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# UK Supreme Court's Ruling In The NCL Investments Ltd Case

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Recently, the United Kingdom Supreme Court in *NCL Investments Ltd v Revenue and Customs Commissioners* [2022] 1 WLR 1829 dealt with the issue of whether accounting debits (Debits) relating to the grant of share options (Options) to employees were a deductible expense under the Corporation Tax Act 2009 (CTA) in the United Kingdom.

#### **Brief Facts**

The taxpayer companies (Companies) employed staff whom were seconded to other companies within the corporate group for a fee. Under the terms of an employee benefit trust (EBT) established by the holding company, Options were granted to the staff. When such Options were granted, the International Financial Reporting Standard 2 required the Companies to recognise an expense in their income statements equal to the fair value of the Options and recognise a capital contribution received from the holding company as a credit on their balance sheets.

The Companies claimed the Debits as deductions in the computation of the profits of their trade for the purposes of corporation tax. However, the Revenue disallowed the deductions.

### The Ruling

The main issues that arose were:

- (a) Whether disregarding the Debits was an adjustment required or authorised by law within the meaning of Section 46(1) of the CTA.
- (b) Whether the deductions were disallowed by Section 54(1)(a) of the CTA.











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- (c) Whether the deductions were disallowed by Section 53 of the CTA, which provides that no deduction was allowed for items of a capital nature.
- (d) Whether the deductions were disallowed by Section 1290 of the CTA.

#### Issue 1

Section 46(1) of the CTA states that the profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for corporation tax purposes.

The court held that the above provision gives statutory primacy to generally accepted accounting principles. Since tax is a creature of statute, any adjustments required or authorised to be made are likely to be specified by statute. While it is possible for a judge-made rule to require or authorise such an adjustment to be made, it has to be a rule that applies notwithstanding that the profits have been calculated in accordance with generally accepted accounting practice.

The court also held that there was no authority to the effect that if profits in a company's profit and loss account were depressed because of an entry which matched an entry in the balance sheet, then that was to be left out of account when computing the company's profits for corporation tax purposes. In other words, there was no requirement to disregard the Debits, whether or not an amount has actually been paid.

#### Issue 2

Section 54(1)(a) of the CTA provides that in calculating the profits of a trade, no deduction was allowed for expenses not incurred wholly and exclusively for the purposes of the trade. The court found that pursuant to Section 48 of the CTA, if an expense was brought into account as a debit in accordance with generally accepted accounting practice, it would be an expense for the purpose of the calculation of trading profits, whether or not an amount had actually been paid.

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The court also agreed with the Companies that the incurring of the Debits has a direct link with the earning of revenue profits. This is because the Debits were required to reflect the consumption by the Companies of the services provided by the employees, who were in part remunerated by the grant of the Options. The Companies consumed those services wholly and exclusively for the purposes of their trades, being the provision of their employees' services to other group companies at a profit.

#### Issue 3

Section 53 of the CTA provides that in calculating the profits of a trade, no deduction was allowed for items of a capital nature.

The court held that the Debits were not capital in nature as they had arisen because the Companies' employees were remunerated with Options and the remuneration of employees has a revenue nature. Further, the Debits were recurring costs that had a connection with the Companies' earning of income and they reflected the consumption of employees' services by the Companies.

In addition, the court held that the fact that the matching credit entry was a capital contribution does not change the Debits from being revenue in nature, as what matters is the character of the Debits, not that of any corresponding credit.

#### Issue 4

Section 1290(1) of the CTA states that the section applies if, in calculating for corporation tax purposes the profits of a company of a period of account, a deduction would otherwise be allowable for the period in respect of employee benefit contributions made or to be made.

If a deduction falls within the above provision, then Section 1290(2)(a) of the CTA provides that a deduction will only be allowed if qualifying benefits were paid out of contributions during the accounting period or within nine months of the end of that period.

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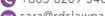
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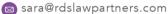
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The court found that the grant of the Options did not fall within the definition of employee benefit contributions for this purpose, as once the Options were granted by the Companies to the employees, the Options were not held by the employees

In accordance with Section 1291 of the CTA, the grant of the

Options to the employees constituted employee benefit

contributions if it results in property being held or used under

under the employee benefit scheme. Further, even if one considers the shares as the contribution, the causal link between the grant of the Options by the Companies and the acquisition from time to time of shares by the EBT trustee was not sufficient to bring this arrangement within the scope of the

Conclusion

provisions.

an employee benefit scheme.

For the above reasons, the court found in favour of the Companies and decided that the Debits relating to the grant of the Options to employees are a deductible expense for corporation tax purposes.

This case also considers the relationship between the principles of tax law and the current accounting standards. It is observed that the court gave primacy to generally accepted accounting principles by adopting the position in Odeon Associated Theatres Ltd v Jones [1971] 1 WLR 442 and the string of cases following it that the profit of a taxpayer's trade is to be determined in accordance with ordinary principles of commercial accountancy.

Similarly, our courts in Perak Construction Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2001] 8 CLJ 498 and Clear Water Sanctuary Golf Management Berhad v Ketua Pengarah Hasil Dalam Negeri (2014) MSTC 30-075 have held that the accounting evidence of the taxpayer is relevant and should be adopted where there is no conflict with our income tax legislation.

Authored by Kar Ngai Ng, an Associate with the firm's Tax, SST and Customs practice.

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