Proskauer

Advisers' Fees Non-Deductible Where Management Decisions Made by Parent Company

Tax Talks Blog on **May 29, 2020**

The UK's First-tier tax tribunal (FTT) has just released an interesting decision considering whether or not expenses incurred by a parent company on advisers' fees that related to a proposed disposal by a group subsidiary and were charged on to its subsidiary were deductible as expenses of management of the subsidiary under section 1219 of the Corporation Tax Act 2009 because the decisions in respect of the disposals had been taken by the parent and not the subsidiary.

The decision provides cautionary advice on how groups should make sure that they operate and document as clearly as possible the different activities and decision-making process of their individual group members.

In the case (*Centrica Overseas Holdings Limited v HMRC*), the FTT held that the relevant advisers' fees were not deductible for the subsidiary because the management decisions on the disposals were taken by the parent company rather than by the subsidiary. This highlights the importance of considering carefully, and documenting, the reasons why particular companies in a group incur their costs.

Facts

The case involved the Centrica group and the disposal of certain assets. Strategic decisions for the Centrica group were made by the parent company (Centrica plc). It decided to dispose of an investment held by Centrica Overseas Holdings Limited (COHL), one of its indirect subsidiaries. Various advisers were engaged to work on the disposal with Centrica plc paying the advisers' fees and then charging them to COHL by means of book entries. The transaction that was actually entered into involved COHL's subsidiary (Oxxio) hiving certain of its investments into a newly formed subsidiary and selling that subsidiary, so the actual disposal was made by a subsidiary of COHL.

As mentioned above, strategic decisions for the group were made by Centrica plc. This was facilitated by various central teams within the group. A distinction was drawn between investment decisions, which were made by Centrica plc, and operational decisions regarding how investments were to be run, financed and managed, which were made by cross-company teams within the group. COHL had no employees of its own and its directors were employees of Centrica plc. There was a lack of clear delineation between the various roles in which the individuals who were the directors of COHL were acting. Directors of COHL would be aware of how the disposal was progressing in their group capacities as opposed to specifically in their capacity as COHL directors. This meant that there was no need to brief the directors of COHL or inform them about how any transaction was progressing as they would already know these things in their respective group capacities. Significantly, there would not always be a formal COHL board meeting considering any particular transaction and there were no COHL board minutes regarding the disposal in question.

Decision

Was the expenditure incurred in respect of COHL’s investment business?

HMRC rejected COHL’s claim to deduct the advisers’ fees from its profits as expenses of management. The FTT, in dismissing COHL’s appeal, held that the fees were not the expenses of management of COHL as the management decisions were made by Centrica plc.

The FTT held that the fact that COHL itself did not dispose of anything was not, of itself, a bar to the disputed expenditure being an expense of management of COHL’s investment business. The FTT also held that the fact that a subsidiary paid for services provided or procured by its holding company did not automatically bar the expenditure from being tax deductible for the subsidiary.

However, the FTT affirmed that deductibility required the relevant expenses to be “in respect of” so much of the company’s investment business as consisted of making investments and that there had to be a link between the expenses and the investment business. As outlined above, the lack of delineation in function between individuals acting as directors of Centrica plc and COHL meant that those individuals did not consider the strategic decisions specifically in their capacity as directors of COHL as the investment company claiming deductions for the expenses. The FTT stated in this regard that “the real difficulty … is that COHL was not actually managing anything. Taking a realistic view of the facts it was [Centrica plc] which made all the decisions, strategic and otherwise. The various group functions did not think of themselves as providing services to COHL, they were working to give effect to [Centrica plc’s] strategic decision to divest itself of the Oxxio businesses”.

Were the advisers’ fees “expenses of management”?

The FTT also considered whether the advisers’ fees would have been deductible if it was wrong on the “lack of management” by COHL discussed above. Acknowledging the breadth of the term “expenses of management”, it drew the distinction between expenses which are essentially part of the costs of buying or selling investments (these being the capital costs of implementation and not deductible) and expenses which are severable from the sale or purchase itself (which are expenses of management and deductible unless they are part of the general expenses of the company or capital in nature).

The FTT reviewed applicable case law and considered that, broadly, once a decision to go ahead with a specific transaction with a specific purchaser on specific terms is made then the expenditure moves from management to costs of sale so that the decision to buy or sell marks the boundary between deductible management expenses and non-deductible implementation expenses. Applying this delineation to the facts, the FTT considered that the fees of the accountants would have been management expenses but that the lawyers’ fees would have been implementation costs.

The FTT also went on to look at whether the advisers’ fees were revenue or capital. Capital expenditure is not tax deductible. The FTT held that the tests applied in relation to trading expenditure and the requirement for recurrence were not readily applicable to an investment company and that rather “the line between income and capital management expenses is to be drawn between expenses which are incurred in connection with an investment company’s consideration of and decisions about managing its investments and expenses incurred in connection with an actual or potential capital transaction”, acknowledging that such a line may not always be easy to draw.

The process of deciding whether and how to make a disposal could be revenue in nature whereas the disposal itself was a capital transaction. Therefore the timing of the expenditure is relevant with regards to the capital/revenue distinction but is secondary to the purpose of the expenditure with regards to the distinction between management expenses and implementation costs.

Key takeaways

The case highlights the requirements for groups to consider carefully the basis on which it might be seeking deductions for expenditure and to make sure that the correct corporate steps are taken, and that there is documentary evidence of the manner in which they are taken, to ensure that the transactions actually entered into satisfy the requirements of the relevant tax provisions. So, while a group might consider itself operating as a unified whole for certain purposes (such as strategic decision making in this case), the fact that the UK tax system operates at a company by company basis means that it is important that each company does what is required to claim deductions for expenses. In this case, that means that COHL should have considered the strategic advice provided by Centrica plc and its directors should have considered and decided on it as directors of COHL notwithstanding that they might have already been in possession of all of the knowledge that they required as employees of Centrica plc (or other group companies) involved in considering the strategic decisions.

So, to ensure that management expenses are deductible from a company's profits under section 1219, those expenses must be expenses incurred in respect of the management of that company's investment business. Therefore there should be clear delineation as far as possible of (a) the function of each company in a group and (b) in what capacity directors with multiple directorships in the group are acting with regards to particular management decisions. Appropriate documentation by way, for example, of board minutes and the following of applicable company procedures should provide evidence of such delineation for the purposes of linking expenses with the investment business.

In addition, the purpose and timing of expenditure should also be considered in relation to whether expenses are management expenses and whether such expenses are revenue or capital in nature. Therefore decision-making should be clearly documented as to both purpose and timing to maximise the ability to claim deductions for the expenses.

View Original