Proskauer

UK Tax Round Up

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Welcome to the November 2024 edition of our UK Tax Round Up. This month has seen publication of the Finance Bill 2024-25 and interesting cases on the loan relationship unallowable purpose test and the extent that tax applies to employment settlement payments. In addition, HM Treasury is asking for responses to its proposed changes to the carried interest tax rules, which will take effect from 6 April 2026.

Finance Bill 2024-25

The government published the Finance Bill 2024-25 on 7 November. Significant changes that have been announced include:

- increases to the capital gains tax (CGT) rates from 10% to 18% and 20% to 24% for gains realised after 30 October 2024;
- increases to the business asset disposal relief (BADR) CGT rate from 10% to 14% for gains realised between 6 April 2025 and 5 April 2026 and then to 18% for gains realised from 6 April 2026;
- increase to the carried interest CGT tax rate from 28% to 32% on carried interest arising from 6 April 2025 until 5 April 2026 with a new carried interest tax regime (discussed below) to apply from 6 April 2026;
- replacement of the domicile tax rules from 6 April 2025 with a new incoming residents' foreign income and gain relief regime that will, broadly, allow relief on foreign income and gains arising to individuals becoming UK resident after a period of non residence of 10 years in the tax year in which they become UK tax resident and the next three tax years. These rules are detailed and are linked to changes to trust and inheritance rules and introduce new rules relating to overseas employment income. They should be considered in detail to the extent that they might be applicable; and
- increase in the primary employer national insurance contribution rate from 13.8% to 15% from 6 April 2025.

Proposed changes to carried interest tax rules

On 30 October, HM Treasury published a Summary of Responses and Next Steps in respect of its prior Call for Evidence on the proposal that the tax rules applying to carried interest would be changed.The document summarises the government's broad proposal that carried interest that arises from 6 April 2026 will be taxed as deemed trading income of the carried interest recipient subject to income tax and Class 4 national insurance contributions, in the same way as disguised management fee income (DIMF) is taxed.

However, in order to recognise the distinguishing characteristics of carried interest as a reward linked to the long-term performance of fund investments, the proposal is that "qualifying carried interest" will have relief applied to it so that only 72.5% of the carried interest will be subject to tax, resulting in an effective rate of about 34% (applying 45% additional rate income tax and 2% Class 4 NICs).

Carried interest will be "qualifying" if it is not income based carried interest (IBCI). In addition, HMRC is considering adding one or two additional requirements relating to required co-investment alongside the carried interest by fund managers and/or a required minimum holding period before the qualifying carried interest is paid to the carry holder.

We discuss the proposals in detail in this *Tax Talks* article.

HM Treasury is asking for responses to the proposals by 31 January 2025.

UK Case Law Developments

Acquisition funding had unallowable purpose and so non deductible

In *Syngenta Holdings Ltd v HMRC*, the First-tier Tribunal (FTT) has decided in favour of HMRC that the taxpayer was not entitled to deductions in respect of the finance costs on debt used for the purpose of an acquisition because the taxpayer was party to the debt for an unallowable purpose. This is the latest case on the unallowable purpose question, following those in *KwikFit*¸ *BlackRock* and *JTI Acquisitions*, each of which have been won by HMRC.

The broad facts in this case were that Syngenta Holdings Ltd (SHL) acquired the entire share capital of a sister company Syngenta Limited (SL) from its parent Dutch tax resident Syngenta Alpha BV (Parent). This meant that all of the group's UK companies were held under SHL. The consideration for the purchase was part shares issued by SHL to Parent and part cash that was funded using a new loan made to SHL by Syngenta Treasury NV (Treasury). As in other recent cases, SHL agreed to the amount and interest rate on the loan from Treasury with HMRC under an advance thin capitalisation agreement (ATCA).

There was some documentary evidence suggesting that the purpose for the transfer of SL was to reorganise and rationalise the group's UK holdings and that it simplified distributions for UK profits to be distributed through a single chain of companies. There was also, however, a lot of other documentary evidence around the expected tax benefit to arise from the transaction, in particular from the difference in the value of the UK tax deduction from the loan from Treasury to SHL and the Dutch tax on the interest paid on that loan. Internal documents described the transaction as a "Tax project" and "Tax optimization project" and that SHL had taken advice from Deloitte on the "debt push down".

As with the other recent cases, the directors of SHL argued that they had only taken into account the benefits that would arise to SHL of acquiring SL (which were, broadly, the UK group rationalisation and simplifying dividend payments) and that the purpose of the loan from Treasury was purely to provide funds for the acquisition.

The questions before the FTT were (i) what was SHL's purpose in being party to the loan and (ii) if it had more than one purpose was there a just and reasonable apportionment that could be made to allow some of the deductions and disallow the rest?

The judgement provides a detailed exposition of the law around a company's purpose (generally effected through the purpose of its directors) and of the evidentiary facts available to it. As stated, and unfortunately for SHL, the vast majority of the documents available, being largely the internal discussions around the transaction, seemed to point to the overarching reason for the transfer to SL to SHL being to allow SHL to borrow from Treasury and generate the UK tax benefit rather than being to simplify the UK group structure and dividend payment. The judgement provides a very stark example of how the basis on which a transaction is discussed (and documented) by the people responsible for it will provide significant colour to the question of what the purpose of the transaction was. It also reiterates that the purposes of the wider group will be relevant to the purpose of the specific taxpayer company where it is evident that the taxpayer question took into account that wider group purpose and that HMRC and the courts will not be bound by the specific narrow purported purpose of the taxpayer company in the context of "main purpose" anti avoidance provisions.

This, alongside the other recent unallowable purpose cases, should now make clear that taxpayers should take a realistic approach to the question of what their purposes in entering into a transaction might be and not rely on a narrow, immediate purpose (such as using money to make an acquisition) when that narrow purpose clearly sits as part of a wider driver for the transaction in question.

Certain settlement payments not subject to tax as payments for discrimination

In *L v HMRC*, the FTT has held that certain payments made to L as part of a settlement arrangement with her employer were not subject to tax as earnings (or as an amount received in connection with the termination of her employment) because the payments were made to settle her discrimination claim against her employer and so did not derive "from" her employment.

L was employed by her employer in April 2011. Her remuneration terms were a fixed salary, a discretionary cash bonus (guarantee for the first year) and a discretionary share award. In December 2011 and January 2012, L was paid her bonus and notified that she would be granted a number of shares vesting over three years. L was also awarded a discretionary bonus for 2012 but it was assumed by the FTT that she was not awarded any shares. On 14 January 2013 she was notified that she was at risk of being made redundant. She was made redundant in April 2013. She appealed the redundancy but it was confirmed in August 2013.

In July 2013, L filed a claim against her employer at the Employment Tribunal (ET). She claimed discrimination, harassment, unfair dismissal and inequality of pay. The claim was linked to the period of her employment, her selection for redundancy and the redundancy process. In particular, she claimed that her role had been unjustly split into two roles, she was sidelined, she was deprived of access to opportunities to develop business and there was an unfair allocation of client revenue between her and her peers. The harassment claim related to aggressive and demeaning behaviour and treatment by her peers and managers.

In October 2013, L's employer indicated willingness to settle the claim. The claim was settled in March 2014 by no admission of liability by the employer, a payment of £L, a payment of £M in consideration of the waiver of all future claims and an acceleration of vesting of the share award previously made to her. This resulted in L receiving a total sum of £N, including (but in excess of) £O (deferred cash component under the long-term incentive plan), £P (cash under the equity award) and shares valued at £Q (accelerated vesting of equity).

The sums were paid with £30,000 tax free (under section 401 ITEPA as a payment in connection with the termination of L's employment) and the remainder paid to L net of income tax and national insurance contributions. Under the settlement agreement, L was entitled to submit her tax return on a different basis. L submitted her tax return on the basis that the amounts of £O plus £P plus £Q were subject to tax with relief for £30,000 and the remained of the amount paid was outside the charge to income tax. HMRC sought to assess L to tax on a higher amount and the details of the difference between the parties depended on a detailed breakdown of the overall payment, which is not clearly explained in the decision.
Having said that, the case in front of the FTT involved the question of whether an element of the overall payment related to settlement in respect of L's claim of discrimination and so did not derive "from" her employment. The case provides a detailed review of the case law on

whether certain payments should or should not be subject to tax as employment income and the requirement from *Hochstrasser* that the payment be "from" the employment to be taxed as general earnings. Having reviewed the case law, the FTT summarised the correct approach to adopt when determining whether a payment made to settle a discrimination is taxable as being:

1. where a global settlement sum has been paid to compromise a number of discrete claims it must be determined whether that single sum can sensibly and realistically be apportioned and attributed to the various components of the claim;

2. where the payment can be apportioned and attributed each portion of the payment is to be considered separately;

3. any payment or apportioned part payment which is paid "directly or indirectly in consideration for in consequence of, or otherwise in connection with" termination of employment will be taxed under section 401 ITEPA;

4. when considering any part of the payment made otherwise than in the circumstances envisaged under section 401 ITEPA, and thereby in connection with a period of employment (past, present or future), the critical question is whether the payment is a reward for services of the employee (as per Hochstrasser and Mairs);

5. where claims are made under the Equalities Act the focus of attention should be whether the payment is made to compensate for actual or potential discrimination or "to pay back money which [the employer] thought [the employee] was entitled to under [their] service agreement"; and

6. where there are multiple reasons for the payment or apportioned part payment the existence of a non "from employment" reason will be unlikely to deprive the nature of the payment as "from employment".

It was accepted that part of the overall payment was made to L to settle her claim for discrimination. The FTT decided that the relevant part of the payment was not subject to tax as being "from employment" notwithstanding that it was calculated by reference to the bonus that she might have received had she not been discriminated against and made redundant. The FTT stated that "We have found as a fact that the balance was paid to settle the Appellant's claim that they suffered discrimination following the appointment of a second executive director to the team facing the same market thereby bifurcating of the Appellant's role, resulting in lost opportunity to develop business and unfair allocation of revenues together causing financial loss. We consider that to be exclusively a reason other than "from employment" because, the heart of this part of the Appellant's claim is not that they were not fairly paid for what work they did but that they were deprived of the opportunity to perform their full role. Consistent with the analysis and description of the nature of a redundancy payment in *Mairs* compensation for such lost opportunity cannot be directly connected to the employment as it was an employment she never fulfilled because of the discrimination she experienced". The FTT went on to state that "Consistently with the accepted position of both parties the mere fact that the measure of the damage was the financial loss caused cannot create the necessary causal connection between the payment and any services rendered by the Appellant" and "whilst the Appellant would not have received the payment had she never been employed by the employer it is plain that a "but for" test is not sufficient. The payment must be a reward for services and for the reasons given it was not".

The case highlights how the parties need to have a detailed understanding of exactly why each element of a settlement payment is made when the overall settlement can be divided into discrete elements and also that it is not sufficient that an employee would not have received payment "but for" their employment or that the payment is calculated by reference to what the employee might have received as remuneration for it to be taxable. It must be that the element of payment derives "from" the employment and not from another head of claim, such as discrimination.