Comment

Views on topical issues

Tax on multinational businesses

Peter Vaines
Barrister, Squire Sanders

HMRC brings some much needed balance to this debate.

I imagine that there may be some frustration among tax professionals about the media interest presently given to tax issues. Accuracy, and indeed common sense have been early casualties in the pursuit of headlines by politicians (and the media) on tax issues.

There have been many claims that various multinational companies did not pay much tax last year with the clear implication that they have been involved in some dodgy tax arrangements which have relieved them unfairly from their tax obligations or that they have done something else which is equally morally repugnant. The possibility that in these difficult times, the company might have made significant losses which have not yet been fully recovered, or has continuing and substantial capital expenditure are factors which do not even get onto the radar.

Furthermore, a multinational, by its very nature, operates in various parts of the world and may make profit in other countries. However, it is simply assumed that if they operate in countries which charge lower taxes, the operations there must be all part of some overall plan to deprive the UK tax authority of their entitlement.

Anybody would think that we do not have any transfer pricing legislation or that HMRC is completely unaware of the tax saving possibilities of transfer pricing (which the journalists naturally understand fully). That is both ill-informed and insulting.

Most companies do their very best to obey the law when dealing with their tax affairs. However, others who use deception and concealment in their tax affairs are not seeking to obey the law – they are trying to break it and they should be vigorously condemned and pursued. But it is very important that we understand the difference – if lawful conduct is not to be distinguished from unlawful conduct, we are not safe in our beds.

It is therefore with some satisfaction that I read the HMRC statement on this subject on 11 October. It refers to the recent stories in the media about multinationals and confirms that HMRC is alive to the risks and that it deploys specialist professionals to ensure that multinationals comply with the rules.

Apart from the references to people 'paying the right amount of tax' (which presumably is the amount that HMRC would like you to pay), the HMRC statement is fair and balanced and should be read by all those who wish to pontificate on the matter.

These two sentences really say it all:

'Company accounts include references to tax liabilities but it is not generally possible to identify from the accounts how much UK corporation tax has been paid. So an apparently low tax rate in the company's accounts might indicate tax avoidance, it could also be the case that the business has acted entirely properly, by making use of specific tax reliefs and incentives designed, for example to encourage capital investment or research and development.'

HMRC has got it exactly right but I fear this may not be a convenient message for either the media or the politicians.

HMRC's statement is set out in its issue briefing titled 'Taxing the profits of multinational businesses', available via www.lexisurl.com/taxingMNCs.

Tax deductions for commercial penalties

Timothy Brennan QC
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In *McLaren Racing Ltd v HMRC* TC/2010/6733, the First-tier Tribunal departed from established principle when allowing a tax deduction for a fine of £32m for industrial espionage.

A specific deduction in computing a trader's taxable profits is not often discussed in prime time on Radio 4. When *Today* considered the First-tier Tribunal's decision to allow a deduction to McLaren for a misconduct fine, the note of incredulity from John Humphries was well justified.

The Federation Internationale de L'Automobile is both the regulator and the commercial owner of Formula One and contracts with its teams. The McLaren chief designer, Mr Coughlan, was provided with detailed Ferrari plans and information by a Ferrari employee. After High Court proceedings, some 780 pages of Ferrari documents were found in Mr Coughlan's house. Ferrari took a dim view, and requested an investigation. It eventually turned out that a number of McLaren personnel, including two drivers, received confidential Ferrari information. McLaren was charged with misconduct and publicly apologised.

A huge penalty was imposed. The starting figure was $100m. McLaren's claim to deduct a fine of some $64.5m, or £32m, was in issue before the Tribunal.

In *McKnight v Sheppard* (1999) 71 TC 419 Lord Hoffmann expressly approved the refusal of the Special Commissioners and the High Court to allow a tax deduction for a Stock Exchange fine levied on a stockbroker for misconduct. HMRC resisted McLaren's deduction on conventional grounds: the expenditure was not wholly and exclusively for the purposes of the trade (ICTA 1988 s 74(1)(a)) and/or it was a loss which did not arise out of, and was not connected with, the trade (s 74(1)(e)). The argument was that the fine was imposed as a result of conduct which fell outside any normal and acceptable way of conducting the trade. This was industrial espionage of a gross kind.

The Tribunal was divided in its opinion, but Tribunal Judge Hellier took the chequered flag, using his casting vote to overrule the concise dissenting opinion of Mr Nicholas Dee.

Judge Hellier expressly found that the activities which gave rise to the penalty were not a normal or ordinary part of McLaren's trade. McLaren was cheating. Nonetheless, the cheating activities 'were so closely associated with mainstream [*sic*] of McLaren's trade that I cannot say they were not part of it'. Accordingly unless the penalty was 'personal punishment' (this, for a corporate body) and unless there was a 'public policy argument' against allowing the penalty to be shared with the general body of taxpayers, the penalty was deductible. He held that the penalty was 'commercial' rather than 'personal punishment' and that the protection of fairness in motor sport did not carry the same public interest as that protected by a regulator of a profession based on trust.

The decision is astonishing. The effective conclusion was that any activity carried out by McLaren which made its cars more competitive was for the purposes of the trade. But the risk of penalty here was not a regular, almost unavoidable, incident of the trade, nor something which trading required the trader to assume. On the contrary, it was an extraneous risk deliberately, unnecessarily and improperly assumed (just the formula used by Lightman J in *McKnight v Sheppard*). Millions of individual followers of (and indeed, gamblers on) commercially regulated sports merited more consideration than this of their interests in the integrity of their sports.

Any appeal seems likely to succeed. If it were not to do so, any fines imposed by the governing body of a sport (and potentially, other regulatory bodies) would appear to be deductible. Judge Hellier should have paid more heed to the opinion of his co-driver.

Akash Nawbatt and Christopher Stone of Devereux acted for HMRC in this case.

The proposed creative industries tax relief

Rachel Austin
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The proposed creative industries tax relief will increase the UK's competitiveness in the animation, high end television and video games sectors as long as the government sets the rate of relief at a competitive level.

The government announced the proposed introduction of corporation tax reliefs for the animation, high-end television and video games industry in the 2012 Budget. Subject to EU State aid approval, legislation is expected to be included in Finance Bill 2013 and the new regime will apply from 1 April 2013. Since the announcement, HM Treasury and HMRC have been consulting widely with industry, both formally and informally, on the detail of the proposed relief.

The Department for Culture, Media and Sport (DCMS) is currently consulting on the proposed cultural tests that are necessary to meet EU State aid requirements (see www.lexisurl.com/1RWHk).

The aim of the proposed relief – to support a sustainable creative industry with a world class skills and talent base in the UK – is welcome. If the government sets the rate of relief at the right level, the proposals should increase the UK's competitiveness in these sectors, encouraging additional investment in the UK and discouraging UK companies from producing culturally British content in countries that already offer incentives such as Canada, Ireland, Hungary and France.

However, given the long lead time for productions in these sectors, in order to achieve the desired behavioural change companies need to know the value of the proposed reliefs as soon as possible to start building it into their planning processes.

The proposed design of the reliefs is based on the current film tax relief (FTR) (see CTA 2009 Part 15), which provides an additional corporation tax deduction for culturally British films with the option of surrendering the additional deduction for a cash tax credit.

The chancellor has stated that the creative sector reliefs 'will be among the most generous available anywhere' but the consultation document merely states that the relief is expected to be of similar generosity to the FTR. The FTR is currently worth between 12.8% and 20% of core expenditure for films produced wholly in the UK, depending on the budget of the film and whether a payable credit is claimed.

Furthermore, the value of the additional deduction will diminish as the UK corporation tax rate decreases. For large budget films, it will fall from 15.36% to 14.72% when the UK corporation tax rate reduces to 23% from 1 April 2013 (FA 2012 s 6) and to 14.08% if the proposed 22% rate is enacted. In contrast, our research shows that a number of other countries offer incentives worth around 20% of production costs.

It is clear from the current consultation on the cultural tests that the government wants the relief to apply as widely as possible to UK production activity in the three sectors, but this won't be enough to meet the government's objectives if the rate doesn't measure up to those of our competitors.

HM Treasury's consultation on this issue closed on 10 September. The DCMS consultations close on 29 October.