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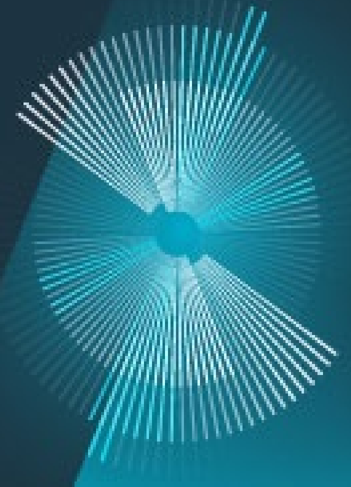

Zoe Andrews	Welcome to the February 2025 edition of Slaughter and May's "Tax News" podcast. I am Zoe Andrews, Head of Tax Knowledge.
Tanja Velling	And I am Tanja Velling, Tax Knowledge Counsel. We will discuss the Court of Appeal's decision in *ScottishPower*, the First-tier Tribunal's decision in *NHS Mid & South Essex* and news around international tax reform from the US, the UK and the OECD. The podcast was recorded on the 4th of February 2025 and reflects the law and guidance on that date. Let's start with the Court of Appeal's decision in *ScottishPower* and to discuss this, we're joined by Nadia Hourihan, one of our tax associates. Nadia, do you want to take us through the facts?
Nadia Hourihan	Of course, Tanja. *ScottishPower* addresses whether or not tax deductions are available for payments in lieu of penalties. UK regulators had opened investigations into various failings by different energy providers. These investigations were settled: nominal £1 penalties were imposed on the energy providers, and they made redress payments of about £28 million to customers, consumer groups and charities. Now, there's a general rule against giving tax deductions for penalties and there's a public policy reason for this: the point of a penalty is punishment and allowing a tax deduction for penalties is at odds with that punishment. Deductions would take some of the punch out of a penalty's economic impact and allow the taxpayer to share the cost with others.
Zoe Andrews	That means the nominal £1 penalties are non-deductible, and the dispute was about the redress payments, right?
Nadia Hourihan	Exactly. The taxpayers accepted that the penalties were non-deductible, but sought deductions for the redress payments, and HMRC challenged this. The point you'll be most interested in is the discussion of HMRC's argument that the redress payments should be non-deductible, just like penalties and on the same public policy grounds that I mentioned earlier. In this case, if the taxpayers hadn't agreed to the redress payments, the penalties would have been much greater than the nominal £1. In this sense, the redress payments were in lieu of the penalties, and HMRC argued that this should make them non-deductible. Ultimately, the Court of Appeal decided in favour of the taxpayer, bucking the trend in the First-

	tier Tribunal and the Upper Tribunal. This meant that the whole £28 million was deductible, because the FTT had found that all of the other requirements for deductibility had been met.
Zoe Andrews	That's a great result for the taxpayer, but let's just go back for a moment to the general rule that penalties are non-deductible. Did the Court of Appeal say a bit more about that?
Nadia Hourihan	The Court of Appeal's view is that this general rule is a judge-made rule, but that it's given effect through section 46(1) of the Corporation Tax Act 2009. Section 46(1) requires that a company's taxable trading profits are "*calculated in accordance with generally accepted accounting practice, subject to any adjustment required… by law*". One such "*adjustment required by law*" would be leaving penalties out of account in accordance with case law that pre-dates the legislation, on the grounds that Parliament implicitly accepted such case law when enacting section 46(1). Lady Justice Falk cited the Supreme Court in *NCL Investments* to add that, in order for judge-made-law to deny a deduction, such law will also need to be "*clear in its effect*".
Zoe Andrews	Why did the Court of Appeal decide that the general rule does not extend to payments in lieu of penalties?
Nadia Hourihan	No authority was cited to support any general proposition that whether a payment is deductible should be determined by reference to the nature of the payment it is replacing. The court emphatically cautioned against the judiciary using fuzzy "policy" justifications to usurp Parliament by creating judge-made tax laws. Extending the rule as argued for by HMRC would have made its scope uncertain and regulators can take into account the fact that payments in lieu of penalties would be tax deductible when negotiating a settlement. So, the Court of Appeal clarified that the general prohibition against deductibility applies only to fines and penalties, and not to payments in lieu of penalties (that are not themselves penalties).
Zoe Andrews	It sounds to me then that there is significance to the legal form of the payment.
Nadia Hourihan	Yes, I think that is an important element, and this thinking would seem to be supported by the Court of Appeal's consideration of the type of penalty to which the general prohibition applies. It definitely applies to penalties imposed under a statutory penalty regime, but the Court of Appeal left open whether it also applies to penalties under non-statutory regimes (such as Formula One fines) because it was unnecessary to decide the point in this case. I wouldn't say, however, that substance is completely irrelevant. After all, I suppose, courts may have to determine whether a particular payment under a statutory regime is a penalty or something else. The Court added that whether a payment can be regarded as compensation for a loss isn't crucial to the question of deductibility, but it did observe that the "*fact that a payment is compensatory may indicate that it does not have the character of a penalty*".

Zoe Andrews	That makes sense. Is the Court of Appeal's decision likely to be the last word on the matter?
Nadia Hourihan	We'll have to watch this space. Given the amount at stake and the important policy point involved, HMRC may well apply for permission to appeal to the Supreme Court. Maybe you'll have to have me back on the podcast to discuss a Supreme Court decision!
Zoe Andrews	That would be a pleasure! Thank you, Nadia.
Tanja Velling	And now for *NHS Mid & South Essex*, another case on redress payments, but this time the issue is not deductibility but whether part of the payments comprised interest which should have been subject to withholding tax under section 874 of the Income Tax Act 2007. The First-tier Tribunal found in favour of HMRC that the payments were yearly interest within section 874. There are more than 200 similar appeals stayed behind this case, so this is a significant win for HMRC. More generally though, this case is a good reminder of the conditions for section 874 to apply and includes a review of the cases on the meaning of "interest". Let's have a look at what the redress payments were and why tax should have been withheld.
Zoe Andrews	The redress payments were made by the NHS Integrated Care boards (ICBs) to individuals who had wrongfully been denied funding for continuing healthcare (CHC) and consequently had to self-fund their care. The payments compensated the patients for not having the funding sooner and having to expend their own money in the meantime and included an element (which was labelled as "interest" in the redress guidance) to put the individuals in the position they would have been in had the CHC payments been awarded at the appropriate time. HMRC had assessed the ICBs to amounts under section 874 and the ICBs appealed to the FTT. The burden of proof was on the ICBs to show that the conditions in section 874 were not satisfied on the balance of probabilities. Let's unpick the requirements of section 874 as applied to this case. Starting with what is "interest" and was the element labelled "interest" actually "interest" for the purposes of section 874?
Tanja Velling	There is no statutory definition of "interest", so the FTT looked to the characteristics of interest in the relevant cases. The common theme in the cases is that interest is a payment of compensation for the time value of money. The fact that the interest element was labelled as interest was not definitive for tax purposes. The FTT considered the correct tax treatment is determined by the substance of what is paid and why. Here, the FTT found that the interest element of the redress payment was made because, for a period from when they made the payments themselves for care, the patients had been deprived of that money. The true nature of this element of the payments was therefore payments by time for the use of money. And it didn't stop being interest just because it was just one part of a greater sum of money. The next question is whether this interest is yearly interest.
Zoe Andrews	The FTT concluded it was yearly on the basis of the application of the *Lehman Brothers* case but if wrong on this, the FTT considered the payments would fall within the deeming provision for amounts of interest payable in respect of compensation.

	As most of the other news that we are going to cover relates to international tax, or more specifically, the OECD's Two-Pillar Solution, we should probably address the elephant in the room.
Tanja Velling	Yes, recent US developments. One of the executive orders signed by President Trump on Inauguration Day specifically addressed the "Global Tax Deal", and two days later, the Republican Ways and Means Committee announced the re-introduction of their "Defending American Jobs and Investment Act" which would provide for adverse tax and other consequences for persons resident in countries that impose "extraterritorial or discriminatory" taxes. Another executive order covered tariffs and the establishment of an "External Revenue Service" which I don't propose to cover today - not least because tariffs is currently such a fast-moving area that anything we say now may be out of date by the time the podcast is published. But what then is the impact of Trump's stance on the "Global Tax Deal", in particular on the global minimum tax under Pillar Two?
Zoe Andrews	The Income Inclusion Rule and Domestic Minimum Taxes should be unaffected. The Trump Administration seems happy for other countries to adopt a minimum tax on their own companies, and on subsidiaries of those companies. After all, with GILTI, the US itself already has in place a tax regime similar to an IIR (although it isn't identical). What the Trump Administration appears to object to most strongly is the way in which the Undertaxed Profits Rule would allow, for instance, the UK to impose an additional charge on the UK subsidiary of a US multinational in respect of the group's US profits where the US has chosen to tax profits at below the 15% minimum rate.
Tanja Velling	Could you then just sever that element from the rest of the deal on Pillar Two?
Zoe Andrews	The Undertaxed Profits Rule was always brought in as a backstop, to encourage countries to adopt the global minimum tax, and that works well for small and medium-sized economies. Jersey and Guernsey, for example, have introduced different versions of a domestic minimum tax. The UAE, Qatar, Kuwait and Bahrain are set to introduce Pillar Two provisions as well.
Tanja Velling	But the UTPR works less well (or one might say not at all) when you're dealing with an economic superpower like the US or China.
Zoe Andrews	That's right. So, what do you think will happen?
Tanja Velling	Ultimately, the UK, the EU and many others have already adopted the global minimum tax, and it's extremely unlikely that either the UK or the EU will abolish it anytime soon. Indeed, just last week, HMRC published further draft guidance on the multinational and domestic top-up taxes. It includes sections on flow-through entities, the insurance sector and joint ventures. This last aspect has been covered in a European Tax Blog post by another of our tax associates, Stephanie Mullins. The draft guidance does not yet include the promised map, showing which parts of the OECD's

	Model Rules and Commentary correspond to which legislative provisions in the UK. Comments can be sent until the 8th of April. But going back to the international context. The retaliatory measures threatened by the US mean that governments may want to think hard about whether to press ahead with the UTPR. In the UK, the relevant legislation is in the Finance Bill that's currently before Parliament and has effect for accounting periods beginning on or after the 31st of December 2024 and so far, the Government has not signalled any change of heart. In my view, a more likely scenario would be an agreement at the OECD-level to extend the operation of the transitional UTPR safe harbour until 2030 or beyond. What do you think the US developments will mean for Pillar One?
Zoe Andrews	The bigger issue here is clearly Amount A which is effectively dead. As with the Trump Administration's stance on the UTPR, that shouldn't be a big surprise, but it raises the question: what happens next? Amount A was an attempt to deal with political concerns over highly profitable low-taxed technology businesses (largely from the US), which had led many countries, including the UK, to levy digital services taxes as a (very) blunt response. During President Trump's first term, the US had started the process for imposing trade sanctions in response to this. Under President Biden, a compromise was agreed, but this was premised on Amount A taking effect.
Tanja Velling	So, that deal is off now. What's that likely to mean?
Zoe Andrews	Well, I don't see the UK Government immediately repealing our DST, although it is due for a review this year. In terms of what the US reaction to that may be, this Trump Administration seems to be looking at more draconian measures than the trade sanctions considered during President Trump's first term. The Defending American Jobs and Investment Act (which you mentioned earlier) would introduce a 20% withholding tax on payments from the US to persons in any country that imposes an "extraterritorial or discriminatory" tax on the US and restrictions on federal government procurement.
Tanja Velling	It's worth adding here that not just DSTs are likely to count as "extraterritorial or discriminatory", but also UTPR charges and the UK's diverted profits tax. So, UK businesses would then likely be affected and would then need to reassess whether it still makes sense to sell to customers in the US where that has been made 20% more expensive. In some cases, you might even see businesses spin out their US operations into a standalone business, so they're not subject to the 20% surcharge.
Zoe Andrews	Overall, these developments do illustrate how difficult it is to achieve international tax reform, and how fragile any deal can be. Which reminds me that, at the time of recording this, the

	organisational session of the UN Tax Framework Convention negotiations is ongoing in New York. Do you think this will fare any better?
Tanja Velling	No, there's no reason to think it would fare better, given the Trump Administration's general hostility towards the idea of having US tax policy be "beholden to foreign organisations". Indeed, we understand that the US delegate has announced that the US will pull out of the negotiations. Now, with these rather lengthy introductory remarks out of the way, what are all these international tax reform developments you wanted to talk about?
Zoe Andrews	Let's start with the UK. HMRC added new guidance to the International Manual on Amount B of Pillar One, intended to simplify transfer pricing for in-country baseline marketing and distribution activities. At present the application of Amount B is optional and the guidance covers different scenarios. Where both counterparty jurisdictions have opted into Amount B, it is binding. Otherwise, the pricing must be determined by reference to the OECD's guidelines excluding passages on Amount B. If you're now thinking, but what's the status of Amount B in the UK? The very last paragraph makes that clear. The UK has not yet adopted Amount B; "Further guidance will be added to this manual if the UK adopts" it.
Tanja Velling	So, it's wait and see for Amount B. In contrast, there has been a lot of action on the UK's implementation of Pillar Two. The current Finance Bill makes changes to the rules; in addition to substantive changes (most notably to implement the UTPR), there are a number which the Exchequer Secretary to the Treasury described as "essentially, software updates". The government also published various amendments to those changes and, in good Tax News podcast style, we'll highlight three. The first is important if you have been looking at how the substance-based income exclusion applies to flow-through entities. The Finance Bill, as originally published, would have inserted a new section 198ZA into the multinational top-up tax legislation to deal with this point. The government amendments adopt a slightly different approach. They amend the substance-based income exclusion rules themselves to give a nil result for flow-through entities. Then three new sections 198ZA to 198ZC provide more detailed rules on the amounts that can be taken into account, either for another member of the group to whom profits of the flow-through entity are allocated or - and this is new in the amended version - for the flow-through entity itself, if it was to some extent not flow-through for the period. This would be the case where some owners treat it as transparent and others as opaque.
Zoe Andrews	The second point relates to additional top-up amounts. In some circumstances, the MTT rules require that amounts which were relevant to the determination of an MTT liability in an earlier period are recalculated. For example, if (after you have filed the return) there is a material decrease in tax liabilities taken into account for the MTT calculation in an earlier period, you have to redo the MTT calculation for that earlier period. If the redone calculation gives you a higher

	MTT liability, there's a mechanism to collect the difference in the current period. But what if you have, for example, acquired a new subsidiary in the meantime? One of the government amendments addresses this. The additional top-up amount is calculated by reference to the actual and recalculated position in the past period. But it applies in the current period in respect of all current members of the group.
Tanja Velling	The final government change to highlight relates to the commencement provisions. There is a general rule (with some exceptions) that the commencement date is the 31st of December 2024, but groups can elect for provisions to apply from the 31st of December 2023 instead. This is called a "retrospection election" and requires the consent of current members chargeable to domestic top-up tax. The government amendments add former group members to this, and a saving provision. If you should have obtained a person's consent, but failed to do so, the election can still be valid, if you get the person's consent within 60 days after you become aware that the consent should have been obtained. This is a sensible addition which will prevent a mere administrative error from invalidating the election and changing the group's tax position. Anything new from the OECD on the global minimum tax?
Zoe Andrews	Yes! Less than a week before President Trump's inauguration, the OECD published new documents on the global minimum tax, including an updated information return, associated exchange of information agreement and three pieces of Administrative Guidance. One of these concerned the revised return. Another relates to transitional rules for determining whether countries' rules have qualified status, which means essentially whether they are recognised as a proper implementation of the minimum tax. There are two lists of rules with transitional qualified status - one lists qualified income inclusion rules, the other qualified domestic minimum taxes and whether they are eligible for the QDMTT safe harbour. The UK's MTT and DTT are included. What's covered by the third?
Tanja Velling	Deferred tax assets created by governments before the implementation of the minimum tax so companies can shelter income from the minimum tax. The new Administrative Guidance provides that such deferred tax assets must be excluded from the application of transitional rules which would otherwise allow pre-implementation deferred tax assets to be taken into account in the minimum tax calculations. The new Administrative Guidance further reiterates a general concern about benefits provided by governments that could undermine the minimum tax. Work is ongoing to develop guidance on identifying such "Related Benefits" and how they impact on whether a country's rules can have qualified status. There would also be an "ongoing monitoring process" in respect of government-granted benefits, "including through investment promotion agencies or subnational governmental authorities". Were there any non-Pillar Two related topics you wanted to mention before we talk about what's coming up?

Zoe Andrews	Yes. I have two quick points. The first is an update on a consultation that ran from March to May last year on draft regulations for new information reporting requirements. It will be good news that the government has decided against the additional PAYE reporting requirements, having "listened to businesses and acted on their feedback about the administrative burden the requirements in these regulations would bring". And secondly. Well, last month, we talked about advance pricing agreements in the context of the Court of Appeal's decision in *Refinitiv* and you said the decision meant "that the value of an APA is potentially more limited than one might have thought". But neither that, nor the long time it takes to agree an APA, seems to deter applications. According to the latest Transfer Pricing and Diverted Profits Tax statistics, in 2023-24, there were 45 applications (and 27 APAs agreed) but the average time to reach agreement climbed from 45.5 to 53 months. Diverted profits tax revenues increased again to £108m after a dip to £40m for 2022-23, but the number of DPT notifications received by HMRC and of preliminary and charging notices issued by HMRC all decreased. Now, what's coming up?
Tanja Velling	• Well, the Finance Bill is still going through Parliament. • The 8th of April is the closing date for comments on the latest instalment of draft HMRC guidance on the multinational top-up tax and the domestic top-up tax. The Manual is supposed to be published in the Spring.
Zoe Andrews	And that leaves me to thank you for listening. If you have any questions, please contact Tanja or me, or your usual Slaughter and May contact. Further insights from the Slaughter and May Tax department can be found on the European Tax Blog - www.europeantax.blog

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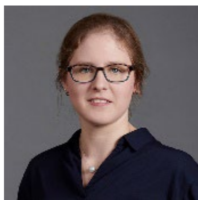

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