

UK TAX DISPUTE RISKS

CLIENT BRIEFING

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Unexpected tax liabilities are a key business risk. For governments facing challenging fiscal environments, a tougher approach to tax compliance and enforcement can be a critical revenue raiser. The UK is no exception.

This briefing outlines current areas of focus for HMRC investigations and some practical tips. It aims to help you identify potential issues in your organisation early, and to then confidently work with your tax function to manage risk effectively.

High-risk areas of HMRC focus

Intra-group transactions

We are seeing a steady stream of HMRC enquiries into the pricing of cross-border intra-group transactions to ensure the “right level” of profit for the group’s business is taxed in the UK. This is especially true if group IP is involved, or if there are supply chain reorganisations. This can be a subjective and highly fact-dependent area, leading to lengthy and complex disputes.

HMRC tend to take a two-pronged approach, seeking to either increase the amount of UK corporation tax or to levy a higher-rate parallel charge (currently diverted profits tax) in relation to those profits that “should” have been taxed in the UK. Dealing with the interaction between the two regimes can be difficult and costly. Some taxpayers end up pursuing multiple strands of litigation in respect of the same underlying facts.

Major debt financing or group debt restructurings

HMRC may also argue that an otherwise arm’s length amount of interest is non-deductible because the purpose of the loan itself was tax-driven. Increased UK interest deductions from debt used to acquire foreign assets, or following a reorganisation initiated or led by the tax function, can be particularly vulnerable to challenge.

VAT grouping

Generally, no VAT applies to supplies between UK VAT group members. HMRC are, however, focussed on the limits of this rule, which may not apply if intra-VAT-

group supplies were originally ‘bought into’ the UK from overseas, or if payments for supplies are made after relevant entities have left the VAT group. Groups which undertake exempt or partially exempt businesses for VAT purposes should be especially careful here.

Remuneration in partnerships and LLPs

A lot has been written, including in the national press, about the private equity industry and changes to the tax treatment of carried interest. But HMRC’s focus in this area is wider. This includes challenges to the tax treatment of deferred remuneration structures.

Remuneration structures

HMRC have litigated several cases on deferred remuneration structures within LLPs. The structures generally work by allocating a profit share to a corporate partner (that pays corporation tax on those profits) before reinvesting them in the LLP. When relevant performance targets are met, those reinvested profits are transferred to individual members. This was intended to be tax-free. HMRC have relied on novel arguments and previously little-used rules to impose income tax on the individual members. One case, *HFFX*, was heard by the Supreme Court in June 2025. Judgment is awaited.

Salaried members rules

Another way for HMRC to impose additional tax on LLPs is the “salaried members rules”. If three conditions are met, members of an LLP are taxed as if they are employees (meaning significantly higher national insurance contributions). The rules have been the subject of controversy, with changes in HMRC guidance being made without warning (and largely changed back in response to industry concern). One case, *Bluecrest*, is heading towards the Supreme Court.

Press speculation has also suggested that, in the forthcoming Budget, this additional tax could essentially be extended to apply to all LLP members, not just members who are de facto employees.

Uncertain tax positions

The UK government is focussed on raising revenues by reducing the “tax gap”. This is the difference between the tax HMRC thinks it should collect and the amount that it actually collects. One element of the “tax gap” is

the “legal interpretation gap”, where a taxpayer and HMRC have different views of the law (without avoidance or aggressive planning necessarily being in play).

Disclosure requirements and expectations

HMRC are looking for more ways to identify and prevent situations where there is a “legal interpretation gap”. One seemingly innocuous change to HMRC guidance may have a big impact in this area.

Where the tax at stake exceeds a certain threshold, large businesses already must notify HMRC if they adopt a position contrary to HMRC’s “known” position. This is not new. However, it is not uncommon for tax law to be unclear, with HMRC not having a “known” position. In this case taxpayers could file returns taking a position which they considered to have a fair prospect of success (which could be below 50%). New HMRC guidelines say that taxpayers must adopt a position that they “believe is, on balance, most likely correct”. This encourages taxpayers to make additional disclosures - which might prompt enquiries.

Recent cases

HMRC will not hesitate to take cases to court to clarify the law. Recent high-profile examples cover:

- VAT recovery on deal fees where a subsidiary is sold to fund business expansion (*Hotel La Tour*, heard by the Supreme Court in June 2025)
- Deductibility of payments in lieu of penalties under a regulatory settlement (*ScottishPower*, to be heard by the Supreme Court in 2026)
- Capital allowances for costs of planning and designing major projects (*Gunfleet Sands*, to be heard by the Supreme Court in 2026)

Practical considerations

Most larger businesses’ affairs are necessarily complex, and the UK’s tax code is (many say) the longest in the world. So, it is likely that, from time to time, mistakes will happen or disagreements with HMRC will arise.

Minimising risks

Do ensure a regular exchange between you and your tax function. Be aware of when the group is undertaking projects that are likely to be in HMRC’s focus. Examples

noted earlier include changes to IP holding structures, supply chain reorganisations and debt-funded acquisitions (especially of non-UK assets).

Internal tax teams should be involved early in key projects, although having the tax team in the driving seat could increase the risk of challenge: avoid the temptation to let the tax tail wag the commercial dog.

Managing enquiries, disputes and litigation

In the case of an HMRC enquiry, early engagement of professional advisers can reduce costs in the long run.

Again, ensure a regular exchange between you and your tax function to ensure a clear and joined-up strategy, covering the technical position, the decision to settle or litigate, and decisions relating to the review and disclosure of relevant evidence and documents to HMRC.

This is important to help flag unexpected ramifications elsewhere. Whilst your UK tax team may be happy to share some privileged legal advice with HMRC during the enquiry (because it is helpful), could this run contrary to the approach to privilege you are taking in other non-tax commercial disputes relating to the same assets or transactions? It is also important in order to ensure that considerations regarding PR and disclosure requirements are well understood and managed.

Whilst settlement is often the preferred outcome, litigation is sometimes necessary. Our [recent blog post series](#) covers various practical points from the start of an HMRC enquiry up to litigation.

How we can support you

We can support you from managing risk to managing any tax dispute, from high-level strategic advice to running large disclosure exercises and litigation. We have extensive experience in advising at every stage of a wide range of disputes from questions of UK corporation tax, partnership taxation and VAT to international issues.

When asked why we are their firm of choice, clients cite our “technical expertise, practical, commercial advice, and high degree of competence in dealing with disputes with authorities” (Chambers UK, 2026).

On the horizon

- The pressures on public finances likely mean not only further tax rises at the Autumn Budget, but also increasingly aggressive compliance activity targeted in high-risk and high-value areas - including large businesses and the wealthy.
- With decreasing the “interpretation gap” as an area of focus, we can expect more “soft law” in the form of HMRC guidance (or “guidelines for compliance”) that will have to be considered in addition to the legislation.
- The government appears set to grant ever more far-reaching powers to HMRC to address a small number of rogue advisers marketing avoidance schemes with low chances of success. Legitimate advisers, in-house tax teams and businesses supplying goods or services to a scheme promoter may end up caught in the crosshairs.

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