29/1/2013 H:/ORDERS/knw/knwtijd/HI/HI1301 - 13-6691-01/Tnp90c_HENI1301_proef3_01.3d pag. 90

4.2 The Commission could furthermore consider that the undertaking of these functions would form part of the mandate of an EU Taxation Observatory, whose formation under the auspices of the Commission has been suggested in EESC opinions dealing with multiple and discriminatory taxation[1]. The Observatory would contribute to the more effective resolution of inheritance tax obstacles on an ongoing basis through research and investigations and provide fora for consultation, collaboration and agreement between different national tax jurisdictions.

Brussels, 18 September 2012

The President of the European Economic and Social Committee

Staffan NILSSONEN C 351/44 Official Journal of the European Union 15.11.2012

12 Closing the European Tax Gap. Report for Group of the Progressive Alliance of Socialists and Democrats in the European Parliament. Tax Research UK

Closing the European Tax Gap. A report for the Group of the Progressive Alliance of Socialists & Democrats in the European Parliament by Richard Murphy FCA.

This report has three objectives. It:

1. explains the ways in which tax evasion occurs within and between EU Member States;

2. estimates the total losses to EU Member State Treasuries arising from that evasion and tax avoidance;

3. identifies policy options, from the modest to the radical, for intensifying EU and Member State action against such abuse.

European Parliament 06 December 2012, no. 3842_120229

Closing the European Tax Gap

A report for

Group of the Progressive Alliance of Socialists & Democrats

in the European Parliament

by Richard Murphy FCA

Director, Tax Research UK

DIRECT TAXATION, CASE LAW

13 Felixstowe Dock and Railway Company and Others; UK Group Relief system: Non Discrimination in tax treaties and EU Law. First-Tier Tribunal (comments by da Silva)

Hutchison is a worldwide group of companies headed by Hutchison Whampoa Limited, a Hong Kong resident company. Some of the UK subsidiaries of the group (the 'Claimants') claimed group relief in respect of losses made by one member of the group, Hutchison 3G UK Limited (the 'Surrendering company'). At the time the Surrendering company was owned by a consortium of companies through the intermediate holding company, Hutchison 3G UK Investment Sarl, a company resident in Luxembourg. Under the applicable UK domestic law, a consortium relief is available between two companies where one of the companies is a member of a group of companies and the other is owned by a consortium and another company (the 'link company') is a member of both the group and the consortium. According to Section 406(2) of the Income and Corporation Taxes Act 1988, the grant of relief to the group member is conditional on the link company itself being able to claim consortium relief. For that purpose, pursuant to Section 402(3) of the Income and Corporation Taxes Act 1988, the link

1 See footnote 1.

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HEN1301_proef3_01.3d pag. 91

company can only claim the relief if it is a UK tax resident or it carries on a trade in the UK through a permanent establishment. Since this requirement was not met in the case of Hutchison 3G UK Investment Sarl, the surrender of the losses by the surrendering company was rejected by the HMRC. The claimants argued that such requirement was inconsistent both with the freedom of establishment set forth in Article 49 of the TFEU and with the non-discrimination provision of Article 26 (4) of the Double Tax Treaty concluded between the UK and Luxembourg. The UK First Tier Tribunal ('FTT') confirmed that there was indeed a discriminatory treatment pursuant to the capital ownership provision of paragraph 4 of the Double Tax Treaty. As regards the EU law aspect of the case, the FTT decided to refer questions for a preliminary ruling to the Court of Justice, which is now pending as case C-80/12, Felixstowe Dock and Railway Company and Others.

First-Tier Tribunal 26 May 2011, no. TC01674 and TC/2010/4962

DECISION

1. We are asked to determine certain questions on a joint referral pursuant to paragraph 31A of Schedule 18 to the Finance Act 1998 in the course of enquiries into the tax returns of certain companies in the Hutchison Whampoa group.

2. The Hutchison Whampoa group is a worldwide group of companies headed by Hutchison Whampoa Limited, a company resident for tax purposes in Hong Kong. The referral arises out of claims for group relief by the relevant Hutchison Whampoa companies ('the Applicants') in respect of losses made by one member of the group, Hutchison 3G UK Limited ('the Surrendering Company').

3. At the relevant time the Surrendering Company was owned by a consortium of companies through an intermediate holding company. Relief has been claimed pursuant to the provisions of s 406 of the Income and Corporation Taxes Act 1988 ('ICTA'). In order for such relief to be available there must exist a 'link company' which is both a member of the consortium and a member of a group of companies. In the present case the Applicants say that Hutchison 3G UK Investments Sarl ('Investments'), a company resident in Luxembourg, was such a company on the basis that it was a member of the consortium owning, through an intermediate UK resident holding company (Hutchison 3G UK Holdings Limited), the Surrendering Company, and was in addition a member of a group of companies which included the Applicants.

4. It is a requirement of s 406(2) ICTA that the obtaining of relief by a group member is dependent on the link company itself being able to make a consortium relief claim. In the present case it was not possible for Investments to make such a claim on the face of the relevant legislation. Entitlement of a company to group relief is given by s 402(3) ICTA. Subsection (3A) provides that such relief is not available unless the claimant company satisfies the condition in subsection (3B), namely 'that the company is resident in the United Kingdom or is a nonresident company carrying on a trade in the United Kingdom through a permanent establishment.'

5. It is common ground that this condition is not satisfied in respect of Investments. The Applicants say that such a requirement is ineffective as regards the Applicants in that:
(a) it is a requirement that is inconsistent with European Union law; and/or
(b) it is a requirement that cannot be applied as against the Applicants in order to give effect to Article 26(4) of the double taxation convention between the United Kingdom and Luxembourg ('the DTC')

6. In addition to these issues on the fundamental right to claim consortium relief in 40 these circumstances, a question also arises in the circumstances of this case on the application of the anti-avoidance provisions in s 410 ICTA. This arises as a result of certain share sale agreements entered into at the relevant time.

7. At the May 2011 hearing we heard oral argument from Mr Baker and Miss Shaw for the Applicants and from Mr Goy (assisted by Mr Facenna) for HMRC. Because the appeal of the decision of the First-tier Tribunal in FCE Bank plc v Revenue and Customs Commissioners [2010] SFTD 718 had only recently been heard in the Upper Tribunal (Tax and Chancery), and the decision had not been released, we adjourned for written submissions following the release of the Upper Tribunal decision. That decision (see [2011] UKUT 420 (TCC)) was released on 13 October 2011. We

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HEN11301_proef3_01.3d pag. 92

are grateful for the written submissions we have received in that respect, which we have considered in reaching our decision.

The referral questions

8. The questions referred to the Tribunal for determination are:
(1) In relation to the claims for group relief, does the requirement in section 406(2) ICTA for the link company to be resident in the United Kingdom or carrying on a trade in the United Kingdom through a permanent establishment infringe the EU law rights of any company in the Hutchison Whampoa Group and, if it does, can the Applicants rely on that infringement in support of their claims for group relief? ('the EU Law question')
(2) To what extent does Article 26 of the UK/Luxembourg double taxation convention (the non-discrimination article) impact upon the Applicants' claims for group relief? ('the DTC question')
(3) What is the impact, if any, of section 410 ICTA [on] the claims made for group relief in the periods up to 22 June 2005? ('the section 410 question')

The facts

9. There was no dispute on the facts. We reproduce below the statement of agreed facts produced by the parties:
1. The Applicants are all companies incorporated and resident in the United Kingdom and were members of the group comprising Hutchison Whampoa Ltd and its subsidiaries (the 'Hutchison Whampoa Group') during all, or part of, the period from 26 April 2002 to 23 June 2005 (the 'Total Period') (as specified in Appendices 2 & 3 to this Agreed Statement of Facts). They have made claims for consortium relief under sections 402 and 406 of the Income and Corporation Taxes Act 1988 (ICTA) in respect of the trading losses of Hutchison 3G UK Limited ('the Surrendering Company'), a company incorporated and resident in the United Kingdom. A list of the relevant Applicant claims appears at Appendix 1 to this Agreed Statement of Facts1
2. The Surrendering Company, a company incorporated and resident in the United Kingdom, commenced trading on 26 April 2002 and had an accounting period for all relevant years ending 31 December. The accounting periods of the Surrendering Company that fall within the Total Period are referred to here as the 'Relevant Accounting Periods'. On 23 June 2005 the consortium relationship ceased to exist and the Surrendering Company became a member of the same group as the Applicants.
3. The ultimate parent company of the Hutchison Whampoa Group is, and was throughout the Total Period, Hutchison Whampoa Limited ('HWL'), a company incorporated and resident in Hong Kong. The diagram at Appendix 2 2. illustrates the Group position of the Applicants and the Surrendering Company as at 7 November 2003 (the relevance of that date is explained below). The diagram at Appendix 3 3. of this Agreed Statement of Facts illustrates the Group position of the Applicants and the Surrendering Company as at 23 June 2005.
4. The Surrendering Company is, and was throughout the Total Period, a 100% subsidiary of Hutchison 3G UK Holdings Limited ('Holdings'), a company incorporated and resident in the United Kingdom. On 7 November 2003 Holdings was owned:
(i) as to 50.1% by Hutchison 3G UK Investments SARL ('Investments'), a company incorporated and resident in Luxembourg;
(ii) as to 14.9% by three indirect subsidiaries of HWL, Brave First Limited (as to 1.5%), Clear Choice Limited (as to 5%) and Bright Thought Limited (as to 8.4%), all three being companies, incorporated and resident in the British Virgin Islands;
(iii) as to 20%, by Brilliant Design Limited ('Brilliant Design') a company incorporated in the British Virgin Islands, whose indirect 100% shareholder was NTT DoCoMo, Inc. ('DoCoMo'), a company incorporated in Japan; and
(iv) as to 15%, by Waerdah Limited ('Waerdah') a company incorporated in the British Virgin Islands, whose 100% shareholder was KPN Mobile N.V. ('KPNM'), a company incorporated in the Netherlands.
5. Throughout the Total Period, Investments was 100% owned by Hutchison Europe Telecommunications SARL, a company incorporated and resident in Luxembourg, which was throughout the Total Period 100% owned by Hutchison Whampoa Europe Investments SARL, also incorporated and resident in Luxembourg, which was throughout the Total Period 98.98% owned by Auditorium

29/1/2013 H:/ORDERS/knw/knwtijd/HI/HI1301 - 13-6691-01/Tnp90c_HEN1301_proef3_01.3d pag. 93

Investments 1 SARL, a company incorporated and resident in Luxembourg. The balance of the shares in Hutchison Whampoa Europe Investments SARL were, throughout the Total Period, owned by Auditorium Investments 2 SARL (0.51%) and Auditorium Investments 3 SARL (0.51%), which two companies were incorporated and resident in Luxembourg.

6. Throughout the Total Period, Auditorium Investments 1 SARL, Auditorium Investments 2 SARL and Auditorium Investments 3 SARL were each 100% owned by New Millennium Corp, a company incorporated and resident in the Cayman Islands, which was 100% owned by Ommaney Limited, a company incorporated and resident in the British Virgin Islands, which was owned 100% by Hutchison Whampoa International (00/03) Limited, a company incorporated and resident in the British Virgin Islands, which was owned 100% by Hutchison Telecommunications Limited, a company incorporated and resident in Hong Kong, which was owned 100% by Hutchison International Limited, a company incorporated and resident in Hong Kong, which was owned 100% by HWL.

7. During each Relevant Accounting Period (or part thereof) in respect of which consortium claims have been made, the Applicants were not less than indirect 75% owned subsidiaries of HWL. During each Relevant Accounting Period, the Applicants were neither directly nor indirectly owned by Investments.

8. The principal activity of the Surrendering Company is owning network infrastructure and providing mobile telecoms services in the United Kingdom. In May 2000, the Surrendering Company acquired a UK 3G telecoms licence ('the Licence') and began incurring substantial expenditure in establishing a network, acquiring content and other services to be provided to customers, promotional work and agreeing contracts with suppliers and customers.

9. On 12 July 2000, HWL, KPNM, New Millennium Corp and Koninklijke KPN NV entered into an agreement under which KPNM agreed to subscribe for shares representing 15% of Holdings' issued share capital, and this transaction completed on 21 September 2000. Also on 12 July 2000, HWL, DoCoMo, and New Millennium Corp entered into an agreement under which DoCoMo purchased all of the shares in the issued share capital of Brilliant Design, and this transaction also completed on 21 September 2000.

10. On 7 November 2003 and on 27 May 2004, HWL entered into share purchase agreements (the 'SPAs') with KPNM and DoCoMo respectively under which (a) HWL agreed to purchase from KPNM all of the issued shares in Waerdah, and (b) HWL agreed to purchase from DoCoMo all of the issued shares in Brilliant Design.

11. On 23 June 2005, HWL exercised its rights under the SPAs by procuring that New Millennium Corp, an indirect 100% owned subsidiary of HWL, acquired from KPNM all of the issued shares of Waerdah and acquired from DoCoMo all of the issued shares of Brilliant Design. Since 23 June 2005, Holdings has been 100% owned by HWL indirectly and directly owned by Waerdah Ltd (as to 15%), Brilliant Design Ltd (as to 20%), Brave First Ltd (as to 1.5%), Clear Choice Ltd (as to 5%), Bright Thought Ltd (as to 8.4%) and Investments (as to 50.1%).

12. During the Total Period the Surrendering Company incurred substantial losses. For each of the Relevant Accounting Periods to which the claims for consortium relief relate all of the Applicants made trading profits of at least the amount of relief claimed by them.

13. Pursuant to an arrangement within the Hutchison Whampoa Group, the Surrendering Company was entitled to receive 30 pence for every £ 1 of losses surrendered. Appendix 4 details the quantum of the claims made, the amounts invoiced and amounts paid to date4.

The EU law question

10. Having heard argument on the EU law question, we decided that we could not with complete confidence reach a conclusion on that question without a reference to the Court of Justice of the European Union ('CJEU'). Accordingly, we invited the parties to submit a draft form of reference for us to settle. We have made directions, incorporating the form of the reference to the CJEU, and have released those directions to the parties at the same time as this decision.

The DTC question

11. Investments is a company resident in Luxembourg for the purposes of the UK/Luxembourg double tax convention of 24 May 1967 ('the DTC').

12. Article 26 of the DTC is a non-discrimination provision. Article 26(4) provides as follows:

'(4) Enterprises of a Contracting State, the capital of which is wholly or partly owned or con-

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tnp90c_HEN1301_proef3_01.3d pag. 94

trolled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of that first-mentioned State are or may be subjected.'

13. The Surrendering Company is an enterprise of the UK, and its capital is partly owned indirectly by Investments. That much is not in dispute. But Mr Baker submitted that the link company residence requirements in s 406(2), (3A) and (3B) contravened Article 26(4) in two particular respects:

(1) First, that by reason of its inability to surrender its losses to the Applicants the Surrendering Company was subjected to taxation or a requirement connected therewith that is other or more burdensome that the requirements attaching to similar enterprises of the UK.

(2) Secondly, that the inability to surrender losses arises solely on the ground that the Surrendering Company is indirectly owned by a Luxembourg (and not a UK) company.

14. Mr Baker submitted that the effect of Article 26(4), taken with s 788(3) ICTA, is that the Applicants can obtain relief from corporation tax by means of the group relief claims notwithstanding the link company residence requirement.

15. Mr Goy, on the other hand, argued that the Applicants' claims could not be made out, for three reasons:

(1) The inability of the Surrendering Company to surrender losses is not 'any taxation or any requirement connected therewith' to which that company is subject.

(2) Relief is not precluded solely because Investments is resident outside the UK.

(3) Section 788 ICTA does not have the effect of enabling the Applicants to obtain relief for losses surrendered by the Surrendering Company, which is the company entitled to the benefit of the DTC.

Taxation or any requirement connected therewith

16. In any group relief claim there are two elements: the surrender of a tax loss by the surrendering company and the claim for relief from tax by use of the surrendered loss by the claimant company. In the latter case it is easy to conclude that, if the claim for relief is denied to a company in foreign ownership in circumstances where it would have been available to reduce the claimant company's liability to tax if the claimant company had been owned by a UK resident, the claimant company would have suffered more burdensome taxation. That was the accepted position in FCE Bank plc v Revenue and Customs Commissioners [2010] SFTD 718 before the First-tier Tribunal and in the Upper Tribunal [2011] UKUT 420 (TCC). We shall discuss FCE Bank in more detail later, but we do not agree with the written submission of Mr Baker and Miss Shaw that the Upper Tribunal decision in FCE Bank can in any way be authority that the inability to surrender losses is 'taxation' which is 'other or more burdensome'. The point was not argued in FCE Bank, but was merely accepted in the context of group relief, where the company alleging discrimination on the ground that it was owned by a non-UK resident company was the claimant company. The position is less straightforward in the case of the Surrendering Company, which does not itself make a claim to relieve its own taxation.

17. There is no dispute on the appropriate comparison that needs to be made in construing Article 26(4). Noting that the First-tier Tribunal in FCE Bank left the position open regarding discrimination on account of third state-ownership (p 729, fn 5), in this case the relevant comparison is between the case where the capital of the Surrendering Company, as here, is partly owned or controlled, indirectly, by a Luxembourg-resident company (Investments) that is a link company within s 406(1) ICTA, and the same structure where the link company is a UK-resident company.

Applying this comparison, there is clearly a difference of treatment; in the latter case the Surrendering Company would have been able to surrender its losses, whereas in the former it would not. The question is whether this is a difference in treatment which has the result that the Surrendering Company in the former case has been subjected to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which the Surrendering Company in the latter case would be subjected.

18. This then is a matter of treaty interpretation. We were referred to the helpful summary of the approach to treaty interpretation by the special commissioners in Re the Trevor Smallwood Trust, Smallwood v Revenue and Customs Commissioners [2008] STC (SCD) 629 (at [94], [95] and [98] –

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tnp90c_HEN1301_proef3_01.3d pag. 95

[99]), which was repeated by the First-tier Tribunal in FCE Bank (at [3]). We need not set that out in full. We must look for a clear meaning of the words used, having regard to the purpose of the particular article or of the treaty as a whole. The interpretation of an international treaty should take account of the general principle of international law, embodied in article 31(1) of the Vienna Convention on the Law of Treaties, 23 May 1969, 1155 UNTS 33 that 'a treaty should be interpreted in good faith and in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object or purpose.'

19. The DTC is based on the OECD (Organisation for Economic Co-operation and Development) model tax convention of 1963. As the special commissioners described the position in Smallwood (in that case in relation to the corresponding OECD model of 1977), the model has a commentary explaining its terms and this is accordingly an important means of interpretation of the model and of the treaties that follow it. If particular treaty wording to which meaning has been attached by the commentary is used by the treaty negotiators or drafters, it may be readily assumed that those words should bear such a meaning even if, on their ordinary meaning, they arguably might not do so.

20. In the commentary on the non-discrimination article (Article 24) of the 1963 model treaty, the OECD refer to the phrase '... shall not be subjected ... to any taxation or any requirement connected therewith which is other or more burdensome'.

Although this is in the context, not of Article 24(5) (which is the equivalent provision in the 1963 model to that with which we are concerned in Article 26(4) of the DTC), but of Article 24(1), which provides that nationals of a contracting state may not be less favourably treated in the other contracting state than nationals of the latter state in the same circumstances, the relevant wording is identical. The commentary states (at para 9) that those words:

'mean that when a tax is imposed on nationals and foreigners in the same circumstances, it must be in the same form for both, its basis of charge and method of assessment must be the same, and, finally, the formalities connected with the taxation (returns, payment, prescribed times, etc.) must not be more onerous for foreigners than for nationals.'

21. In relation to Article 24(5), the commentary makes the point that the provision relates only to the taxation of enterprises, and not of the persons owning or controlling the capital. But in that context it states that Article 24(5):

'forbids a State to give different treatment to two enterprises residing in its territory, the capital of one of which is wholly or partly owned or controlle[d], directly or indirectly, by one or more residents of the other Contracting State.'

22. We were referred also to the 2010 version of the OECD commentary, which contains an expanded commentary on Article 24(5) of the model treaty. This is relevant as it represents the current views of the member states of the OECD, although, as the First-tier Tribunal in FCE Bank pointed out (at [30]), some caution must be exercised in relying on commentaries added later than the treaty because it cannot be said that the parties made the treaty in reliance on them. Our attention was drawn to paras 76 and 77 of the 2010 version in particular. Paragraph 76 repeats the principle that Article 24(5), and the discrimination which it puts an end to, relates only to the taxation of enterprises and not of the persons owning or controlling their capital. Its object is to ensure equal treatment for taxpayers residing in the same state, and not to subject foreign capital, in the hands of the partners or shareholders, to identical treatment to that applied to domestic capital. Paragraph 77 then continues:

'77. Since the paragraph relates only to the taxation of resident enterprises and not to that of the persons owning or controlling their capital, it follows that it cannot be interpreted to extend the benefits of rules that take account of the relationship between a resident enterprise and other resident enterprises (e.g. rules that allow consolidation, transfer of losses or tax-free transfer of property between companies under common ownership). For example, if the domestic tax law of one State allows a resident company to consolidate its income with that of a resident parent company, paragraph 5 cannot have the effect to force the State to allow such consolidation between a resident company and a non-resident parent company. This would require comparing the combined treatment of a resident enterprise and the non-resident that owns its capital with that of a resident enterprise of the same State and the resident that owns its capital, something that clearly goes beyond the taxation of the resident enterprise alone.'

23. We do not find this further commentary in para 77 to be of any assistance in determining the

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HEN11301_proef3_01.3d pag. 96

issue before us. The most it tells us is that questions of treaty nondiscrimination can fall to be considered in the context of domestic legislation concerning transactions within, or tax treatment of, groups of companies with an element of foreign ownership. Mr Goy did not seek to argue that para 77 had the effect of precluding non-discrimination from applying in the case of group relief generally. In any event, we would share the view expressed by the First-tier Tribunal in FCE Bank that para 77 does no more than say that grouping of losses etc might not be claimed where one group company is resident and the other non-resident, which is a very different case from that with which we are concerned, where both the Surrendering Company and the claimant companies are UK resident, and so the focus is clearly on the taxation of resident enterprises and not on that of the non-resident parent company.

24. Mr Baker submitted that the refusal to allow the Surrendering Company to surrender its trading losses to the Applicants constituted both 'taxation' that was other or more burdensome than in the case of the equivalent UK-owned surrendering company, and also 'any requirement connected therewith' that was similarly other or more burdensome. He referred to the need to interpret the treaty provision purposively; the purpose, ascertained from the OECD commentary, is to prevent differences in tax treatment based solely on foreign ownership. That purpose would not be achieved by taking a narrow view of the meaning of 'taxation' in this context.

On the ordinary meaning of the words in Article 26(4) of the DTC, the Surrendering Company is subjected to taxation other than or more burdensome than in the equivalent case. The Surrendering Company cannot, in contrast to its UK-owned counterpart, transfer its losses. It is restricted to carrying those losses forward, and may, or may not, be able to use them against its own trading profits.

25. Mr Baker accepted that the inability of the Surrendering Company to surrender its losses did not have the result that it would be liable to a greater amount of tax. Indeed, of course, its liability to tax for the accounting period of surrender would be the same, irrespective of any ability or inability to surrender, namely zero. Furthermore, if it were to be able to surrender its losses, it could, if it subsequently made profits, pay more tax, as it would not have the benefit of the carried forward losses at that time. However, the effect is that the Surrendering Company is deprived of the opportunity, available to its UK-owned equivalent, to use its losses at an earlier date. This, submitted Mr Baker, means that the Surrendering Company is subject to a treatment for tax purposes that is other than that which would apply if it were owned indirectly by a UK company. Furthermore, although he submitted that it was not a necessary ingredient of a claim under article 26(4), Mr Baker argued that the Surrendering Company is disadvantaged because it cannot receive compensation for the surrender of its losses.

26. Mr Goy submitted that the inability of the Surrendering Company to surrender losses is not taxation, nor is it another requirement connected therewith. The 'other requirement' must be connected with taxation to which the company in question is subject. The relief in this case is not taxation to which the Surrendering Company is subject and hence the requirement complained of cannot be a requirement connected with such taxation. Mr Goy argued that the question is not whether the Surrendering Company is subject to different treatment but whether it is subjected to different taxation, or other requirement connected therewith. An inability to part with a relief cannot mean that the Surrendering Company is subjected to taxation. In respect of requirements connected with taxation, those, submitted Mr Goy, can relate only to obligations and not, in the case of a surrender, to opportunities.

27. In this respect, Mr Goy referred us to two cases, R v Inland Revenue Commissioners, ex parte Commerzbank AG [1991] STC 271, and UBS AG v Revenue and Customs Commissioners [2005] STC (SCD) 589, as illustrative of the application of non-discrimination articles in cases that were concerned with burdens faced by the taxpayer. In Commerzbank the question concerned a repayment supplement sought by the bank in respect of certain tax overpaid. The claim was refused on the basis that eligibility for repayment supplement depended on the bank being resident in the UK. On the issue of the non-discrimination article in the applicable treaty in that case, the Divisional Court (Nolan LJ and Henry J), whilst finding that the repayment supplement did not fall within s 788(3) ICTA, so that the non-discrimination provision did not have effect to that extent in UK law, nevertheless decided that the bank had been subjected to a more burdensome requirement than its UK counterpart, by not being entitled to the possibility of compensation on the overpayment.

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HENI1301_proef3_01.3d pag. 97

That was a more burdensome requirement as regards the payment of tax, which was paid without the prospect of obtaining compensation.

28. In UBS, a claim was made, under s 243 ICTA, for payment of tax credits by the setting of losses against franked investment income. The special commissioners took the view that payment of the tax credit was part of the levying of taxation and that the taxation of the appellant in that case was less favourably levied. Mr Goy submitted that the non-availability of the tax credit to the appellant meant that the tax burden on the appellant would be heavier. However, on the facts of that case, the appellant (or its predecessor) had accumulated trading losses. Its claim was an attempt to monetise those losses by making a s 243 claim so that its surplus franked investment income for the relevant accounting period was treated as trading income of that period and that accordingly the carried forward losses could be set against that income and payment of the tax credit could be received. UBS is not therefore, in our view, a case where the difference in treatment resulted in an increased liability to tax. It is closer to the facts of this case, where an inability to surrender does not lead to any change in the liability to tax of the Surrendering Company for the relevant period.

29. In our view, construing Article 25(6) so as to relate only to discrimination that results in a liability to tax or a burden in respect of tax would be to take too narrow an approach to the interpretation of that article. The article does not refer to tax liability as such, and we regard the more natural reading of 'subjected to taxation' as referring to the taxation regime of the relevant contracting state, and not to any particular liability or burden. The reference in the OECD commentary to 'different treatment' suggests a broad meaning, and it is one that in our view accords with the ordinary meaning of the words in the article.

30. We agree therefore with Mr Baker that the inability of the Surrendering Company to make use of its losses by surrender, in circumstances where its UK-owned counterpart could do so, and the inability therefore to obtain a payment for group relief, does have the result that the Surrendering Company has been subjected in the UK to taxation that is other or more burdensome than the taxation to which corresponding enterprises are subjected. Although the inability to surrender losses can have no impact on the immediate tax liability of the Surrendering Company, and the fact that it carries forward the losses and may therefore suffer lower taxation in future accounting periods than if the losses had been surrendered, this inability, both to surrender and to obtain payment from the claimant companies for the losses, is a difference in treatment that in our view falls within Article 26(4).

Is the difference in treatment solely on the ground of non-UK ownership?

31. Mr Goy argued that, even if it were found that the inability of the Surrendering Company to surrender losses was a taxation or requirement connected therewith, that inability to surrender was not the sole ground on which the relief was precluded. Accordingly, argued Mr Goy, relying on Boake Allen Limited v Revenue and Customs Commissioners [2007] UKHL 25; sub nom NEC Semi-Conductors Ltd v IRC [2007] STC 1265, the difference in treatment did not fall within the ambit of article 26(4) of the DTC.

32. In Boake Allen the dispute concerned the application of the group income provisions of s 247 ICTA under which UK resident group companies could, subject to certain conditions, elect to pay and receive dividends without the paying company being liable to account for the then advance corporation tax ('ACT') and without the recipient company receiving a corresponding tax credit. On a claim that the refusal to apply the same treatment to payment of a dividend by a UK company to its non-UK parent, the House of Lords held that this did not amount to discrimination contrary to the relevant double taxation convention. The equality ensured by a double taxation convention was only that any enterprise which a company or individual resident in one country owned in the other country would not be subject to taxation which discriminated on the ground of its foreign control, but the denial of the right of election for group income treatment was not on the ground of the company's foreign control but on the ground that s 247 could not be applied in a case in which the parent company was not liable to ACT.

33. Arguments based on Boake Allen were raised by HMRC in FCE Bank. In that case, which concerned the UK's group relief rules as they operated prior to the Finance Act 2000, group relief as between two UK subsidiaries of a common US parent was denied in circumstances where it would have been available had the US parent company been resident in the UK. The Upper

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301-13-6691-01/Tmp90c_HENI1301_proef3_01.3d pag. 98

Tribunal, upholding the decision of the First-tier Tribunal, held that denial of group relief in those circumstances was in contravention of the non-discrimination article of the relevant treaty.

34. In finding as it did, the Upper Tribunal examined HMRC's reliance, in particular, on the speech of Lord Hoffman in Boake Allen. Having set out a passage from that speech (para [14] to [22]), the tribunal concluded (at [18]):

'In our view it is clear from this passage, read as a whole, that the reason why there was no breach of the non-discrimination article in Boake Allen is that section 247 was incapable of application to a case in which the parent company, being non-UK resident, was not liable to ACT. Lord Hoffmann explained why this was so in the latter part of paragraph 17 and in paragraphs 18 to 19. He then repeated his conclusion, in unambiguous language, in paragraph 22. Since the concept of a joint election was incapable of meaningful application in a cross-border context, there could be no discrimination against a US parented group because it was denied the right to make an election which only made sense in a purely domestic context. In other words, the reason for the difference in treatment (which prohibited the non-UK tax-resident company from being a party to a group income election) was not the foreign ownership of the UK tax-resident subsidiary's share capital but rather the absence of any charge to ACT on the non-UK tax resident parent.'

35. Accordingly, whilst there could be no doubt that the actual statutory prohibition was that s 247 could not apply to a non-resident parent company, this was unrelated to the question of control or ownership, and simply related to the fact that a company that was not liable to ACT could not be a party to a group income election.

36. Boake Allen concerned a case where the non-resident company was itself a party to the transaction in question, in that case the payment of a dividend between group companies. That was not the case in FCE Bank, where the group relief was claimed as between two UK-resident companies, and the only connection the non-resident company had with the transaction was as the common parent of both UK companies.

Accordingly, the reasoning of Lord Hoffman in relation to the group income election in Boake Allen had no application to the group relief claim in FCE Bank. As the Upper Tribunal observed (at [19]):

'We observe at this point that this crucial part of Lord Hoffmann's reasoning has no relevance to the present case, because the claim for group relief was a claim that only affected the UK tax position of the two UK subsidiaries. The claim had no effect at all on the tax position of the US parent, and the only relevance of the parent company was to establish (or not, as the case may be) the necessary group relationship between the two UK companies which surrendered and accepted the trading losses. It is conceptually quite irrelevant whether the US common parent is within the charge to UK corporation tax or not, in relation to the question of whether two UK tax resident companies are sufficiently connected to each other so as to form a group which permits the surrender of losses from one to another.'

37. As the Upper Tribunal went on to say, whilst Lord Hoffman's conclusion needed no further reasoning to support it, he nevertheless gave certain examples designed to illustrate that control by the non-resident company could not have been the sole ground for denial of the right to make a group income election. HMRC argued in FCE Bank that, having regard to an example given by Lord Hoffman, there was no discrimination as regards group relief on the ground that the capital of the UK companies was owned or controlled by the non-UK resident parent company, because it would have been perfectly possible for group relief to be obtained if a UK resident intermediate company had been interposed. This argument was rejected by the tribunal as it was just another way of saying that the reason why group relief was not available is because the actual (not hypothetical) parent of the two UK companies was in fact not resident in the UK.

38. Lord Hoffman was not saying in Boake Allen that the mere ability to interpose a UK company and obtain the relevant relief will in all cases mean there is no discrimination. The real reason why s 247 could not be applied in that case was not because a non-UK resident had control. It was because a group income election is a concept that cannot be applied to a case where one of the entities is not within the scope of ACT. In drawing attention to the fact that a s 247 election could be made if a UK intermediate parent company were interposed, Lord Hoffman was not suggesting that the non-discrimination article cannot apply if a different structure (albeit with the same ultimate non-UK ownership) can be adopted to achieve the relief; he was merely illustrating that the reason for the UK rule on group income elections was related to the quality of one of the

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tnp90c_HEN1301_proef3_01.3d pag. 99

parties to the election as a UK-company within the charge to corporation tax, and not solely to the fact of non-UK control.

39. As the Upper Tribunal found in FCE Bank, the same analysis could not apply in the case of group relief. In that case there is no need for the parent of two UK20 resident subsidiaries itself to be UK resident in order for a group relief claim to be made between the UK–resident subsidiaries. Where the UK law requires the parent company to be UK resident to establish the necessary group relationship, the only reason for the difference in treatment is the non-UK resident status of the parent company.

40. In their written submissions on FCE Bank HMRC make the point, which we acknowledge, that they do not accept that the decision of the Upper Tribunal is correct. Whilst accepting of course that this tribunal is bound by the Upper Tribunal, HMRC reserve the right, if appropriate, to raise at a higher level the correctness of that decision.

41. Essentially the written submissions of Mr Goy and Mr Facenna sought to distinguish FCE Bank from this case on the basis of the various separate arguments we refer to in this decision. We shall not repeat those arguments here. But Mr Goy also argued before us, and this was repeated in the written submissions, that in relation to the 'sole reason' issue the position in this case is different from that in FCE Bank for two reasons. The first is that the real reason why the Surrendering Company cannot surrender its losses is that the Applicant companies cannot claim. The second is that the relevant requirement would have been satisfied, and the consortium relief would have been available (subject to the section 410 question) if either the Luxembourg parent was resident in the UK or if it carried on a trade in the UK through a permanent establishment.

42. As to the first of these submissions, we discuss later the question whether s 788 ICTA applies to provide the Surrendering Company with the relief claimed. In that context we have concluded that the position of the Surrendering Company cannot be considered in isolation from that of the claimant companies. There are two sides to any group relief equation: the surrendering company and the claimant company. If the Applicant companies cannot claim losses surrendered by the Surrendering Company, it is because the relevant consortium relationship does not exist. The reason why that relationship does not exist is that the Surrendering Company is indirectly owned by a Luxembourg company. The inability of the Applicants to claim group relief is not a separate, unrelated, reason why the surrender cannot be achieved;

it is inextricably bound up with the underlying reason, namely the indirect ownership of the Surrendering Company by the Luxembourg company.

43. The second submission has echoes of HMRC's failed argument in FCE Bank. But instead of relying on the argument that the position would have been rectified if an intermediate company had been interposed, it is argued that the relevant requirement for consortium relief would also have been satisfied if the Luxembourg company, whilst remaining non-UK resident, had carried on a trade in the UK through a permanent establishment (see s 402(3B)). Mr Goy argued in this respect that it could not in those circumstances be said that the real and sole reason for the refusal of the claim is that the Luxembourg company was not resident in the UK.

44. In our view this argument fails for the same reason that HMRC's arguments in FCE Bank failed. In distinguishing Boake Allen from the group relief position in FCE Bank, the Upper Tribunal noted, as we have quoted at [19] of their decision, that it is conceptually quite irrelevant whether the parent company is within the charge to UK corporation tax or not in relation to whether or not two UK tax-resident companies are sufficiently connected to each other so as to form a group which permits the surrender of losses from one to another. In our view the reasoning of the Upper Tribunal in FCE Bank is equally applicable to a case of consortium relief. Unlike the position in Boake Allen, where the status of the parent company receiving the dividends as within the charge to corporation tax was the material factor, there is in this case no conceptual need for a link company, that is simply part of the ownership structure and is not itself seeking either to surrender or claim group relief, to be within the scope of that charge to tax.

45. The essential question is whether in this case s 402 discriminates against the Surrendering Company on the ground that its capital is in part indirectly owned or controlled by the Luxembourg company. In this case we consider that it plainly does. In our view, following the reasoning in FCE Bank, the fact that a different structure may be put in place whilst preserving the ultimate non-UK ownership is not sufficient to displace a finding that the sole reason for a difference in treatment is that non-UK ownership. If a non-UK resident company does not carry on a trade in the

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HEN11301_proef3_01.3d pag.100

UK through a permanent establishment, the only reason group relief for the consortium that would otherwise be available if it had instead been resident in the UK is that it is non-UK resident.

46. In our judgment Mr Goy's argument also fails because it necessarily involves the ownership structure for the Surrendering Company being subject to other or more burdensome requirements than those for a corresponding company owned by a UKresident link company. In the latter case there is no requirement for the UK company to carry on a trade; it may be a pure holding company. By contrast, a non-UK resident company must, if it is to be a link company, carry on a trade in the UK through a permanent establishment. This is itself a difference of treatment that is solely based on the non-resident status of the non-UK company. The alternative structure suggested by HMRC does no more therefore than to confirm that the sole ground for the discrimination is that the Surrendering Company's capital is indirectly partly owned or controlled by the Luxembourg company.

Section 788 ICTA

47. The provisions of the DTC have effect by virtue of s 788 ICTA. So far as material, that section provides:

'(1) If Her Majesty by Order in Council declares that arrangements specified in the Order have been made in relation to any territory outside the United Kingdom with a view to affording relief from double taxation in relation to'

(a) income tax,

(b) corporation tax in respect of income or chargeable gains, and

(c) any taxes of a similar character to those taxes imposed by the laws of that territory,

and that it is expedient that those arrangements should have effect, then those arrangements shall have effect in accordance with subsection (3) below.

...

(3) Subject to the provisions of this Part, the arrangements shall, notwithstanding anything in any enactment, have effect in relation to income tax and corporation tax in so far as they provide –

(a) for relief from income tax, or from corporation tax in respect of income or chargeable gains;

...'

48. We start therefore with the interpretation of section 788. This was considered by Park J in the High Court in NEC Semi-Conductors [2004] STC 489, which, as we have described, was a case concerning the application of non-discrimination provisions in certain double tax conventions to the same effect as Article 26(4) of the DTC. We have described the factual background to that case earlier. For this purpose it suffices to say that the issue was the inability of UK subsidiaries of foreign parent companies to make a group income election pursuant to s 247 ICTA, so that they could pay dividends to those parent companies without accounting for ACT. Mr Justice Park held that the words in s 788(3) 'in so far as they provide for' are limiting words: if the infringement of the double tax convention is not within the matters listed, then that aspect of the convention is not part of our domestic law. Furthermore, there was no requirement to give a wide interpretation to the various matters listed; what was required was a natural interpretation, neither too wide nor too narrow.

49. This approach was approved on appeal to the Court of Appeal [2006] STC 606.

There it was argued on behalf of the appellant that if reliefs from ACT were not covered by the natural meaning of s 788(3)(a), that paragraph should nevertheless be construed so as to extend to ACT since otherwise the UK would be in breach of its treaty obligations. The court rejected that argument, and distinguished Salomon v Customs and Excise Commissioners [1967] 2 QB 116, as s 788 is a general provision whereby a number of treaties may be given effect as part of domestic law, whereas the provision in question in Salomon was intended to enact a particular treaty. The court agreed with Park J that the only proper approach is to consider what is the natural meaning of the words used in s 788(3). In the House of Lords [2007] STC 1265, the claim in question was held not to fall within the non-discrimination provision, so the question of the effect of s 788 did not fall to be determined. Nevertheless, Lord Neuberger considered it, and, whilst recognising that the principle in Salomon would have less weight where the legislative provision had not been enacted to give effect to a specific treaty obligation, expressed the view (at [51]) that the point would have some force, but not sufficient to require the section to be construed other than on a fair reading of it.

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301-13-6691-01/Tmp90c_HEN11301_proef3_01.3d pag. 101

50. Mr Goy argued that s 788(3)(a), in this context, gives effect to the provisions of the DTC only so far as they confer a right to a relief from tax. To the extent that a claim for relief from tax may be made under the relevant treaty article, it has effect by virtue of s 788. But s 788 does not refer to the ability of one company to surrender losses to another company. Such a surrender may provide relief from tax for a company claiming losses, such as the Applicants, but it is not a relief from tax for the company surrendering losses. The position is rather the reverse. The company surrendering losses is giving up a relief rather than claiming it.

51. Mr Goy argued further that the application and effect of the non-discrimination provision can only be considered from the point of view of the Surrendering Company, as the company whose capital is indirectly owned by a Luxembourg resident. A relief from tax that can be obtained under the provisions of a treaty must necessarily be a relief from tax for someone capable of benefitting from an article in the treaty. Here, he argued, the Surrendering Company is not claiming any relief from tax but is rather claiming the right to surrender a relief. On this basis, Mr Goy submitted, s 788 does not enable Article 26(4) to confer on the Surrendering Company the right claimed.

52. Mr Goy submitted that the true analysis in this case is that the requirement complained of is taxation or another requirement to which the Applicants, and not the Surrendering Company, are subject. On its terms Article 26(4) is only concerned with the taxation treatment of a UK company owned or controlled by residents of Luxembourg. It cannot operate to provide a relief from tax for other companies such as the Applicants. Whilst it was accepted that an inability to claim group relief could be a difference in treatment falling within the scope of a non-discrimination article, subject to that difference in treatment being solely on the ground of ownership or control in the other contracting state, there was nothing in the terms of Article 26(4) to suggest that it could affect the claims of other companies not so owned or controlled. Furthermore, the OECD commentary on the 1963 model treaty, in its reference to Article 24(5) of the model, could only refer to enterprises owned or controlled by residents of the contracting state in question. A claimant company that was not in this category could not make a claim on the basis of the consequential effect of discrimination affecting a surrendering company.

53. We were referred to a number of cases where treaty non-discrimination claims had been made by a company controlled by residents of the other contracting state, but in each case the claim had been denied on the ground that s 788 had only a limited effect. We have referred above to NEC Semi-Conductors. In that case it was held in the High Court and in the Court of Appeal that a claim in respect of ACT failed because, although it was corporation tax, it was not corporation tax in respect of income or chargeable gains. In Commerzbank the repayment supplement was held neither to be a charging nor relieving provision, and so fell outside s 788(3), and in UBS the right to payment of the amount of the tax credit on set-off of franked investment income against the losses was not itself a relief from corporation tax. These cases illustrate the application of the principle, clearly expressed, as we have described, in NEC Semi-Conductors, that s 788 does not import all the provisions and effects of a double tax convention into UK law. But they provide no answer to cases involving different facts; each such provision and effect must be examined on its own merits.

54. Mr Baker argued that, ex hypothesi, there are two parties to a claim for group relief: the surrendering company and the claimant company. A restriction on the ability of the surrendering company to surrender its losses impacts on both companies, and the only way to ensure that the Surrendering Company in this case is not subject to taxation or any connected requirement which is other or more burdensome is to allow the Applicants to utilise those losses.

55. Mr Baker further submitted that the terms of s 788(3)(a) were not limited to the grant of relief to a resident of the other contracting state, or, in this case, to a company controlled by residents of that state. On a plain reading of the legislation it is not limited to relief granted only to the Surrendering Company. There is no reason to give s 788(3)(a) a narrow interpretation so that it applies only to a claim for relief by the company owned by a resident of the other contracting state. To grant relief from corporation tax by allowing the Applicants to claim group relief is the only way to give effect to the non-discrimination commitment in Article 26(4). Mr Baker submitted that an analogy could be drawn with FCE Bank where the grant of group treatment to the claimant company necessarily had an impact on the surrendering company.

56. Mr Baker referred us to a number of cases where, he argued, it had been accepted that a claim for relief from income tax or corporation tax could be made by a person other than the

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HEN1301_proef3_01.3d pag.102

person who is a resident of the contracting state for the purposes of the relevant tax treaty. In Lord Strathalmond v IRC (1972) 48 TC 537 relief was claimed by the husband of the person entitled to the benefit of the treaty. In Avery Jones v IRC (1976) 51 TC 443 relief was claimed by the executor of the deceased person entitled to the benefit of the treaty. In Padmore v IRC (1989) 62 TC 352 relief was claimed by a partner in the partnership entitled to the benefit of the treaty. Finally, in Smallwood relief was claimed – although rejected on other grounds – by the settlor of a trust claiming entitlement to the benefit of the treaty.

57. We do not consider that any of these cases are of assistance in resolving the question before us in this appeal. As Mr Goy submitted, all those cases involved situations where the treaty provided protection or relief from the taxation of particular income or gains, and the protection was available to the person sought to be taxed. Nor do we accept that FCE Bank is analogous to the position in this case; that case was concerned with a claim for relief by a company owned by a resident of the contracting state in question.

58. Nonetheless, although it is the case that, unlike other provisions of a double taxation convention, such as those dealing with dividends, interest and capital gains, a non-discrimination provision does not itself provide for a specific relief from tax, that itself, as a matter of principle, does not, as FCE Bank illustrates, prevent s 788 from giving effect to the non-discrimination provision.

59. In their written submissions, Mr Baker and Miss Shaw argued that, although the s788 issue was not addressed explicitly by the Upper Tribunal in FCE Bank, the tribunal must be taken to have accepted that s 788 would apply to the ability of one company to surrender losses to another company. We do not regard FCE Bank as authority for such an application of s 788. That issue was not argued in that case, and FCE Bank is accordingly of no assistance in that respect. We agree with the written submission of Mr Goy and Mr Facenna that the effect of s 788 was not an issue in FCE Bank because the companies concerned in that case were claiming a relief from tax. The issue in this case, where the Surrendering Company is the company whose shares are indirectly owned by the Luxembourg company, was not present in FCE Bank.

60. In our view the correct approach to the question we have to address in this case is to look first at the nature of the difference in treatment that the non-discrimination article seeks to prohibit. In this case it is that the Surrendering Company is not permitted to surrender its losses in the way an equivalent UK-owned subsidiary could, nor, consequently, can it receive a tax-free payment for group relief. The treaty obligation therefore, is to remove those differences in treatment. It would not be sufficient, in our view, despite Mr Goy accepting that this was the effect of his submissions, for the UK simply to enable the Surrendering Company to surrender its losses into a void. That would not in practice enable it to obtain a payment for group relief and that result would once more leave the Surrendering Company in the position of having been treated differently from its UK-owned counterpart.

61. For the difference in treatment to be effectively eliminated, the group relief system must operate as regards the Surrendering Company in the same way that it does in the equivalent UK-owned case. That means that the Surrendering Company's position cannot be considered in isolation. The difference in treatment can only effectively be remedied by resolving both sides of the group relief equation. For the Surrendering Company to be treated in the same way as its UK-owned counterpart, the claim for group relief must also be enabled. If it is not, then the Surrendering Company remains at a tax disadvantage. No payment for group relief could be made unless there is a recipient of that group relief in the form of the claimant company or companies, represented in this case by the Applicants. To remedy the difference in treatment of the Surrendering Company, it therefore follows that, in order for the discrimination against the Surrendering Company to be eliminated, Article 26(4) must require that the concomitant group relief must be capable of being made. The effect of Article 26(4) therefore is that the Applicants must be enabled to claim group relief in relation to losses surrendered by the Surrendering Company.

62. On that basis the effect of the treaty obligation is not only to require that the Surrendering Company be entitled to surrender its losses notwithstanding the fact that its capital is partly, and indirectly, owned by Investments, but also to require that the Applicants be enabled to claim group relief on the surrenders of those losses. That requirement accordingly provides for relief from corporation tax, and so falls within s 788(3)(a) ICTA.

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301-13-6691-01/Tmp90c_HENI1301_proef3_01.3d pag. 103

Conclusions on the DTC question

63. We therefore conclude on the DTC question as follows:

(1) By reason of its inability to surrender its losses to the Applicants, the Surrendering Company was subjected to 'any taxation or other requirement connected therewith' within the meaning of Article 26(4) of the DTC.

(2) That inability to surrender losses arose solely on the ground that the Surrendering Company was indirectly owned by a company (Investments) which was resident in Luxembourg, and not resident in the UK.

(3) Section 788 ICTA has the effect of enabling the Applicants to obtain relief for losses surrendered by the Surrendering Company (subject to s 410).

The section 410 question

64. Section 410 ICTA has the effect of precluding group relief in certain circumstances if specified 'arrangements' exist. HMRC say that, as a result of the sale and purchase agreement entered into by Hutchison Whampoa Limited ('HWL') with KPN Mobile NV ('KPNM') on 7 November 2003 (and subsequently the agreement, on 27 May 2004, with NTT DoCoMo, Inc) to acquire indirectly their respective 15% and 20% interests in Hutchison 3G Holdings Limited ('Holdings'), such arrangements existed from 7 November 2003 to 23 June 2005, when HWL exercised its rights under the SPAs and completed the purchase indirectly of the 15% and 20% shareholdings in Holdings.

65. So far as material s 410 provides as follows: 'Arrangements for transfer of company to another group or consortium

(1) ...

(2) If a trading company is owned by a consortium or is a 90 per cent subsidiary of a holding company which is owned by a consortium and –

(a) in any accounting period the trading company or a member of the consortium has trading losses or other amounts eligible for relief from corporation tax which it would, apart from this section, be entitled to surrender by way of group relief; and

(b) arrangements are in existence by virtue of which –

(i) the trading company or any successor of it could, at some time during or after the expiry of that accounting period, become a 75 per cent subsidiary of a third company; or

(ii) ...

(iii) any person, other than a holding company of which the rading company is a 90 per cent subsidiary, either alone or together with connected persons, holds or could obtain, or controls or could control the exercise of not less than 75 per cent of the votes which may be cast on a poll taken at a general meeting of that trading company in that accounting period or in any subsequent accounting period; or

(iv) ...

then, for the purposes of this Chapter, the trading company shall be treated as though it did not (as the surrendering company or the claimant company) fall within section 402(3).

(3) ...

(4) In this section 'third company' means a company which, apart from any provision made by or under any such arrangements as are specified in paragraph (b) of either subsection (1) or subsection (2) above, is not a member of the same group of companies as the first company or, as the case may be, the trading company or the holding company to which subsection (2) above applies.

(5) In subsections (1) and (2) above 'arrangements' means arrangements of any kind whether in writing or not;

'connected persons' shall be construed in accordance with section 839 [but as if subsection (7) of that section (persons acting together to control a company are connected) were omitted]1; and 'control' has the meaning assigned by section 840.'

66. There is no dispute on the facts. Nor is it disputed that the SPAs had the effect that the Surrendering Company could become a 75% subsidiary of a company that was not a member of the same group as the Surrendering Company or Holdings. However, the Applicants say that the SPAs are not 'arrangements' falling within s 410. They make this submission on the basis that the arrangements in question in s 410 are those which transfer the benefit of losses of a company within a group or owned by a consortium to another group or consortium, and that the scheme of the provisions is to target the manipulation of group relief so as to allow a non-associated, third

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HEN1301_proef3_01.3d pag. 104

company, which is not a member of the group or consortium to take the benefit of the tax advantage.

67. The Applicants point to the fact that the effect of the SPAs, and the transfers of the interests in the shares of Holdings, was not to take the benefit of the losses of the Surrendering Company outside of a relevant association (group or consortium in existence at the time the losses were incurred). They contend that s 410(2) is not targeted at commercial arrangements which allow the holding in a company to be increased from one where a consortium claim can be made to one where a primary group relief claim can be made. The Applicants say that if HMRC are right on the impact of s 410, the result would be that prior to 7 November 2003 the Applicants could (subject to the EU law and DTC questions) make valid consortium claims, and from 23 June 2005 they could make a valid group relief claim. However, between those two dates they could make neither a consortium claim nor a group claim because of the existence of the SPAs. The Applicants say that such a result is absurd and cannot be consistent with the will of Parliament.

68. We were taken by Miss Shaw to a number of authorities on statutory construction. Little of this was controversial, and we set out below a summary of the principles she referred to:

(1) The object of statutory interpretation is to identify the intention of Parliament (R v Secretary of State for the Environment ex p Spath Holme [2001] 2 AC 349 at p 396).

(2) Parliament is presumed to intend that its legislation will be interpreted in a meaningful and purposeful way so as to give effect to its basic objectives (A-G's Reference (no 5 of 2002) [2004] UKHL 40; IRC v McGuckian [1997] STC 908 at pp 915-6).

(3) Regard must be had to the whole of the statute and it should be construed so that the various parts make sense together (Colquhoun v Brooks (1889) 14 App Cas 493; Canada Sugar v R [1898] AC 735 at p 741).

(4) Regard may be had to the heading of the section. For this proposition Miss Shaw relied upon Dixon v British Broadcasting Corporation [1979] QB 546, citing in particular the judgment of Shaw LJ at p 552, where in the context of construing the meaning of the phrase 'fixed term' in the Trade Union and Labour Relations Act 1974, he found it requisite to look at the applicable heading, which referred to 'unfair dismissal'. This does not seem to us to indicate that interpretation of the words of a statutory provision should in any way be constrained by reference to a heading; the Dixon case is merely an illustration of the need to look at the statutory words in their context.

In this connection, Mr Goy referred us to Page v Lowther [1983] STC 799. There, in relation to an assessment to tax under s 488 ICTA 1970, the court had to consider whether the phrase 'arrangement or scheme' construed in light of a preamble in s 488(1), which stated the anti-avoidance purpose of the section, and a sidenote reading 'Artificial transactions in land', denoted only a scheme or arrangement of an artificial nature, designed to avoid tax. It was held that the operation of the section was not limited to transactions specifically designed to avoid tax. The sidenote could not be relied upon as a guide to the construction of the section. In his judgment, Slade LJ said (at p805g):

'... I myself feel no doubt that, even having full regard to the sidenote and s 488(1), the lease of 1971 was an 'arrangement' within the meaning of sub-s (2), entered into between the trustees and Trafalgar. The trustees' task on this appeal in this context would have been much easier if s 488 had specifically provided that a condition for the application of sub-s (2)(ii) should be that the main object, or one of the main objects, of the scheme or arrangement in question was for the avoidance or reduction of liability to tax.'

(5) Parliament is presumed not to have intended a statute to have absurd or anomalous results (R (oao Edison First Power Ltd) v CVO [2003] UKHL 20 at [116], [117]; Hirsch v Crowthers Cloth Ltd [1990] STC 174 at p 181).

69. There was no dispute that s 410 is an anti-avoidance provision. But Mr Baker argued that the mischief at which the provision is aimed is arrangements to transfer the benefit of losses of a company within a group or owned by a consortium to another group or consortium, having regard to the heading to s 410. He submitted that the scheme of the provisions is to target the manipulation of group relief and that, accordingly, the 'arrangements' referred to are 'avoidance arrangements'.

70. Mr Baker submitted that, having identified its basic objective as being concerned with avoidance arrangements, this in turn informs the proper interpretation of each of the sub-provisions of s 410.

29/1/2013 H:/ORDERS/knw/knwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HEN1301_proef3_01.3d pag. 105

71. Mr Baker took us first to s 410(1)(b), which applies in the case of group companies. The focus of that provision is on arrangements by virtue of which a group company could cease to be a member of the group (specifically, by becoming a member of an associated 'third company' group, or by another person obtaining control, or by a 'third company' group carrying on its trade). Plainly, as Mr Baker put it, these are all avoidance arrangements.

72. Section 410(2)(b) contains the comparable provisions that apply in the case of a consortium. We accept that these were intended to be parallel provisions to those applying to groups. Mr Baker submitted that the focus of s 410(2)(b) is on arrangements by virtue of which a company could cease to be owned by the consortium members.

73. Turning to s 410(2)(b)(i), this applies where the surrendering company becomes a 75% subsidiary of a 'third company'. The expression 'third company' is a defined term, and its meaning is set out in s 410(4). In the context of consortium relief, it means a company that is not, apart from any relevant arrangement, a member of the same group of companies as the trading company in question or the holding company of the trading company. On the plain wording of this definition, HWL was not a member of the same group as either the Surrendering Company or Holdings. However, Mr Baker argued that s 410(4) should be interpreted in a way consistent with its meaning for the purposes of s 410(1); that is, that the third company should also be a company that is not itself a member of the consortium.

74. As regards s 410(2)(b)(iii), Mr Baker submitted that, having regard to the purpose of the provisions and in the light of the other situations posited by the section, this sub-section is concerned only with avoidance arrangements involving manipulations to the voting rights attached to shares. He argued that if s 410(2)(b)(iii) applied to arrangements relating to the mere acquisition of shares, it would overlap with subparagraph (i), but without the limitation contained in that sub-paragraph relating to 'third companies' This might lead to a result which conflicted with sub-paragraph (i). On a proper interpretation of s 410(2)(b)(iii), Mr Baker submitted that it does not apply to the SPAs in this case, as those are agreements for the acquisitions of shares and not arrangements to alter the voting rights attached to shares.

75. Mr Baker submitted that, as a general matter, s 410(2) is not targeted at commercial arrangements which allow the holding in a company to be increased from one where a consortium claim can be made to one where the primary claim to group relief can be made. He argues that denial of relief in the circumstances of this case, where, assuming a valid claim for consortium relief could, absent s 410, be made in the relevant periods, the Applicants could make consortium claims prior to 7 November 2003, and group relief claims after 23 June 2005, but not (because of s 410) in the intervening period, was an absurd result and could not be consistent with the intention of Parliament. If the remaining 355 of the shares in Holdings had been acquired immediately upon entering into the SPAs there would be no objection to the relief for the losses. There is no rational basis, according to Mr Baker's submission, for distinguishing between that and the facts of the present case.

76. We turn first to the question whether s 410 is to be construed as limited to arrangements that have an avoidance purpose. It is clear that the section is designed to counter avoidance of tax through losses being used outside the relevant group or consortium. One example of avoidance is the temporary introduction of a lossmaking company in one group to another group. In the context of consortium relief, we accept, as Mr Goy submitted, that s 410(2)(b) appears to have as its purpose the prevention of companies being introduced as members of a consortium for a limited period.

77. Mr Goy referred us to Shepherd v Law Land plc [1990] STC 795, which concerned the period during which s 29 FA 1973 (a precursor to s 410) operated.

That case concerned denial of a group relief claim on account of the existence of a series of options that were acknowledged to have been commercial and not designed to abuse the group relief system. It was common ground that the options were 'arrangements' of the kind referred to in the section (see Ferris J at p 803c). However, we do not regard this as material to our own decision, as the issue of whether arrangements must have an avoidance purpose was not raised.

78. Mr Goy also referred us to the special commissioners' decision in Scottish and Universal Newspapers Ltd v Fisher [1996] STC (SCD), where again the arrangements in question concerned the grant of an option to acquire a company. The appeal was allowed on the basis that the arrangements were conditional on the consent of the Office of Fair Trading having been obtained,

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HEN11301_proef3_01.3d pag.106

and that until that time the arrangements had no effect. But significantly the special commissioners referred (at [16]) to what Lord Bridge said in Pilkington Bros Ltd v IRC [1982] STC 103 (at p 113) about the expression 'by virtue of' in the introductory part of s 410(2): 'This directs attention to the effect of the arrangements not to their purpose.' This shows clearly that there is no purpose test in s 410, and there is no reason for one to be implied.

79. Parliament could have legislated against devices for the manipulation of group relief by introducing a purpose-based anti-avoidance provision. It did not do so. Instead it set out objective tests designed to achieve its own purpose of preventing losses being used in cases where arrangements it perceived as objectionable were put in place. This inevitably catches all such arrangements, whether or not those arrangements themselves have an avoidance purpose, and whether or not they are commercial. That objective measure was intended by Parliament to be the yardstick by which its anti-avoidance purpose was achieved. Accordingly, adopting a purposive approach to s 410, we can see no foundation for a construction outside of its clear words. The arrangements in question do not have to be shown to have an avoidance purpose.

80. The next question is whether, as the Applicants submit, the definition of 'third company' in the material part of s 410(4) should be read so as to exclude a company that is a member of the consortium, or, it would follow, a member of the same group as a member of the consortium. On this we agree with Mr Goy that such an approach could not be supported by the wording of s 410. Nor can any of the principles of statutory construction compel or permit us to make changes to what is clear and unambiguous legislation.

81. In any event, we do not consider that such an intervention could be justified by regard to the purpose of the provisions. It is quite clear that to import the exclusion from the definition of 'third company' (as the Applicant proposes) would open up the very opportunities for avoidance that Parliament was seeking to forestall. A loss making company could be transferred out of a group and placed in the temporary ownership of a consortium including a member of the original group, with arrangements for it to be re-acquired by the original group. Mr Goy provided us with an example of this:

A company (Company A) has a loss-making subsidiary (Company B).

Company A can make use of some of Company B's losses, but not all of them. Company A parts with 35% of the Company B shares to one or two other companies that can benefit from consortium relief.

Company A retains the right to re-acquire Company B through options, an agreement or other arrangements.

82. Mr Goy submitted, and we agree, that this is clearly an example of the sort of arrangement which s 410 is designed to counter. Section 410 cannot possibly, therefore, be construed in the way the Applicants submit it should.

83. Mr Baker referred in his submissions to the difficulty in discerning why s 410(4) excludes from the definition of 'third company', in relation to consortium relief, companies that are members of the same group as the trading company or the holding company. Mr Baker pointed out that, under s 402(3) a trading company owned by a consortium could not be a 75% subsidiary of any company other than its holding company. Mr Goy acknowledged that the reason for this exclusion was obscure, but submitted that this was not relevant to the question whether members of the consortium should be outside the definition of 'third company'. We agree with that submission. In any event, it seems to us plain that, in a holding company case (such as the present case), the trading company and the holding company are members of a group together. If the holding company had another 75% subsidiary, the exclusion in s 410(4) would not preclude consortium relief if there were arrangements to transfer the trading company to that other subsidiary. The provision is understandable in that context, and not of no effect.

84. In relation to s 410(2)(b)(iii), we do not accept Mr Baker's submission that this must be construed only so as to affect arrangements for the manipulation of voting rights. There may well, in some cases, be an overlap with s 410(2)(b)(i), but that will not universally be the case, and it cannot justify an interpretation of s 410(2)(b)(iii) that is narrower than its ordinary meaning. The definition of 75% subsidiary, which is the focus of the condition in sub-paragraph (i), is not concerned with voting rights. It focuses on the beneficial ownership of ordinary share capital and the economic rights of the shares. In cases where such ownership does not correspond to voting rights, it is clear that Parliament intended that arrangements for the acquisition of 75% of the

29/1/2013 H:/ORDERS/knw/knwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HEN1301_proef3_01.3d pag. 107

votes, by whatever means, should be covered by the section. This is confirmed, in our view, by the wide meaning afforded in s 410(5) to 'arrangements' as meaning arrangements 'of any kind'. It is true that in some cases the protection of the 'third company' definition would not be available where both of sub-paragraphs (i) and (iii) would apply to a particular arrangement, but that is a defect that cannot be addressed by construction without itself producing further anomalies. That therefore is a question for Parliament and not for this tribunal.

85. As Mr Goy submitted, the real complaint that might be made by companies in the position of the Surrendering Company, and the Applicants, is not in relation to the conditions for the application of s 410, but in the effect of that application. Section 410 does not operate in a subtle way; it is all or nothing. If the section does not apply, group or consortium relief is unrestricted, according to its terms. If it does, relief is wholly denied. There is no middle course that arguably might provide a more logical result in cases of this nature, where a claimant company is at one time a member of a consortium, and at another a member of a group. In such a case, if Parliament had decided to adopt a more nuanced approach, it could have provided that the effect of s 410 would be to deny relief only in respect of claims by consortium members outside the group to which the trading company was to be transferred under the arrangements in question. But Parliament made no such provision, and no amount of statutory construction can fill that gap. If Parliament considers that a different approach should be introduced, that will be a matter for it to enact.

Conclusion on the section 410 question

86. In conclusion, therefore, we find that the effect of s 410 is to treat the Surrendering Company as not falling within s 402(3) for the period from 7 November 2003 to 22 June 2005 inclusive.

Summary of our determination

87. We have determined the questions referred to us as follows. In each case this is a very brief summary only and must be read in conjunction with our decision as a whole.

(1) The EU law question. We have decided to refer certain questions to the CJEU. Our directions in this respect, and the form of reference, are released at the same time as this decision.

(2) The DTC question. We determine that the effect of Article 26(4) of the DTC, as applied by s 788 (3) ICTA, is that the Appellants are (subject to s 410) entitled to obtain relief from corporation tax by means of the group relief claims notwithstanding the requirements of s 402(3B) ICTA.

(3) The section 410 question. We determine that the effect of s 410 ICTA is to treat the Surrendering Company as not falling within s 402(3) for the period from 7 November 2003 to 22 June 2005 inclusive.

Application for permission to appeal

This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to 'Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)' which accompanies and forms part of this decision notice.

1. Not included in this print.
2 Not included in this print.
3 Not included in this print.
4 Not included in this print.

Comment

1 Introduction

There are several possible forms of interaction regarding non-discrimination provisions in general, and specifically regarding tax treaties and EU law. Tax treaty non-discrimination precludes certain kinds of discriminatory treatment against inbound investments. Comparatively, the fundamental freedoms under the TFEU are broader, as they cover not only inbound but also outbound investments. This is an example of a case where both forms of agreement (bilateral tax treaty and the TFEU) provide guarantees of non-discrimination which are rele-

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HEN1301_proef3_01.3d pag. 108

vant for the same tax issue. In this case, the taxpayer used alternatively both arguments in order to address the same situation. A separate analysis regarding each one of the arguments will be made.

2 Tax treaty non-discrimination

2.1 *– Non-discrimination in tax treaties: general remarks*

The vast majority of the more than 3,600 bilateral tax treaties currently in force include an article similar or virtually identical to Article 24 of the OECD Model Convention. This provision does not provide for a general rule on non-discrimination but rather precludes differences in tax treatment based on specific grounds:

- Article 24(1) precludes discrimination on the basis of nationality;
- Article 24(3) precludes permanent establishments of non-residents from being discriminated against compared to resident enterprises.
- Article 24(4) requires that payments to non-residents are deductible under the same conditions as payments to residents.
- Article 24(5) precludes discrimination against enterprises that are owned or controlled by non-residents.

Much of the controversy surrounding the application and interpretation of the non-discrimination provisions involves determining their exact scope. The objective that States try to achieve by adopting a non-discrimination principle in tax treaties is not clear. The absence of a well-articulated objective of Article 24 is probably the main reason for the difficulties in how it should apply in particular cases and how far-reaching this principle is.

This case deals with the application of paragraph 4 of Article 26 of the DTT UK/Luxembourg which is virtually identical to paragraph 5 of Article 24 of the OECD Model Convention, also referred to as the 'capital ownership' provision. It reads as follows:

'Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first mentioned State are or may subjected.'

It is possible to identify four requirements in order to trigger the application of this provision:

- A subject of discrimination: foreign-controlled enterprises
- The object of comparison: 'other similar enterprises'
- A discriminatory treatment: other or more burdensome taxation and connected requirements
- The reason for discrimination: foreign ownership or control

2.2 *– Application of the capital ownership provision to the group relief system*

A preliminary question in this case – and which illustrates the uncertainty around the scope of the tax treaty non-discrimination principle – is whether paragraph 5 is applicable in the context of the group relief system (and group taxation regimes in general). Essentially, there are three possible options: (i) paragraph 5 is not applicable at all in the context of group taxation regimes, (ii) it is applicable but limited to domestic situations, i.e. only companies which are resident in the same State and therefore are within that State's tax jurisdiction, and (iii) paragraph 5 applies ultimately to allow claiming cross-border group taxation.

The FTT dealt briefly with this issue (see paras. 21 to 23) by making reference to its previous decision in case *FCE Bank plc v Revenue and Customs Commissioners case* (2010 UK FTT 136 (TC), of 1 April 2010). That case involved the application of the UK group relief system and whether two UK resident companies held by a common US parent company could surrender losses to one another under such system based on the applicable UK-US tax treaty which contained a standard paragraph 5 capital ownership provision. The FTT concluded then that the capital ownership provision could indeed be invoked for the application of the group relief system between the two UK subsidiaries. This decision was later confirmed by the Upper Tribunal

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HEN1301_proef3_013d pag. 109

(UKUT 420 (TCC), of 13 October 2011) and more recently, by the Court of Appeal (EWCA Civ 1290, of 17 October 2012).

The doubt arises due to the wording of paragraph 77, included upon the 2008 amendments of the Commentary to Article 24, which reads:

'Since the paragraph relates only to the taxation of resident enterprises and not to that of the persons owning or controlling their capital, it follows that it cannot be interpreted to extend the benefits of rules that take account of the relationship between a resident enterprise and other resident enterprises (e.g. rules that allow consolidation, transfer of losses or tax-free transfer of property between companies under common ownership). For example, if the domestic tax law of one State allows a resident company to consolidate its income with that of a resident parent company, paragraph 5 cannot have the effect to force the State to allow such consolidation between a resident company and a non-resident parent company. This would require comparing the combined treatment of a resident enterprise and the non-resident that owns its capital with that of a resident enterprise of the same State and the resident that owns its capital, something that clearly goes beyond the taxation of the resident enterprise alone.'

Paragraph 77 of the Commentary infers that the combined effect of the taxation of the parent and subsidiary cannot be taken into account. The plain wording of the Commentary is that the benefits of group taxation regimes may not be claimed where one company is resident and the other is non-resident. This conclusion can already be derived from para. 18 of the Commentary to the 1963 OECD Model Convention which referred that the object of paragraph 5 of Article 24

'is to ensure equal treatment for taxpayers residing in the same State, and not to subject foreign capital, in the hands of the partners or shareholders, to identical treatment to that applied to domestic capital.'

That statement is logical: if a controlled company would be forced to transfer its income to its foreign parent company (or could claim a transfer of losses) that could lead to situations of double non-taxation as it would be highly unlikely that the State of the foreign parent would recognize the effects of the group taxation regime of the subsidiary's State. That cannot and should not be the effect of this provision. A fundamental distinction in tax treaties is between residents and non-residents and being subject and not subject to tax. The interpretation and application of tax treaty non-discrimination should not affect the allocation of taxing rights in accordance with the distributive rules. Therefore, as recently affirmed in a judgment of the Netherlands Supreme Court (*Hoge Raad*, case no. 10/05268, 21 September 2012, *V-N* 2012/47.14) cross-border consolidation is not allowed pursuant to paragraph 5 of Article 24. This is due to the fact that in those cases, the resident of the parent company (and not merely foreign ownership) is clearly relevant with respect to the benefits of consolidation, since tax treaty provisions (notably Article 7) would preclude the taxation of the income from the foreign parent. Ultimately, the extension of the capital ownership provision to situations which would potentially lead to double non-taxation (such as cross-border consolidation) would require a teleological reduction of the scope of paragraph 5 of Article 24 (see A. Rust 'Ermoglischen Diskriminierungsverbote eine Organschaft uber die Grenze', IStR 19/2003, p. 661) considering that the purpose of Double Tax Treaties is (at least since the amendments to the 2000 Commentary to the OECD Model Convention) avoid not only double taxation but also double non-taxation. Therefore, the interpretation of treaty provisions should, whenever possible, accommodate both those results.

This is different in the case of grouping of profits and losses between two subsidiaries of a non-resident parent company which are located in the same State, or, more specifically where the surrender and surrendering entity are both located in the UK. That situation is not specifically addressed in the Commentary. In any event and contrary to cross-border grouping, in such case, the State where the subsidiaries are located is able to take into account both profits and losses as those entities fall within the State's tax jurisdiction. Allowing the benefits of group taxation does not distort the allocation of taxing rights nor does it collide with the tax treaty distributive rules. In addition, as pointed by the FTT, allowing the application of the UK group relief system involves focusing exclusively on the taxation of two resident companies and not on that of the non-resident parent company.

In fact, the interpretation of the Commentary as meaning a total exclusion of the benefits of group taxation regimes under paragraph 5 rather than limiting this exclusion to cross-border

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tnp90c_HENI1301_proef3_013d pag. 110

situations would be inconsistent with the Commentary to paragraph 1 of Article 24 which provides examples in which tax treaty non-discrimination (if based on nationality) may be claimed to allow domestic consolidation whenever residence is not the relevant factor for the distinction.

Naturally, one of the open issues (to be dealt below) is whether this reasoning can apply, mutatis mutandis, to other group taxation systems with different features from the UK group relief system.

2.3 – *The construction of the comparator: other similar enterprises*

A second issue refers to the object of comparison and to the meaning of the expression 'other similar enterprises'. In other words, what is the correct comparator for the purposes of paragraph 5 of Article 24? This is part of a long-standing debate, especially in the UK, in which the HMRC considered in the past that the appropriate comparator would not be with a pure domestic situation but rather with enterprises owned or controlled by residents of a third State. In *Felixstowe*, this would mean a parent company resident in Luxembourg compared with a foreign parent company resident in a different State. The consequence of following this approach would naturally be that typically, there would not be a discrimination since as the comparator always involved a cross-border situation, group relief would also not be possible.

The FTT dealt with this issue of the correct comparator very succinctly and affirmatively by stating that there was no dispute on the appropriate comparison that needs to be made in construing para. 5 of Article 24. Therefore, in this case, the relevant comparison was between the case where the capital of the surrendering company was partly owned or controlled by a Luxembourg resident company (the link company) and the same structure where the link company was a UK resident company.

Naturally, the UK Court was entirely correct. In fact, the OECD in its public discussion draft released in May 2007 regarding the Application and Interpretation of Article 24 dealt with this issue concluding that the correct comparator for the purposes of paragraph 5 was indeed a domestic enterprise owned by residents of the same State.

2.4 – *Discriminatory treatment: meaning of 'other or more burdensome taxation or connected requirements'*

One of the most interesting points in this case is the requirement of discriminatory treatment and the meaning of the words '*other or more burdensome taxation or connected requirements*'. I recall that in this case, it was the surrendering entity rather than the claimant that argued the discriminatory treatment due to the link company being a Luxembourg resident. This means that the denial of the group relief did not need to lead to a direct disadvantage of the company arguing the discriminatory treatment since this company, upon the surrender of its losses could actually end up having to pay taxes sooner than in the case it did not transfer those losses as it could carry them forward for future years.

The taxpayer argued that the inability of the surrendering company to surrender its losses constituted both: (i) other or more burdensome taxation, and (ii) any requirement connected therewith which was also other or more burdensome. The HMRC took the opposite view, following a particularly narrow approach, arguing that the surrendering company itself had not been subject to taxation. It considered that the inability to surrender losses could in any event be considered as 'taxation' to which such company is subject. Similarly, the HMRC considered that the reference to other requirement must be connected to taxation. Since the inability of relief could not be considered taxation, it could also not be understood as a requirement connected with taxation. Putting it more simply: the interpretation of the UK revenue of the discriminatory treatment targeted under paragraph 5 was that it does not comprise a mere different treatment but only a different taxation or other requirement connected therewith. Disallowing loss relief could in any event mean that the surrendering company was being subject to taxation. In addition, it interpreted the expression *requirements* as referring to obligations rather than mere opportunities lost as it would be the case of surrender of losses. To address this issue and the interpretation of the above-mentioned expression, the UK Court seems to have relied on the reference in paragraph 3 of the Commentary to Article 24, that tax treaty non-discrimination aims at preventing differences in tax

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tnp90c_HENI1301_proef3_01.3d pag. 111

treatment rather than only differences in taxation. Therefore, it concluded that the inability to surrender losses by the surrendering company and to obtain payment from the claimant companies for those losses amounted to a difference in treatment which is other or more burdensome and falls within the scope of Article 26 (4) of the DTT UK/Luxembourg. The Court considered this interpretation to be the correct one, taking into account not only the scope of the tax treaty non-discrimination principle but also the ordinary meaning of the words of the capital ownership provision.

I am of the view that the Court's conclusions are correct. The fact that the surrendering company was deprived, contrary to a UK-owned company, to use its losses implies other tax treatment than that which would apply if it were owned by a UK company. Therefore, there is not only different treatment based on capital ownership as protected by art. 26 (4) of the DTT UK/Luxembourg but also and contrary to the HMRC other (although not less disadvantageous) taxation of the surrendering company. On the whole, I am of the view that this decision confirms that the scope of the capital ownership provision when referring to other taxation means different treatment which can extend for instance from a different taxation to the application of different tax provisions.

2.5 – *Reason for discriminatory treatment: foreign ownership*

Finally, the FTT dealt with the fourth requirement by analyzing whether the reason for the discriminatory treatment was indeed due to the non-UK ownership. The HMRC contended that this requirement was not met in the present case, relying on the reasoning of a previous UK case which dealt with analysis of paragraph 5 of Article 24: *NEC semi-conductors*. That case concerned the application of the group income provisions under which a UK resident group of companies could, subject to certain conditions, elect to pay and receive dividends without the paying company being liable to account for the ACT and without the recipient company receiving a corresponding tax credit. In that case, the UK provisions require a UK parent be challenged claiming a similar treatment for situations involving a non-UK parent. Naturally, the difference in the situation in Felixstowe is immediately blatant: in *NEC semi-conductors* the non-resident parent company was itself party to the transaction. In *Felixstowe*, the group relief is claimed between two UK resident companies whereas the only role of the foreign company related to the loss relief is to be the link company of the surrendering company. In *NEC semi-conductors*, the ACT exemption was not available in cross-border situations because the non-UK resident was not liable to ACT in the first place. In other words: the relevant reason for the different treatment was not the foreign ownership but rather the non-liability to tax of the foreign parent company. In the case of *Felixstowe*, it is clear that there is no need for the link company to be resident in the UK in order for a group relief claim to be made between two UK resident subsidiaries. The link company in Luxembourg is not itself seeking to either surrender or claim group relief and therefore, it is immaterial to be within the scope of UK tax.

The UK revenue used an additional argument to claim that the sole or relevant reason for refusal of the claim was not due to the Luxembourg company being not resident in the UK. It pointed to the fact that the relief would be available even if the Luxembourg parent, while being non-resident, could carry on a trade in the UK through a permanent establishment. The FTT rejected the argument that the fact that a difference structure could have been put in place would be sufficient to displace the finding that the relevant reason for the different treatment was due to the non-UK ownership. In addition, it made a very interesting remark from the point of treaty interpretation: it considered that such requirement of carrying on a trade in the UK would constitute other or more burdensome requirement for the surrendering company as per comparison with a UK resident link company as in this latter case, there is no such requirement for the UK company to carry on a trade. It could merely be a purely holding company.

3 *Breach of the freedom of establishment in Art. 49 TFEU*

In addition, a claim was made on grounds that the requirement of a UK link constituted a breach of the freedom of establishment. The UK Court had doubts on the interpretation in this particular case and referred a question to the CJ. The question here essentially concerns the

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tnp90c_HENI1301_proef3_01.3d pag. 112

scope of the fundamental freedoms due to the fact that the parent in this case is resident in a third country (Hong Kong).

In accordance with the current case law of the CJ, the scope of application of the freedom of establishment is limited to EU Member States whereas the free movement of capital also applies to third countries. According with the Court, the freedom of establishment is applicable whenever the scope of the legislation involves company control by the shareholders (or in the Court language: '*definite influence over its subsidiaries*'). Therefore, in the case of group relief, there is always company control as the shareholding is far superior to 50%. This being the case, is it possible to claim breach of the freedom of establishment if the ultimate parent company is resident in a third state. In *Felixstowe*, it is important to note that the ultimate parent company does not have any intervention whatsoever in the group relief as it is neither the surrendering, the claimant or the link company. Therefore, and for the purposes of the UK group relief, the role of the Hong Kong company is irrelevant.

Probably the doubt of the FTT arises due to a previous judgment of the Court in *Test Claimants in the Thin Cap Group Litigation* (ECJ 13 March 2007, C-524/05). In that case, the Court was confronted with the scope of the freedom of establishment in multiple scenarios. In one of those scenarios it considered that if the direct or indirect parent company was resident in a third country, the freedom of establishment would not in principle apply even in a pure intra-Community loan (i.e. a loan between two subsidiaries resident in EU Member States with no intervention of the parent company). However, I also recall that in this case, in the Opinion of AG Geelhoed, the exception to this would be (see paragraph 97) where the lending company itself exercises a definite influence over the decisions of the borrowing entity (i.e. the borrowing company was a subsidiary of the lender), and where the discrimination arose based on the location of the lending company. In such event, the alleged restriction would be on the right of establishment of the lending company and not the third country parent company and therefore, the freedom of establishment would apply. This exception in fact, appears to find support also in the CJ judgment. In para. 98, the Court stated:

'Article 43 EC has accordingly no bearing on the application of national legislation such as the legislation at issue in the main proceedings to a situation in which a resident company is granted a loan by a company which is resident in another Member State and which does not itself have a controlling shareholding in the borrowing company and where each of those companies is directly or indirectly controlled by a common parent company which is resident, for its part, in a non-member country.' [underscore BdS]

In other words: the Court, although less clearly than AG Geelhoed, draws a distinction for the purposes of determining whether the freedom of establishment is applicable on whether the lender has a control over the borrowing company. This reasoning applies mutatis mutandis to the *Felixstowe* case. Although the ultimate parent is in Hong Kong, the link company controls the surrendering entity. The discrimination under the UK legislation is due to the link company being a non-UK resident. In fact, the location of the ultimate parent is totally irrelevant to this case. This link company is resident in Luxembourg and therefore, I am of the opinion that the Court should rule that the freedom of establishment is indeed applicable in this case.

Aside from this issue of the scope of the freedom of establishment, the remaining substantive part of referral has already been addressed in the recently delivered judgment of *Phillips Electronics UK* (CJ 19 April 2012, Case C-18/11), and can also find its roots in *Imperial Chemical Industries plc (ICI)* (ECJ 8 July 2000, C-200/92) and therefore, the CJ should confirm that the denial of group relief based on the location of the link company constitutes an unjustified breach of the freedom of establishment.

4 Open issues and concluding remarks

This case offers a number of interesting issues regarding both tax treaty interpretation of non-discrimination provisions and the scope of the fundamental freedoms. In either sets of arguments I expect that the decision will be favourable to the taxpayer. From a tax treaty perspective, the recent judgment of the Court of Appeal in the *FCE Bank* case ([2012 EWCA Civ 1290, of 17 October 2012) confirming the application of the capital ownership provision regarding cases of denial of group relief between two UK resident subsidiaries with a foreign parent company fully supports the outcome of the FTT in the *Felixstowe Dock* case.

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HEN1301_proef3_01.3d pag. 113

From an EU Law perspective, I am of the view that the CJ will confirm that the freedom of establishment is applicable in this case since the reason for the discrimination is a link company resident in an EU Member State which controls the UK surrendering entity. Therefore, this Court will conclude that the denial of the group relief due to the location of such link company is a breach of the freedom of establishment.

If, in my view, the outcome of this case is somehow expected and clear, there are several fundamental questions that can be derived from this which are far less clear. I shall address only three of them.

4.1 – *Extension to other group taxation regimes*

The first fundamental question is whether the reasoning applied for the purposes of the UK group relief can be transposed to other group taxation regimes. I shall not enter into details regarding the different possible classifications that can be made regarding the different group taxation schemes that exist in different countries. I shall only use some of the most common references. For instance, in the case of the group contribution schemes (used, for instance, in Sweden and Finland) the national courts have already confirmed that paragraph 5 of Article 24 is indeed applicable to situations involving two resident companies which intend to make a group contribution and are held by a non-resident parent company (e.g. the Swedish decisions in cases RÅ 1996 ref. 69 and RÅ 1998 ref. 49). This is not surprising. I recall only that group contribution somehow mirrors the group relief system in the sense that while this latter involves transfer of losses, the former operates through a transfer of profits. But what about pooling systems? This question was subject to scrutiny in Luxembourg involving the regime d'integration fiscal. Briefly, the situation involved a Belgian parent company with five subsidiaries resident in Luxembourg. The taxpayer claimed that the refusal to allow the pooling of the results of the Luxembourg subsidiaries by reason that they were held by a Belgian parent company breached the capital ownership provision. The Luxembourg Administrative Court confirmed the taxpayer's claim (*Tribunal Administratif du Grand-Duché de Luxembourg*, Case no. 19717 and 29624, of 23 October 2006) but this decision was overruled by the Court of Appeal (*Cour Administrative du Grand-Duché de Luxembourg*, Case 21979, of 19 April 2007). In essence, the reasons were that: (i) inherent to the pooling of the results was not only horizontal compensation (between the subsidiaries) but also vertical compensation and that always required the inclusion of the parent company which naturally had to be resident in Luxembourg to be within its tax jurisdiction; (ii) also in a domestic situation it would not be possible to consolidate only the results of the subsidiaries. I do not find this reasoning entirely convincing. I am of the view that the Court followed a too narrow interpretation of the non-discrimination provision. I briefly mention a few arguments that uphold my views.

The construction of comparator requires similarity of facts – except the one which is arguably discriminatory – but not legal similarity. The legal requirement that there is always a need for a parent company resident in the same State is precisely the circumstance being challenged as discriminatory. To require always the inclusion of the parent company would deprive para. 5 of its meaning, turning it inoperative. Factually, sister companies with a resident parent company are able to consolidate their results. However, in the case of a foreign parent company, the same sister companies are deprived of the benefits of consolidation, the reason being that they are held by a company resident in another State. This discrimination based on the place of residence of the parent company is precisely the type of discriminatory treatment prohibited by the capital ownership provision. Actually and contrary to the Luxembourg Court referred, even in purely domestic situations it is possible to find situations in which only the results of the subsidiaries are aggregated: frequently, the parent is a holding company which obtains little or no income and therefore, only the income of the subsidiaries is factually and effectively consolidated. In addition, para. 76 of the Commentary to Article 24 is clear in stating that the capital ownership 'forbids a Contracting State to give less favourable treatment to an enterprise', which implies that its purpose is to avoid differences in treatment due to foreign ownership which are disadvantageous. If through the application of para. 5 of Article 24 it is possible to consolidate only the results of the subsidiaries differently to what occurs in a purely domestic situation that is the result of applying para. 5 itself and by leading

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HENI1301_proef3_01.3d pag. 114

to a somewhat more favourable result, i.e. with no inclusion of the parent, that is not a disadvantageous treatment for the purposes of the capital ownership provision.

For the purposes of determining the capital ownership provision, the relevance is then to determine what is the role of the parent company and the degree of integration with its subsidiaries. In other words: whether it is possible to consolidate only the results of the subsidiaries without the involvement of the parent. That seems to be the case under the Luxembourg system. In a pooling system, each company maintains its independence. In other words, if the grouping of the subsidiaries is possible without the parent company being involved, then the inapplicability of the group taxation regime due to the absence of a domestic parent company falls within the capital ownership provision (see John Avery Jones et al 'Art. 24 (5) of the OECD Model in Relation to Intra-Group Transfers of Assets and Profits and Losses', World Tax Journal, June 2011 (IBFD), pp. 206-207).

A similar question can be asked regarding the Netherlands fiscal unity. The fiscal unity provides for a higher degree of consolidation where transactions within a group are disregarded for tax purposes.

In the judgment of 21 September 2012 referred to above, the Hoge Raad dealt with a scenario of cross-border fiscal unity. That case dealt with the Netherlands thin cap rules. A Netherlands company had different interest payments concerning loan arrangements with its French parent company, a Portuguese subsidiary and a German sister company. The deductions related to the interest paid by the Netherlands company to the related foreign companies were rejected. The taxpayer claimed, inter alia, that regarding the interest payments made to its parent company located in France, there was a breach of the capital ownership provision pursuant to Article 25 (5) of the DTT France/Netherlands. According to the Netherlands tax rules, in general both interest deductions payments involving companies which belong to the same group (meaning companies which have shareholding relations). These limitations are applicable in principle in the case of either resident or non-resident shareholders. The situation differs only within the scope of the fiscal unity in which there are no interest deduction limitations because in that case, the group of companies are treated as a single taxpayer. For the purposes of the fiscal unity, foreign parent companies are not allowed to be part of the group. The Netherlands Supreme Court correctly considered that that the purpose of the capital ownership provision cannot be interpreted in order to extend the fiscal unity to cross-border situations. Relying on the construction of the comparator for the purposes of paragraph 5, it concluded that there was no discrimination in this case since domestic and foreign shareholders were in principle subject to the same tax treatment and that for the purposes of the fiscal unity, a domestic parent company with a foreign parent company were not comparable as in this latter case the company is not within the tax jurisdiction of the Netherlands. The Hoge Raad, following the Opinion of AG Wattel, relied not only on the 2008 amendments to the Commentary referred to above which exclude cross-border consolidation through the combination of the results of both parent and subsidiary, but by making reference that it would be extremely unlikely that the purpose of the capital ownership in the DTT would allow such cross-border effect. In that regard, a reference was made to that from the 1963 Commentary, that it was evident that the treatment of the foreign shareholder was entirely beyond the scope of paragraph 5 and only the treatment of the domestic subsidiary was covered by such a provision. But what about consolidation of only Netherlands subsidiaries? The 2003 amendments to the fiscal unity clarified that each group member should be treated as independent for tax (treaty) purposes, i.e. each company of the group remains autonomous and 'liable to tax' pursuant to Article 4 (1) of the applicable double tax treaties. In that regard, there are good arguments to maintain that a similar reasoning should be followed concerning the pooling systems and that consolidation of results of the subsidiaries held by a foreign company should be possible.

4.2 *– Per element v overall approach*

If the decision referred to above of the *Hoge Raad* may from the perspective of rejecting that the capital ownership provision force the extension of cross-border consolidation is correct, it gives rise to another interesting debate. The fiscal unity involves several consequences for its group members, such as the possibility to offset profits with losses, the non-application of the

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HENI1301_proef3_01.3d pag. 115

interest deduction limitations, intra group tax free transfers of assets, etc. In this case, the taxpayer submitted that it was only referring to the discriminatory tax treatment of the *Netherlands subsidiary* from the perspective of the interest deduction limitation and not arguing for inclusion of the French parent company in the fiscal unity (i.e. requiring consolidation in a cross border scenario). In other words, the taxpayer claimed that, only for the purpose of the interest deduction limitations, it should receive the same treatment as a resident taxpayer included within the fiscal unity, as in such case, the interest deduction limitations are not applicable. As referred to above, the Hoge Raad did not accept such arguments by considering that a taxpayer with a domestic parent company within the fiscal unity was not comparable to a taxpayer with a foreign parent company. Although recognizing the difference in treatment, the Court stated that this arises in dissimilar situations. The Hoge Raad rejected the argument raised by the taxpayer, i.e. the possibility to have a single benefit of the fiscal unity. It considered that the fiscal unity is a package deal, which involves all related tax consequences and not only a tax consequence as claimed by the taxpayer. Therefore it was not possible to reap the benefits of the fiscal unity without entering into the fiscal unity itself. Since in this case, a foreign parent company and a domestic parent company were not comparable for the purposes of cross-border consolidation, the outcome was that there was no violation of the capital ownership provision. This case brings into debate within the tax treaty non-discrimination context something which has been discussed a great deal within the EU Law context following the judgment in the *X Holding* case (CJ 15 April 2010, C-538/08): the per element approach v the overall approach regarding the fiscal unity. One of the debates following the decision in *X Holding* was whether the application of the fiscal unity in a cross-border situation was by itself, compliant with EU Law, or rather whether one should analyse, element-by-element, the different benefits which are inherent to the fiscal unity to test whether its limitation to pure domestic situations was both justified, and proportional with EU Law. The arguments raised, in particular by D. Weber (X Holding: Refusal of advantage of a cross-border tax consolidation a justified restriction of the freedom of establishment in *H&I* 2010/7.6) was whether following a per element approach would not be a much more proportional approach (as it would seem to have been already suggested by AG Kokott in its Opinion in *X Holding*) rather than the pure rejection of cross-border fiscal unity. The Hoge Raad followed the view that the fiscal unity was a package deal and therefore, that it was not possible to simply cherry pick the benefits and apply them in cross-border scenario. In this judgment, the Court again used those arguments. I understand the reasoning of the Hoge Raad as regards the construction of the comparator (and the consequent outcome of the decision). But I would like to raise the question on whether a different interpretation can be followed and if a per element approach is possible regarding the tax treaty non-discrimination principle.

In the *UBS AG* case (see *UBS AG v Revenue and Customs Commissioners*, [2005] S.T.C. 589, 7 June 2005), there are some interesting insights for this discussion. The case involved a UK permanent establishment of a Swiss company which had suffered a substantial amount of trading losses and which received dividends from UK companies. If the permanent establishment were a UK company it would be entitled to the benefits of the ACT tax credit in respect of the dividends paid by the UK companies. The taxpayer claimed that such a difference in treatment amounted to a discrimination forbidden by the permanent establishment non-discrimination provision of the DTT UK/Switzerland (in case Art. 23 (3)). One of the arguments raised by the UK revenue was that there was effectively no discrimination because a permanent establishment and a UK company were not comparable: while the UK resident receives a conditional payment in respect of the tax credit which is reversed when that company later pays dividends, in the case of the permanent establishment the tax credit would constitute an absolute payment which ultimately leads to the permanent establishment receiving a better treatment than a UK resident company. Therefore, the UK revenue argued that the ACT regime should be looked as a whole and it was not possible to separate particular aspects of it.

The UK Special Commissioners (which nowadays correspond to the UK First Tier Tribunal) dealt with this issue by referring in paragraph 24 of its decision that:

'Nowhere in the Commentary is there any suggestion that a global approach should be taken so as to take account of each and every tax provision in either the domestic tax law of the Contracting State or the Treaty. [...[we consider that the Commentary requires an item by

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301-13-6691-01/Tnp90c_HEN11301_proef3_01.3d pag.116

item approach when making the comparison. We consider that the effect of the substantive provision under scrutiny on the permanent establishment on the one hand and the resident comparator on the other should be made without regard to the effect on either of other provisions which are not under scrutiny. The application of each and every tax provision is the subject of scrutiny of art. 23 of the treaty [...]. The contrary global view would either make a comparison impossible (because it is always possible to point to some differences between a permanent establishment and a UK resident company which arguably put them in different circumstances or suggest that tax is not levied 'less favourably' on the present establishment) or draw arbitrary lines to determine which provisions other than the provision under scrutiny could or could not be considered.'

Therefore, the UK Special Commissioners looked exclusively at the provision that allowed the tax credit and disregarded the remaining consequences of their item approach. In this particular aspect their decision was upheld by both the High Court ([2006] EWCH 117, 7 February 2006) and the Court of Appeal ([2007] EWCA Civ 119, 21 February 2007).

Using if necessary a purposive interpretation, this outcome seems to reach a more balanced result and one should perform a separate analysis for each element rather than looking at the whole regime.

4.3 – *Non-discrimination cocktails*

A final issue I would like to mention, concerns the possibility to combine both tax treaty and EU law arguments in order to obtain a '*non-discrimination cocktail*'. In *Felixstowe Dock*, the taxpayer used alternatively the tax treaty capital ownership provision and the TFEU freedom of establishment arguments to challenge the denial of group relief. But there are other possibilities to use these two sets of arguments. An interesting possibility is the combined (rather than alternative) use of tax treaty non-discrimination and EU law arguments. In fact, this cocktail was already used in the *Halliburton* case (ECJ 12 April 1994, C-1/93, *Halliburton Services BV v Straatssecretaris van Financien*, ECR I1137). Recalling the facts of the case, Halliburton was an international group with an US incorporated parent company which held both a Germany subsidiary and a Netherlands subsidiary. As part of the reorganization of its activities in Europe, the German subsidiary sold to the Netherlands sister company its Netherlands permanent establishment which included immovable property. Under Netherlands legislation, the transfer of immovable property was subject to real estate transfer tax to be borne by the acquirer. An exemption was applicable in the case of internal reorganizations of a group, being required that all the companies of the group were resident in the Netherlands. The taxpayer claimed from that assessment, based on two instances of discrimination as per comparison with a purely domestic situation: (i) the foreign parent company, and (ii) the foreign sister.

The first situation was dealt with based on the capital ownership provision of the DTT US/Netherlands. The Hoge Raad ruled (Hoge Raad, case 27483 of December 1992) that the Netherlands subsidiary could not be deprived of the exemption due to the foreign ownership as that would lead to a discriminatory treatment (payment of tax) forbidden under the capital ownership provision. The second situation dealt with the actual transfer from the German to the Netherlands subsidiary with the Court concluding that there was a breach of the freedom of establishment. This case illustrates the potential of the combined use of tax treaty and EU law. The first instance of discrimination was solved under a tax treaty non-discrimination provision overcoming the territorial limitation of the scope of the freedom of establishment. The second instance of discrimination was dealt with under EU law considering also that the discriminatory treatment in such situation was not covered by the tax treaty (as either the nationality or the permanent establishment clauses were applicable).

Thus, there seem to be several possibilities to combine the non-discrimination arguments. A possible example is the following: let us image a situation of a US parent company owning two foreign subsidiaries, one located in the UK, and the other in another EU Member State. If this latter company has incurred losses, may the UK subsidiary claim for the surrender of losses of its sister company? The arguments resemble the ones used in *Halliburton*: (i) the fact that the foreign parent company is resident in the US and not in the UK is a violation of the capital ownership provision of the DTT US/UK; (ii) the inability to use the losses in the UK which were incurred by the sister company in another EU Member State may constitute a breach of the

29/1/2013 H:/ORDERS/krw/krwtijd/HI/HI1301 - 13-6691-01/Tmp90c_HENI1301_proef3_01.3d pag. 117

freedom of establishment in the case the conditions of the case *Marks & Spencer* (ECJ, 13 December 2005, C-446/03), no possibilities test is met. Naturally, the application of the *Marks & Spencer* no possibilities test remains uncertain considering not only the litigation still ongoing in this case and the determination of the amount and in what circumstances losses should be considered 'final', but also the uncertainty on whether the flow of negative income (i.e. the surrender of losses whenever they are final) was limited only to upward situations (losses incurred from a subsidiary and surrendered to the parent company) or it would apply to all possible situations in which loss relief was possible under the UK system. The Court ruled in that case that the UK had to allow the cross border relief of the losses incurred by the foreign subsidiaries if those losses could no longer be used either by the subsidiaries or by a third party in the respective State where they were located. My personal view is that the reasoning of the Court in *Marks & Spencer* does not contain such limitation and therefore, does not deny by itself the horizontal loss relief. Nevertheless, I do understand that this issue is far from being clear, particularly in this field of cross border losses.

Bruno da Silva

14 X nv. Withholding wage tax on remuneration due to service provider established in another Member State. Court of Justice (comments by Paternotte)

This judgment of the CJ concerns Netherlands withholding tax (wage tax) on fees paid to foreign (organizations of) artistes or sportsmen. There is no withholding tax if the fee is paid to a domestic organisation.

The CJ ruled that the Netherlands legislation, by levying a withholding tax and imposing a tax liability on the recipient of the services of a foreign service provider, is a restriction of the freedom of rendering services (art. 56 TFEU). Nevertheless, the CJ considered that there is sufficient justification for this restriction because this withholding tax secures the recovery of the taxes that are due by the foreign service provider, and that the Netherlands provisions are appropriate and proportionate. This judgment is in line with the 2006 judgment in the Scorpio case, but there were two reasons why the Netherlands Supreme Court had doubts whether the judgment in the Scorpio case was still valid. The first was the judgment of the Court in the Truck Center case, which suggested a different approach by the Court, and the second was Directive 76/308/EEC on mutual assistance for the recovery of taxes, which was not yet in force at the time of the Scorpio case. The CJ explained in this judgment the difference between Truck Center and Scorpio, and decided that the withholding tax mechanism is still an acceptable way to exercise the taxing powers on foreign service providers. The alternative option of levying tax directly on the foreign service provider might well be more burdensome on the foreign entity than the withholding tax mechanism.

The fact that the Netherlands has decided in later years to stop levying tax on foreign artistes and sportsmen, because the withholding tax mechanism proved to be far more complex than it was expected to be at the time of introduction in 2001, does not change this.

To the last question of the Netherlands Supreme Court the CJ answered that for the judgment, it is not relevant to the decision of the Court whether there is a possibility in the country of residence of the foreign service provider of obtaining a tax credit for the Netherlands wage tax.

CJ 18 October 2012, no. C-498/10

JUDGMENT OF THE COURT (First Chamber)

18 October 2012[1]

(Freedom to provide services – Restrictions – Fiscal legislation – Obligation on the recipient of a service, established in the national territory, to withhold at source the wages tax on the remunera-

1 Language of the case: Dutch.