TAX AND THE CITY REVIEW

The FTT in *West Burton* decides that you can look beyond the face of the accounts to find the component credits and debits making up a single net entry and examines what it means for amounts to be recognised, or brought into account, in determining the profits shown in the profit and loss account. The High Court in *TP ICAP* dismisses several of the purchaser's claims under warranties and the tax deed as too premature, but agrees with the purchaser's interpretation that the relevant tax warranties were wide enough to cover the tax affairs of third parties. A recent survey shows the UK remains the most attractive place in Europe for financial services investment with France and Germany close behind but the 'roadmap' for financial services sets out the Chancellor's post-Brexit vision for the financial services industry to ensures it remains competitive. As the EU reaches political agreement on public country-by-country reporting from 2024, all eyes are on the UK to see if it will follow suit.

West Burton: meaning of 'brought into account'

West Burton Property Limited v HMRC [2021] UKFTT 160 concerns the deductibility of deferred revenue expenditure (DRE) incurred in the course of carrying on a property business and may at first glance seem an odd choice for inclusion in this article. However, it contains principles relevant to the calculation of trading profits and, as Judge Beare explained, if HMRC had succeeded in their submissions, it would have driven a coach and horses through the tax system rendering it incapable of functioning effectively and appropriately. At the heart of this case is the interaction between the accounting rules and the tax computation rules.

WBPL owned a power station and had incurred revenue expenditure on maintaining it which it had capitalised in the accounts for the financial year in which it was incurred. WBPL then amortised the DRE over four years. WBPL sold the power station to another group company to simplify the group structure at a time when approximately £65m of the DRE remained undepreciated in WBPL's profit and loss account (P&L). The P&L recorded a nil amount for the sale because the proceeds were equal to the net book value of the power station at the time of the sale. The calculation of net book value had included the £65m of DRE but the DRE did not itself appear on the face of the P&L. One of the issues the FTT had to determine was whether the DRE was 'brought into account as a debit in calculating the profits' which were shown in the P&L for the relevant financial year in accordance with CTA 2009 s 48.

The FTT found in favour of WBPL that the DRE was deductible and that it had been brought into account as required by the legislation even though it had not appeared as a separate item in the P&L but rather had been taken into account in the calculations underlying an item that was brought into account as a credit or debit in calculating the profits shown in the P&L.

HMRC's construction of "items brought into account as credits or debits in calculating the profits" was too narrow. Judge Beare found there is nothing in the implied language of the legislation which limits the items to be treated as having been brought into account to the items actually set out in the P&L. An item which has increased or reduced those profits because it featured as a credit or debit in the calculation of an amount set out in the P&L is just as much brought into account as a credit or debit in calculating the profits as an item which appears as a credit or debit on the face of the P&L.

So although this case involved the calculation of the taxable profits of a property business, the principles in this case can helpfully be read across into other accounts-based tax regimes (such as trading profits, loan relationships and intangible fixed assets) where similar questions arise as to whether you can look behind the face of the accounts to find the component credits and debits making up a single net entry, and what it means for amounts to be recognised, or brought into account in determining profit or loss etc.

Judge Beare's post-script on fairness at the end of the decision is also quite interesting as although it is the sort of cross check advisers would go through in providing advice or writing an opinion (it is always going to be harder to persuade a court that an answer that does not make sense, or produces a surprising outcome, is in fact the right one), you do not often see this in a judgment. After having reached his conclusion, Judge Beare asks whether it is right as a matter of principle that the taxpayer should get a deduction for the DRE. Having answered yes to this, Judge Beare considered if the treatment is the same as a taxpayer would get if they had chosen to expense as incurred rather than capitalising. The answer is also yes.

TP ICAP Ltd: notices of claims given prematurely

TP ICAP Limited v Nex Group Limited [2021] EWHC 1375 (Comm) concerns, amongst other things, tax warranty and tax covenant claims and is the latest example of the High Court applying the principles of construction summarised by the Supreme Court in *Wood v Capita Insurance Services Limited* [2017] AC 1173. As the share purchase agreement and the tax deed were sophisticated and complex documents prepared with the assistance of skilled professionals, a principally textual analysis was appropriate.

The target companies became involved in the German authorities' investigation of the cum-ex scandal, through their provision of interdealer telephone broking services to third parties under investigation. So the purchaser purported to notify claims in respect of adverse consequence that could arise once the investigation had concluded.

The High Court threw out some of the claims on the basis that, instead of actually making a claim, the purchaser had merely notified that it may, in the future, make a claim. That was insufficient under the contractual notice provisions.

Similarly, claims in respect of the tax covenant were judged to be too vague and premature. Given that the investigation was still ongoing, the High Court decided that there was not yet any tax liability in respect of which the covenant could bite and that included the provision in the tax covenant which would cover the purchaser for costs incurred in avoiding, resisting or settling a tax liability which would otherwise fall to be compensated under the tax covenant.

Another interesting point from the decision is the fact that the High Court accepted that, on the basis of their drafting, certain tax warranties looked not only at the tax affairs of the target companies, but also at those of third parties. Given the business of the target companies (and, perhaps, with the benefit of hindsight in seeing the type of investigation at issue here), the Court thought it commercially unsurprising that such a warranty would be given. If the relevant tax warranties had been intended to reference the tax affairs of the target companies only and not those of third parties, this could have been made expressly clear in the drafting which had been the case elsewhere in the share purchase agreement. The fact that it was not, despite having been drafted by skilled professionals, persuaded the High Court the relevant warranties were not intended to be limited to the tax affairs of the target companies. This is a reminder to take care when drafting such provisions to ensure they are given the desired interpretation in court, or, ideally, to avoid taking the point to court in the first place!

UK remains most attractive place in Europe for financial services investment

According to an EY survey of global investors, the UK was voted the most attractive place in Europe for financial services investment and is the country with the most investment-friendly COVID-19 recovery plans. Germany was second, France and Switzerland were voted joint third. But the gap between the top three places has narrowed.

The UK's lead narrowed in 2020 in response to Brexit, but investor sentiment on the future of UK financial services remains positive with the UK being expected to outperform the rest of Europe in attracting post COVID-19 financial services investment. London is the leading city for such investment.

But there is more that can be done to improve the UK's position. There are some measures already in the pipeline such as the review of bank taxation in the autumn (as promised at Budget 2021) to ensure that the combined rate of tax on banks' profits does not increase substantially from its current level and remains competitive with the UK's major competitors in the US and the EU. There are also the improvements to the tax and regulation of UK funds promised at Budget 2020 to further enhance the attractiveness of the UK as a location in which to set up, manage and administer funds. The new UK funds regime, which is currently going through the consultation process, is intended to enable a wider range of efficient investments better suited to investors' needs, unleash investment into productive and green technologies and grow the number of funds located in the UK to level up the economy by supporting jobs outside London. These measures were further confirmed in the roadmap for financial services published on 1 July which sets out the government's plans to achieve the Chancellor's vision for a globally competitive sector that is open, green and technologically advanced with an internationally recognised ecosystem across both regulation and tax.

It is also promising that the Chancellor has spoken out about a financial services exemption from the G7's agreement on international tax reform. The statement

issued on 1 July following the OECD/G20 inclusive framework meeting indicates that 130 member jurisdictions have now agreed to a financial services exemption from the new taxing right known as pillar one.

Public CBCR: EU proposals and UK reaction

Public country-by-country reporting (CBCR) is set to be implemented across the EU (including for non-EU headquartered groups) by early 2023 to take effect, at the latest, for the first financial year starting on or after early 2024. The measure is expected to be formally approved by the Council and European Parliament by early autumn.

Groups and standalone undertakings with revenues exceeding EUR 750m for two consecutive years fall within the scope of the public reporting obligation, unless they do not operate in more than one country. The reporting obligation falls on the group's parent or the standalone undertaking if it is established in a member state. Otherwise, the reporting obligation passes to its EU subsidiaries or branches.

Reports will have to be published on the parent (or standalone) undertaking's website, or, where the reporting obligation is passed on, the relevant subsidiary's or branch's website, within 12 months of the balance sheet date for the reporting year. Member states may, however, allow the publication of commercially sensitive information to be delayed by up to five years.

The UK has previously spoken out in favour of public CBCR but recognises that it needs to be implemented on a broad multilateral basis if it is to be effective. In the absence of wide international support, it would distort decisions on where companies decide to locate. So although the power to require public CBCR by UK companies has been on the UK statute books since 2016, it has not yet been invoked. So it will be interesting to watch the EU developments: if this is indeed implemented across the EU, the UK may well follow suit but perhaps the UK may wait until other big players, such as the US, get on board too.

What to look out for:

- “L day”? It is usually in July that draft legislation for inclusion in the next Finance Bill is published for consultation although at the time of writing no date has been announced for this.
- The G20 meeting on international tax reform takes place 9-10 July.
- The government will publish a summary of responses to the call for evidence on VAT grouping before the summer although it was announced at Budget 2021 that this measure is not going ahead.
- The government will be publishing a summary of responses this summer to the consultation on ‘VAT and value shifting’, which opened on 5 January and closed on 30 March. Subject to the responses, the government intends to prepare the new rules for introduction and will be providing an update on next steps later this year.

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