SLAUGHTER AND MAY/

TAX AND THE CITY

CLIENT BRIEFING

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In *Dialog*, the FTT considers whether a break fee paid by a target to a bidder was a capital sum derived from an asset taxable under TCGA 1992 s 22(1)(c). The FTT in *Boulting* concludes that a company purchase of own shares was for the benefit of a relevant trade for the purposes of Condition A of CTA 2010 s 1033. The latest report for UK Finance estimates the total tax contribution of the UK banking sector for 2024/2025 to be £43.3bn and shows that London's total tax rate is much higher than other major finance centres and is projected to rise further.

Dialog: taxation of break fees

Although the preliminary issue to be determined by the FTT in *Dialog Semiconductor Limited v HMRC* [2025] UKFTT 1188 (TC) was very specific, the general question of the direct and indirect tax treatment of a termination or break fee is an important one. Although break fees may not be paid that often in practice, when they do arise the amount is usually significant and so HMRC scrutiny of the tax treatment should be expected.

Dialog (as bidder) entered into a merger agreement with Atmel (as target) but Atmel received a better offer and unilaterally terminated the agreement to pursue it. This triggered an obligation for Atmel to pay Dialog a USD 137m termination fee. HMRC stated a very narrow basis for assessment in a closure notice that this fee was taxable as a disposal of assets under TCGA 1992 s 22(1)(c) as a capital sum "received in return for forfeiture or surrender of rights, or for refraining from exercising rights".

It appears from the FTT's decision that HMRC had not made the assessment under the introductory part of s 22 as they wished to take advantage of the timing under s 22(1)(c) (so that the time of the disposal would be when the capital sum was received) and had also not considered whether s 22(1)(a) (capital sums received by way of compensation) applied. The FTT found that the termination fee was paid to compensate the taxpayer for losing their rights under the merger agreement and was paid "in return for" the loss of those rights but, on the facts of this case, there was no forfeiture, surrender or refraining and so the termination fee did not fall within s 22(1)(c). The taxpayer's appeal was accordingly allowed and HMRC must withdraw the closure notice.

Obiter comments

Although not relevant to the determination of the preliminary issue, the FTT considered the termination fee is compensatory in nature, such compensation going beyond reimbursement of costs incurred and taking account of the loss of the opportunity for Dialog to acquire Atmel at a lower price than the price paid by the other bidder. The relevant question for the purposes of s 22 is whether the contractual right to the payment of the termination fee is a capital asset. The FTT distinguished between the situation under a sale agreement where a vendor has a contractual right to the purchase price. In that scenario, case law shows that the contractual right to the payment is not a capital asset. The FTT considered, albeit as *obiter*, that the termination fee in this case was derived from a capital asset because the merger agreement was between the bidder and the target and this is different from a share purchase agreement between a vendor and a purchaser.

Direct tax treatment of a break fee

Although the comments were *obiter*, where does *Dialog* leave the analysis of the tax treatment of break fees? Is the right to receive a break fee on termination of the contract a capital asset which is disposed of on receipt of the fee? This arguably depends on which party receives the break fee. If the target is the recipient, the break fee it receives if the bidder pulls out seems like a windfall because, if the transaction had proceeded the shares in the target would have changed hands and so it is the target shareholders who would be the ones to lose out, not the target itself.

If, as in *Dialog*, however, the bidder is the recipient of the break fee because the target has received a better offer and pulls out, it is easier to argue the break fee is received as compensation for losing the valuable contractual rights the bidder had under the agreement to acquire the target for less than the eventual acquirer did.

Indirect tax treatment of a break fee

For the indirect tax treatment, it is necessary to determine whether the fee is compensation, or if it is consideration for a supply. Historically, the concern was always that a break fee would not be seen as compensatory in nature but as consideration for a service, such as an inducement fee. On this basis, to the extent it exceeded a reasonable estimate of Dialog's costs that the target would have agreed to pay in the event of the target terminating the contract in order to induce Dialog to enter the contract, the fee would arguably be payment for a service. Although *obiter*, the characterisation in *Dialog* of the payment as compensation for loss of rights is helpful from a VAT perspective. In the case of a reverse break fee, where a target is paid not to tout itself to other bidders, this looks more like a supply.

If there is a supply for VAT purposes, in a cross-border transaction the reverse charge rules would need to be considered and so if the recipient of the break fee is, say, in the US, the supply would be outside the scope of VAT. In a scenario where there is a risk the break fee will be for a VATable supply, this risk should be allocated between the parties by the relevant contract.

Boulting: company purchase of own shares was for the benefit of a relevant trade

The FTT in *Boulting v HMRC* [2025] UKFTT 1272 (TC) had to determine whether the taxpayer was subject to income tax or CGT on the repurchase by the company of his shares. This depended on whether Condition A of CTA 2010 s 1033 was satisfied. The key question was whether the purchase was made wholly or mainly for the purpose of benefiting a trade carried on by the company or any of its 75% subsidiaries.

The facts are quite novel but some more general points about the interpretation of Condition A can be taken from the decision. A family-owned company ran a training business. There were differences in opinion between the father (the taxpayer) and the son and it became clear that the business would cease to be profitable if the taxpayer kept blocking investment in IT and having a veto over decisions. It was agreed that the taxpayer would retire and the company would buy back the taxpayer's shares. As the company had only £5m of cash reserves, the taxpayer agreed to gift (to the son and to the grandchildren) any remaining shares that the company could not buy back. The price agreed, based on a negotiated £60m valuation of the company, was £4.8m for eight shares.

Although HMRC had given a clearance that the purchase of own shares would be subject to CGT only, following an enquiry into the taxpayer's self-assessment return, HMRC issued a closure notice treating the sale as subject to income tax. HMRC concluded that the clearance was void on the basis that the share value used by the company was materially greater than market value and, as this had not been disclosed in the clearance application, HMRC were not bound by the clearance. An application for judicial review of the decision to void the clearance was refused because there was a suitable alternative remedy for the taxpayer: to appeal the closure notice to the FTT on the merits of the case.

The taxpayer then brought an appeal against the closure notice before the FTT. HMRC contended that Condition A was not satisfied but the FTT found in favour of the taxpayer that Condition A was met. All of the circumstances of the purchase need to be considered and not just the payment element of the purchase alone. The FTT found that the evidence was clear that the share purchase was undertaken in order to remove the taxpayer from the business. "Whilst the share purchase did not achieve his exit in isolation, it was a prerequisite for the rest of the arrangements to take place and the legislation does not state that the purchase must achieve the purpose in isolation." (para 67)

HMRC's argument that the share valuation was too high and that the purchase remunerated the taxpayer for his historic investment and risk in the business rather than being to benefit the ongoing trade did not find traction with the FTT. The question posed by the statute is: what is the purpose of the share purchase? It is not simply "why did the company pay £4.8m for 8 shares?", although this is a factor which may be relevant in considering the test. On the facts, the details of the valuation exercises (undertaken by the son and by various experts) did not displace the findings as to the purpose of the purchase. The purchase price was the price the board of directors believed was required to obtain Mr Boulting's agreement to sell his shares. In any event, the FTT noted that what Mr Boulting had received in giving up control of the company was by any calculation rather less than the value of the total shares he disposed of.

Is there any value in having an HMRC clearance?

The High Court's decision in this case that it is not possible to use judicial review to enforce an HMRC clearance because appealing the closure notice to the FTT on the merits of the case is a suitable alternative remedy for the taxpayer was disappointing. If a taxpayer has to go to the FTT to argue the merits of the case, it calls into question what the point of the clearance was in the first place.

The reason HMRC gave for voiding the clearance was that the share value was materially greater than market value and that this had not been disclosed in the clearance application. The High Court did not address whether there had been full disclosure or not. The FTT also did not need to consider whether there had been full disclosure because before the FTT, the question was simply whether Condition A was satisfied and the share valuation in this case was a factor but not the only factor. A share price above market value does not automatically mean the purpose cannot be for the purpose of benefiting the trade. The FTT had to consider why the company purchased the shares, not why it paid £4.8m for them.

We are waiting for an update (possibly at the Autumn Budget) on the proposal for a new clearance process to

provide advance certainty in major projects. It is hoped that the framework for such clearances will build in some taxpayer protection to be able to rely on them and to resolve any disputes over whether relevant facts and assumptions have materially changed.

UK Finance report

The latest report commissioned by UK Finance estimates the total tax contribution of the UK banking sector for 2024/2025 to be £43.3bn and shows that London's total tax rate is much higher than other major finance centres and is projected to rise further. The report shows that the total tax rate (TTR) for a model bank in London is 46.4% in 2025 but rising to 46.6% in 2026 to reflect the full year impact of the change to employer's NICs. Other financial centres in the study have significantly lower TTRs: Amsterdam (42.2%), Frankfurt (38.9%), Dublin (28.9%), and New York (27.9%).

In addition to the TTR comparison for model banks, this year's report also looks at how the UK's bank taxation regime compares with other global peers. Of ten countries examined, only the UK, Canada and Italy apply a higher rate of income tax to banking profits. Although nine out of the ten countries examined operate a form of bank levy based on the bank's balance sheet, the UK's bank levy rates are among the highest. Whereas in the UK the bank surcharge and bank levy are permanent features, in many other jurisdictions such taxes are temporary or subject to annual review.

The report highlights areas where the UK is falling behind its competitors such as imposing bank-specific taxes, having uncapped employer national insurance contributions and an out-dated VAT framework which creates uncertainty and additional costs for banks. In order to meet its competitiveness and economic growth objectives, the government would be wise to think carefully about how to increase the UK's global competitiveness to continue to enjoy the significant tax contribution of the UK banking sector.

What to look out for:

- On 25 November, the Court of Appeal is scheduled to hear the appeal in the *Tower One St George Wharf* case on the purpose test in the SDLT group relief rules.
- The Autumn Budget on 26 November will finally bring an end to all the Budget speculation and (hopefully) will inform us how and when some of the measures already consulted on will be taken forward!
- On 10 December, the Court of Appeal is scheduled to hear the appeal in *Burlington* on the application of the purpose test in the UK/Ireland tax treaty.
- On 15 December, the Upper Tribunal is scheduled to hear HMRC's appeal in *Brindleyplace* on the purpose test in the SDLT rules.

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