Press Summary

23 March 2022

Commissioners for Her Majesty's Revenue and Customs (Appellant) v NCL Investments Ltd and another (Respondents) [2022] UKSC 9

On appeal from: [2020] EWCA Civ 663

Justices: Lord Reed, Lord Briggs, Lord Sales, Lord Hamblen, Lady Rose

BACKGROUND TO THE APPEAL

This appeal concerns the proper treatment, for corporation tax purposes, of accounting debits arising in the accounts of the Respondent Companies ("the Companies").

The Companies were subsidiaries of a holding company, Smith & Williamson Holdings Limited ("SWHL"). The Debits arose as a result of the grant to the Companies' employees of options to acquire shares in SWHL. These option grants ("the Options") were made via an employee benefit trust ("EBT") set up by SWHL.

The Companies were required by International Financial Reporting Standard 2 ("IFRS2") to recognise an expense on their income statements in respect of the grant of the Options by the EBT ("the Debits"). Although the grant of the Options did not require the Companies to part with any cash or other assets, IFRS2 nonetheless required the consumption of services provided by the Companies' employees in exchange for the Options to be recognised as an expense. As it was impossible to value precisely how much of the employees' services were to be treated as the result of the incentivisation arising from the grant of the Options, IFRS2 set the value of those services at the fair value of the Options.

The Debits on the Companies' income statement had to be matched by a corresponding credit on their balance sheets. As the share options came originally from SWHL, IFRS2 required the Companies to treat the corresponding credit as a capital contribution from a parent company ("the Capital Contribution").

In computing their liability to corporation tax, the Companies therefore claimed to be entitled to deduct an amount equal to the Debits from their profits. The Appellants, Her Majesty's Revenue and Customs ("HMRC"), contend that the Debits should not be taken into account in this way,

relying on a number of grounds which, they say, preclude such a deduction. The First-tier Tribunal ("the FTT"), the Upper Tribunal and the Court of Appeal rejected HMRC's arguments.

JUDGMENT

The Supreme Court unanimously dismisses the appeal. The judgment is given by Lord Hamblen and Lady Rose, with whom Lord Reed, Lord Briggs and Lord Sales agree.

REASONS FOR THE JUDGMENT

Issue 1: Whether disregarding the Debits is an "adjustment required or authorised by law" within the meaning of section 46(1) of the Corporation Tax Act 2009 ("CTA 2009")

The Supreme Court concludes that there is no law requiring an adjustment to the Companies' financial accounts so as to exclude the Debits from the computation of profits. *Odeon Associated Theatres Ltd v Jones* [1971] 1 WLR 442 and cases following it have established that the profit of a taxpayer's trade is to be determined in accordance with "ordinary principles of commercial accountancy" **[20]-[22]**. In the corporation tax context, this is now reflected in section 46(1) CTA 2009 which requires that profits must be calculated in accordance with generally accepted accounting practice "*subject to any adjustment required or authorised by law*" **[23]**.

Tax is the creature of statute, and while it is possible for a judge-made rule to authorise an adjustment, that rule would have to be clearly applicable. The House of Lords' decision in *Lowry v Consolidated African Selection Trust Ltd* [1940] AC 648 ("*Lowry*") does not authorise any adjustment. There was no equivalent at the time of *Lowry* to section 46 CTA 2009 giving statutory primacy to generally accepted accounting practice **[29]**.

HMRC argued further that generally accepted accounting practices which are directed at preserving the integrity of the taxpayer's balance sheet (such as IFRS2) were less relevant to corporation tax than other accounting practices, because corporation tax was concerned primarily with a company's profit and loss account **[32]**. The Supreme Court holds that there is no basis for such a distinction. A company's balance sheet and profit and loss account are not separate and severable as HMRC suggest because entries on one may affect entries on the other in order that overall they give a true and fair view of the financial state of the company **[33]**.

Issue 2: Whether the deduction is disallowed by section 54(1)(a) CTA 2009

Section 54(1)(a) CTA 2009 states that no deduction should be made for "*expenses not incurred wholly and exclusively for the purposes of the trade"*. HMRC contend that the Debits were not "incurred" because the Companies suffered no loss in relation to them, and / or the Debits were not for the purposes of trade **[34]-[36]**.

The Supreme Court rejects HMRC's case that section 54 imports a further requirement for an "expense" to be deductible, namely that it must be "incurred". The requirements for what constitutes a deductible expense are set out in sections 46 and 48 CTA 2009 **[38]**. Section 54 does not address how profits are to be calculated but rather what deductions are to be disallowed, with a particular focus on expenses incurred for a dual purpose **[39]-[42]**. The Supreme Court also rejects HMRC's argument that, as the Debits arose from a transaction to which the Companies were not parties, it is impossible to ascribe any "purposes" to the Debits on the part of the

Companies **[48]**. The FTT had made a finding of fact that the Debits were incurred for the purposes of the Companies' trades and there are no grounds for challenging that finding **[49]-[50]**.

Issue 3: Whether the deduction is disallowed by section 53 CTA 2009

Section 53 CTA 2009 provides that "*no deduction is allowed for items of a capital nature"* **[52]**. HMRC argued that the Debits are of a capital nature because they are simply the corresponding entry required to match the Capital Contribution from SWHL **[54]**. The Supreme Court rejects this argument, agreeing with the FTT that the Debits had a revenue, rather than capital, nature **[55]**. The fact that the matching credit entry was a capital contribution does not change this; what matters is the character of the Debits themselves **[56]**.

Issue 4: Whether the deduction is disallowed (or deferred) by section 1290 CTA 2009

Section 1290 CTA 2009 places restrictions on deductions that would otherwise be allowable when calculating a company's profits, if that deduction is a deduction in respect of "*employee benefit contributions*". This is defined in section 1291 CTA 2009, the critical part of which requires property to be "*held… under an employee benefit scheme*" **[58]-[60]**.

The Supreme Court analyses the definition of an employee benefit contribution and decides that what happens in this case does not involve any property being so held. The provision therefore does not apply to prevent the deduction **[65], [70]-[71]**.

References in square brackets are to paragraphs in the judgment.

NOTE: This summary is provided to assist in understanding the Court's decision. It does not form part of the reasons for the decision. The full judgment of the Court is the only authoritative document. Judgments are public documents and are available online. Decided cases