SLAUGHTER AND MAY

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Client briefing

In *Take 3.9*, the FTT determines that, on a purposive construction, only the expenditure actually incurred on the production of films qualified as 'expenditure incurred', and that the presence of a fiscally motivated element in the arrangements did not de-nature what was otherwise a genuine trading activity. The Chancellor announces that the foreign PE exemption will become mandatory from 1 January 2027 (1 September 2026 for oil and gas), preventing foreign PE losses from sheltering UK profits. HMRC are launching two advance certainty services: one for binding clearances on how the UK tax rules will apply to certain major investment projects; and the other a targeted assurance pilot for SMEs seeking confirmation on up to two specific areas of complexity or risk within an R&D claim.

Take 3.9: 'expenditure' means expenditure which was actually incurred

The First-tier Tribunal (FTT) in *Take 3.9 TV Partnership and Others v HMRC* [2026] UKFTT 696 (TC) had the challenging task of reconstructing events from 25 years ago in relation to the activities of the five appellants, each of which were general partnerships. This was compounded by numerous changes in HMRC personnel over that period, missing or destroyed documents, lack of legal representation for the appellants and the death or incapacitation of important witnesses. Indeed, HMRC ultimately decided not to defend one set of closure notices because of insufficiency of documentary evidence.

Despite these difficulties, the FTT pieced together the complex arrangements and determined that, for each of the transactions still in dispute, each of the appellants was carrying on a trade in the relevant tax year and that expenditure that was actually incurred on the production of films was incurred wholly and exclusively for the purposes of that trade. But crucially for the appellants, not all the expenditure was found to be 'actually incurred'.

As with previous film tax relief disputes, the arrangements were designed to maximise the relief that could be claimed without the appellants economically bearing the cost of all the corresponding expenditure. The appellants made a payment (the T3 Advance) which comprised an equity component of around £1.2m and a debt component of around £4.4m. Only the equity component was held to be a contribution to the cost of producing a film and went on to satisfy the conditions for the relief. The debt component was found to be interim gap-funding by means of a highly secured loan from the appellants to the film production company. It was effectively a perfectly circular money flow, no more than a device to increase the tax relief, and a fiscally motivated activity without risk or reward for the appellants.

There is a lot going on in this case and the final decision turns on the specific facts but we will focus on three aspects where the general principles may be relevant to other factual situations.

Expenditure incurred

The FTT determined that the reference in the legislation to 'expenditure incurred' on the production of films means, when purposively construed, expenditure which is actually incurred (irrespective of how it is recorded in the accounts). Then applying

Ensign Tankers [1992] 1 AC 655, the FTT viewed the transactions realistically and by reference to their true legal effect and concluded that the debt component was in substance a loan from the appellants. Only the equity component could be regarded as 'expenditure incurred' on the production of films. The FTT then turned to the question whether that expenditure qualified for relief, which required that each appellant carried on a trade and that the equity component was expenditure incurred wholly and exclusively for the purposes of that trade.

Trading test

The FTT provided a summary of the principles from the case-law on what amounts to a trade, including the tests known as the 'badges of trade'. The FTT noted that the badges of trade are at most common sense guidance about whether an activity amounts to a trade but are not a fully comprehensive list and are not always helpful. What is required is for the tribunal to stand back to look at the whole picture. Applying an unblinkered approach to the analysis of the facts and a realistic approach to the transaction, the FTT gave consideration to the package of agreements as a whole.

The FTT observed that there were two quite distinct activities of the appellants: (i) using the equity contribution as funding for the production of films with a view to receiving a commercial return on the equity; and (ii) borrowing money from Barclays and lending it to the film production company under arrangements that effectively eliminated any risk to the appellants in relation to the debt component, which was solely intended to enhance the tax relief claimed. The first activity, on its own, would amount to a trade but the FTT had to consider whether the presence of the second activity 'de-natured' the trading purpose. Applying *Ensign Tankers*, the FTT concluded that the activities as a whole were trading activities 'despite the paramount fiscal motive underlying them' as reflected in the debt component activity.

Wholly and exclusively for the purposes of the trade

For completeness, the FTT found that the sole purpose of the debt component was to generate tax relief so that amount could not satisfy the wholly and exclusively test (even if the FTT were wrong on the expenditure incurred point). The equity component, on the other hand, was a genuine contribution by each appellant to the making of the relevant film for the sole purpose of deriving a profit from the film and was wholly and exclusively for the purposes of the trade.

The FTT noted that film tax relief was intended to incentivise investment in the British film industry. But the fact that a person might be motivated by this tax incentive in incurring his expenditure does not mean that in addition to his trading purpose he must also have had the purpose of obtaining tax relief. The FTT warns about mistaking motive for purpose. Although the partners in the appellant partnerships, and each appellant, were motivated by the availability of the tax relief to contribute the equity component towards the production of the film, the relevant appellant's purpose in incurring that expenditure was to create a film that might generate a profit for the appellant.

The general rule is that for relief to be available for an expense, the whole of the relevant expense needs to be wholly and exclusively for the purposes of the trade. There is, however, an apportionment rule which applies (now codified in ITTOIA s 34(2)) where an expense has a dual purpose and it is possible to identify a specific part of the expense that is wholly and exclusively for the purposes of the trade. There was some discussion about whether the T3 Advance was one expense or two but the FTT concluded that if there were one expense, the equity component was separately identifiable from the debt component and made wholly and exclusively for the purposes of the trade.

The principles applied in this case, particularly the trading test and the wholly and exclusively requirement, will also be relevant where a taxpayer carries on an activity which, on a standalone basis, amounts to trading, but something else is added into

the structure intended to increase the tax advantages attaching to that activity.

Foreign PE exemption changes

Since 2011 the UK has had an elective exemption for profits of a foreign PE of a UK company. The exemption was introduced to align the treatment of foreign branches (as PEs were then called) with foreign subsidiaries following the introduction of the dividend exemption in 2009. An election once made is irrevocable and means the profits of the PE will not be subject to UK corporation tax. The downside of making the election is that the PE's losses cannot be used to offset the UK profits of the company for corporation tax purposes.

Where an election is not made, however, the foreign losses of the PE are currently available to relieve profits of the UK company or for group relief. It seems that too many UK companies are benefiting from the foreign losses being relieved against UK profits and the UK Exchequer is concerned that this impact is not being balanced by equivalent foreign profits being brought into the UK corporation tax charge. In some cases, even where the PE is nominally within the UK tax net, little or no additional UK tax is collected on the foreign profits because of double taxation relief. Another reason for the lack of UK CT on foreign PE profits is that when a PE becomes profitable, a multinational group may subsidiarise it, removing those profits from the UK CT charge without the transfer of the PE business generally giving rise to a taxable gain. The UK Exchequer is unhappy with this asymmetry.

On 21 May the Chancellor announced that the elective regime will become a mandatory exemption and a policy paper was published with more details. The foreign profits and losses of a PE will, for most companies, be exempt from UK tax for accounting periods beginning on or after 1 January 2027. The change comes in from 1 September 2026, however, for 'UK-resident companies that conduct activities in relation to oil and gas extraction and exploration through foreign PEs'. (The policy paper also refers later on to 'exploration and exploitation' so hopefully the draft legislation to be published over the summer will clear up any confusion as to exactly which oil and gas activities are intended to be caught by the earlier effective date!) To achieve this early change, the accounting periods of such companies will be deemed to end on 31 August 2026, with the new regime applying from the following day. The reason given for bringing the change in early for the oil and gas sector is that groups in this sector are able to claim very large amounts of capital allowances in relation to their foreign PEs, and so their PE structures 'can substantially reduce the UK CT liability of multinational groups, even where unusual market conditions result in unusual or elevated UK profits'. The Chancellor stated in the House of Commons that the reforms are expected to 'raise hundreds of millions of pounds a year'.

The existing legislation taxing profits of an exempted foreign PE where there is a 'total opening negative amount' will also be repealed. This mechanism currently requires companies that elect for exemption to bring post-election profits into charge until cumulative pre-election PE losses have been matched. This is a welcome simplification.

After the effective date, losses arising prior to exemption will no longer be available to relieve UK profits of the company or the wider group. An anti-avoidance rule will be included in the legislation to prevent artificial acceleration of the utilisation of such losses and to prevent other arrangements seeking to minimise the impact of these changes. We have to wait for the draft legislation to see the detail of the anti-avoidance rule.

Providing more certainty

HMRC are launching two services intended to provide certainty to taxpayers eligible to apply and facilitate new investment in the UK. The first is the advance tax certainty service which will launch on 1 July 2026 (with expressions of interest accepted from 1 June 2026). This service will provide a very small number of businesses with a binding clearance on how some of the tax rules will apply to a major investment project from before the final investment decision is taken up to when the relevant tax return is made. The service applies only to a new project with at least £1 billion of qualifying expenditure (which excludes financing

costs and amounts invested in equity) in the UK over its lifetime.

There are a number of subject matters on which clearances will not be offered, including transfer pricing and the application of main purpose tests which are arguably two of the biggest areas of uncertainty when investing in a major project. At the moment, then, the advance tax certainty service will be of benefit to a small number of businesses who meet the threshold and have the right sort of uncertainty. We will have to wait for the 12-month review of the service to see if the threshold will be lowered and any other changes made.

The second is the targeted assurance service for R&D tax claims by eligible small or medium sized enterprises which is being run alongside the (little used) existing full-claim advance assurance service. Under the pilot which runs until May 2027, companies may seek HMRC's advance confirmation on up to two specific areas of complexity or risk within an R&D claim, including whether a project meets the statutory definition of R&D, whether overseas expenditure qualifies for relief, whether R&D relief may be claimed where work is contracted from one company to another, and whether the exemption from the PAYE and NICs cap applies. Once assurance is given the enterprise still needs to make a claim in the usual way. The pilot is expected to help HMRC gauge demand and identify which elements of the service prove most useful to businesses, while affording claimants greater certainty in areas where questions and misunderstandings have historically been most prevalent.

These are two measures for HMRC to provide advance certainty to taxpayers at opposite ends of the size spectrum. But we can't help wondering if the resources might be better spent on simplification which would be a more effective way of reducing uncertainty for a greater number of taxpayers!

What to look out for:

- The call for evidence on implementing a UK corporate redomiciliation regime closes on 19 June 2026.
- The first Pillar 2 GIR filings are due on 30 June 2026. The OECD has published guidance addressing practical compliance challenges for calendar year groups and a revised consolidated commentary on the OECD Model Rules is now available.
- The Advance Tax Certainty service for investment in major projects launches on 1 July 2026 (for the lucky few taxpayers who meet the criteria).
- The rate of the Electricity Generator Levy will increase from 45% to 55% from 1 July 2026.

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