers) and then treating the LLP as opaque on appointment of the liquidator (with a step-up in base cost to eliminate the gains prior to the transfer to the LLP).

The draft legislation published on Autumn Budget day inserts a new s 59AA into the TCGA to ensure that where a member has contributed assets to an LLP, chargeable gains accrued up to the contribution are charged to tax on that member when the LLP is liquidated and the assets are disposed of to the member or to a person connected to them.

Visual Investments: VAT on legal fees

In *Visual Investments International Ltd v HMRC* [2024] UKFTT 843 (TC) the taxpayer, Visual, sought to recover input tax on legal fees related to a dispute on the basis that the dispute was linked to management consultancy services it provided to subsidiaries. The legal matter was described as necessary for the protection of Visual's investments. HMRC denied recovery of input tax on the basis that the input tax did not have a direct and immediate link to Visual's taxable supplies and/or that Visual was not the sole recipient of the legal services.

Visual held 51% in a company referred to as BIG but Visual and BIG were not VAT-grouped. Visual, BIG and Visual's majority shareholder, Mr Kenneth Burgess (Ken) sued five defendants to enforce an oral agreement to transfer certain shares to a joint venture company of which BIG was a shareholder. The underlying dispute ultimately settled. The FTT dismissed Visual's appeal finding that the evidence did not establish that the costs of the litigation were attributable to the taxable supplies of management consultancy. The purpose of the litigation was to be able to realise the equity value by the obtaining of shares which had not been transferred. The subjective intention to provide management services in the future was not documented and was not relevant to deciding, objectively, what the purpose of the litigation was.

On the question of to whom the legal services were supplied, the FTT considered the engagement letter and the invoices for the legal services. The lawyer's engagement letter for the underlying dispute was sent to 'Simon [Ken's son] and Ken', invoices were issued to Simon and Ken c/o Visual, and Simon provided the funds to pay for the advice. The evidence therefore pointed against

Visual being the sole recipient of the legal services. As the appeal had already been dealt with on the basis of no direct and immediate link, the FTT did not have to decide on this aspect but had it been necessary it would have found that Visual received one third of the services.

This case is a reminder of the conditions that need to be satisfied to recover input tax on legal fees. The input tax, if recoverable, can be claimed only by the person to whom the services were supplied which, if the legislation is followed correctly, should be the person to whom the invoice is issued.

What to look out for:

- On 26 or 27 November, the Court of Appeal is scheduled to hear the appeal in *ScottishPower* concerning the deductibility, in computing trading profits, of payments made in connection with investigations conducted by Ofgem into the taxpayers' energy supply businesses.
- The offshore receipts in respect of intangible property (ORIP) rules are to be abolished from 31 December, at the same time as the UK's Pillar 2 undertaxed payments rule is introduced which HMRC expects will more comprehensively discourage the tax planning arrangements ORIP sought to counter.

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