C-707/20-1

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

Appeal numbers: UT/2019/0089
UT/2019/0101

ON APPEAL FROM THE FIRST-TIER TRIBUNAL
(TAX CHAMBER)

BEFORE: MR JUSTICE MILES
JUDGE ASHLEY GREENBANK

BETWEEN

GALLAHER LIMITED **Appellant**

-and-

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

ORDER

UPON the Appellant and the Respondents providing a draft of the request for a preliminary ruling in accordance with paragraph 90 of the decision of the Tribunal released on 14 December 2020, which has been approved, with amendment, by the Tribunal

IT IS DIRECTED THAT:

1. The questions set out in the Schedule attached hereto shall be referred forthwith to the Court of Justice of the European Union for a preliminary ruling in accordance with Article 267 of the Treaty on the Functioning of the European Union.

2. All further proceedings in these matters be stayed until the said Court of Justice has given its ruling on those questions or until further order.

MR JUSTICE MILES **ASHLEY GREENBANK**

UPPER TRIBUNAL JUDGES

DATE:

SCHEDULE

REQUEST FOR A PRELIMINARY RULING UNDER ARTICLE 267 OF THE TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION BY THE UPPER TRIBUNAL (TAX & CHANCERY CHAMBER) OF THE UNITED KINGDOM

INTRODUCTION

1. This request for a preliminary ruling is made during two appeals to the Upper Tribunal (Tax & Chancery Chamber) (the "**UT**") of the United Kingdom (the "**UK**"). In the present case the UT consists of The Honourable Mr Justice Miles and Judge Ashley Greenbank.

2. The litigation relates to the imposition of a tax charge, with no right to defer payment of the tax, when a UK resident company, Gallaher Ltd ("**GL**"):

   (1) disposed of shares in a subsidiary to an intermediate parent company resident in the Netherlands, namely JT International Holding BV ("**JTIH**"), in 2014 (the "**2014 Disposal**"); and

   (2) disposed of intellectual property rights relating to tobacco brands (the "**Brands**") and related assets to a subsidiary of JTIH resident in Switzerland, namely JT International SA ("**JTISA**"), in 2011 (the "**2011 Disposal**").

3. If the assets had been transferred to a UK resident parent or sister company (or to a non-UK resident parent or sister company carrying on a trade in the UK through a permanent establishment) then there would have been no such tax charge: instead, the disposal would have been on a tax-neutral basis (described in more detail below).

4. The question in the national proceedings is whether the imposition of a tax charge in relation to the 2011 Disposal and 2014 Disposal, with no right to defer payment of the tax, is compatible with EU law – more specifically, with the freedom of establishment in Article 49 of the Treaty on the Functioning of the European Union ("**TFEU**") in relation to both disposals, and additionally with the right to free movement of capital in Article 63 TFEU in relation to the 2011 Disposal. If the imposition of a tax charge with no right to defer payment was in breach of EU law, then questions arise as to the appropriate remedy.

5. GL initially appealed to the First-tier Tribunal (Tax Chamber) (the "**FTT**") against the absence of a right to defer payment of the tax charge arising in relation to the 2011 Disposal and 2014 Disposal – the appeals are referred to respectively as the "**2011 Appeal**" and "**2014 Appeal**". The FTT held that there was a breach of EU law in relation to the 2014 Disposal but not in relation to the 2011 Disposal; it allowed the 2014 Appeal but dismissed the 2011 Appeal. GL then appealed to the UT in relation to the 2011 Disposal, and the UK's tax authority ("**HMRC**") appealed to the UT in relation to the 2014 Disposal.

THE APPELLANTS AND RESPONDENTS

6. GL is the Appellant in relation to the 2011 Disposal and the Respondent in relation to the 2014 Disposal. GL is represented by Mr Philip Baker QC, and Mr Imran S Afzal, barrister, instructed by Freshfields Bruckhaus Deringer LLP, 100 Bishopsgate, London, EC2P 2SR. The instructing solicitor is Ms Sarah Bond, telephone number 00 44 20 7716 4498, email address sarah.bond@freshfields.com.

7. HMRC are the Respondents in relation to the 2011 Disposal and the Appellants in relation to the 2014 Disposal. HMRC is responsible for the management and collection of corporation tax (and many other taxes) in the UK. HMRC are represented by Mr Rupert Baldry QC, and Mr Ben Elliott, barrister, instructed by the General Counsel and Solicitor to HMRC, HMRC's Solicitor's Office, 2nd Floor, Bush House, Strand, London, WC2B 4 ED. The instructing solicitor is Ms Maureen O'Tuminu, telephone number 00 44 3000 589307, email address maureen.otuminu@hmrc.gov.uk.

SUMMARY OF THE FACTS IN THE CASE

8. The facts in relation to the 2011 Disposal and 2014 Disposal are set out below and the relevant group structure and transactions are shown in the Annex to this Schedule.

9. In relation to the group structure:

   (1) GL is a UK resident company and is a member of the Japan Tobacco Inc. ("**JT**") group of companies (the "**JT Group**"). JT is a publicly-listed company resident in Japan. The JT Group is a global tobacco group and distributes products in 130

countries worldwide. GL and JT were incorporated in, respectively, England & Wales and Japan;

(2) GL became a member of the JT Group in 2007 when the shares in its UK resident parent company, Gallaher Group Limited (which at the time was called Gallaher Group Plc) ("**GGL**"), were acquired by a JT Group UK resident company called JTI (UK) Management Limited ("**JTIUM**");

(3) JTIUM is owned by JTIH, a company resident in the Netherlands. JTIH also owns the entire shareholding in JTISA, a company resident in Geneva, Switzerland. Neither JTIH nor JTISA has a permanent establishment within the UK and neither is within the charge to UK corporation tax;

(4) Following a restructuring that took place in 2009 and 2010, Benson & Hedges Limited ("**B&HL**") became GL's immediate parent company. In turn, Gallaher Overseas (Holdings) Limited ("**GOHL**") became the immediate parent of B&H Limited;

(5) Thus, GL is an indirect wholly-owned UK resident subsidiary of JTIH, which holds its interest in GL through its wholly-owned UK resident subsidiaries JTIUM, GGL, GOHL and B&HL, whilst JTISA is a direct wholly-owned Swiss resident subsidiary of JTIH;

(6) JTISA has been based in Geneva since its incorporation in 1999.

10. In relation to the 2011 Disposal:

(1) The 2011 Disposal involved the sale by GL of certain intellectual property rights relating to tobacco brands (the Brands) and related assets to JTISA on 1 January 2011;

(2) All of the Brands continue to be owned by JTISA;

(3) The consideration received by GL for the 2011 Disposal was £2,410,316,000 (the "**Consideration**"). In respect of the Consideration, on 4 January 2011:

(a) JTIH made inter-company loans totalling the amount of the Consideration to JTISA;

(b) JTISA paid the Consideration to GL;

(c) GL paid a dividend for the amount of the Consideration to B&HL, and equivalent dividends for the amount of the Consideration were paid, sequentially, by B&HL to GOHL, by GOHL to GGL and by GGL to JTIUM; and

(d) JTIUM paid a dividend in the amount of £1,260,090,000 to JTIH and, separately, repaid the balance of a £1,150,226,000 outstanding inter-company loan to JTIH;

(4) In consequence of the 2011 Disposal, JTISA acquired legal title to the Brands and related assets;

(5) As a consequence of the 2011 Disposal and contemporaneous contractual arrangements agreed between GL and JTISA, GL's role in relation to the Brands was to act as: (i) a manufacturer in respect of the Brands; and (ii) a limited risk distributor of the products bearing the Brands in the UK; and

(6) Following the 2011 Disposal, GL continued to own the Mayfair brand rights (worldwide rights) and the rights to use certain other brands in Ireland and eastern Europe.

11. In relation to the 2014 Disposal:

(1) On 16 September 2014, GL sold all of the issued share capital which it held as registered shareholder in one of its subsidiaries, an Isle of Man incorporated company, Galleon, to JTIH;

(2) At the same time, Teofani Limited ("**TL**"), which held 0.01% of the issued share capital in Galleon as nominee for GL, also sold its shareholding to JTIH. GL received all of the consideration from JTIH in respect of the 2014 Disposal, including in relation to the shares held on its behalf by TL; and

(3) The consideration received by GL for the 2014 Disposal was £2,089,000. The 2014 Disposal gave rise to a chargeable gain before adjustments of £1,551,000.

12. The reasons for the transactions were dealt with before the FTT as follows:

(1) In the case of each Disposal, the relevant witness or witnesses explained that there was a commercial reason for the relevant Disposal. The reason for the 2011 Disposal was to centralise brand management within the JT Group in order to maximise the value of the brands, whilst the reason for the 2014 Disposal was to rationalise and simplify the structure of the JT Group by liquidating entities which no longer served any useful purpose and ensuring that entities which could not be liquidated were held in a manner which was most sensible, from a risk and efficiency perspective.

(2) Based on the evidence of the witnesses, the FTT found as facts that there were good commercial reasons for each Disposal, that neither Disposal formed part of wholly artificial arrangements which did not reflect economic reality and that neither Disposal had the avoidance of tax as its main purpose or one of its main purposes.

THE RELEVANT NATIONAL LEGISLATION[1]

The charge to UK corporation tax on chargeable gains

13. A UK resident company is chargeable to corporation tax on all its profits (including chargeable gains) accruing to the company in the relevant accounting period: sections 2 and 5 of the Corporation Tax Act 2009 ("**CTA 2009**") and section 8 of the Taxation of Chargeable Gains Act 1992 ("**TCGA 1992**").

14. A non-UK resident company which carries on a trade in the UK through a permanent establishment is chargeable to corporation tax on profits attributable to the permanent establishment: section 5(3) CTA 2009. Further, such a company is chargeable to corporation tax on chargeable gains accruing to the company on the disposal of assets if the assets are situated in the UK and are used for the purposes of the trade or permanent establishment (s.10B TCGA 1992): such assets are referred to as "chargeable assets" (s.171(1A) TCGA 1992).

[1] It should be noted that although the national legislation is described in the present tense, the description of the legislation, and quotes from the legislation, are based on the provisions in force during the relevant accounting periods. Subsequent amendments which are not relevant for present purposes are not referred to.

15. As a shorthand, a company which is chargeable to corporation tax under either of the above heads is referred to herein as being **"within the scope of UK tax"** and a company which is not so chargeable is referred to as being "**outside the scope of UK tax**".

16. Under ss.17 and 18 TCGA 1992, the disposal of an asset is deemed to be for a consideration equal to market value where the disposal is otherwise than by way of a bargain made at arm's length or the disposal is made to a connected person.

17. There is separate legislation relating to intangible assets in Part 8 of CTA 2009 (this legislation is only relevant in relation to some of the assets disposed of in the 2011 Disposal).

The Group Transfer Rules

18. There are two sets of relevant provisions, namely s.171 TCGA 1992 and ss.775-776 CTA 2009 (collectively the "**Group Transfer Rules**"), which provide for a disposal of assets between group companies within the scope of UK tax to take place on a tax-neutral basis (described in the following paragraphs).

Section 171 TCGA 1992

19. This provision is relevant in relation to both the 2011 Disposal and 2014 Disposal.

20. Section 170 TCGA 1992 states (and for each of the accounting periods of GL relevant for the 2011 Appeal and 2014 Appeal stated):

> "**170 Interpretation of sections 171 to 181**
>
> (1) This section has effect for the interpretation of sections 171 to 181 except in so far as the context otherwise requires…
>
> (2) Except as otherwise provided—

(a) …

(b) subsections (3) to (6) below apply to determine whether companies form a group and, where they do, which is the principal company of the group;

(c) …

(d) "group" and "subsidiary" shall be construed with any necessary modifications where applied to a company incorporated under the law of a country outside the United Kingdom.

(3) Subject to subsections (4) to (6) below—

(a) a company (referred to below and in sections 171 to 181 as the "principal company of the group") and all its 75 per cent subsidiaries form a group and, if any of those subsidiaries have 75 per cent subsidiaries, the group includes them and their 75 per cent subsidiaries, and so on, but

(b) a group does not include any company (other than the principal company of the group) that is not an effective 51 per cent subsidiary of the principal company of the group.

(4) A company cannot be the principal company of a group if it is itself a 75 per cent subsidiary of another company.

…

(7) For the purposes of this section and sections 171 to 181, a company ("the subsidiary") is an effective 51 per cent subsidiary of another company ("the parent") at any time if and only if—

(a) the parent is beneficially entitled to more than 50 per cent of any profits available for distribution to equity holders of the subsidiary; and

(b) the parent would be beneficially entitled to more than 50 per cent of any assets of the subsidiary available for distribution to its equity holders on a winding-up.

…"

21. Section 1154 Corporation Tax Act 2010 states (and for each of the accounting periods of GL relevant for the 2011 Appeal and 2014 Appeal stated):

"**1154 Meaning of "51% subsidiary", "75% subsidiary" and "90% subsidiary"**

> (1) Subsections (2) to (4) define, for the purposes of the Corporation Tax Acts[2], the circumstances in which a body corporate ("B") is a 51% subsidiary, a 75% subsidiary or a 90% subsidiary of another body corporate ("A").
>
> …
>
> (3) B is a 75% subsidiary of A if at least 75% of B's ordinary share capital is owned directly or indirectly by A.
>
> …
>
> (6) In this Chapter references to ownership are to be read as references to beneficial ownership."

22. Pausing there, it may be noted that Japan Tobacco Inc. ("**JT**") (a publicly listed company resident in Japan) wholly-owned (indirectly) JTIH, and JTIH wholly-owned (indirectly) GL and (directly) JTISA. It is common ground that pursuant to the definition of "group" in s.170 TCGA 1992, JTIH, GL and JTISA were all members of a group of which JT was the principal company.

23. Section 171 TCGA 1992 states (and for each of the accounting periods of GL relevant for the 2011 Appeal and 2014 Appeal stated):

> "**171 Transfers within a group: general provisions**
>
> (1) Where—
>
> (a) a company ("company A") disposes of an asset to another company ("company B") at a time when both companies are members of the same group, and
>
> (b) the conditions in subsection (1A) below are met,
>
> company A and company B are treated for the purposes of corporation tax on chargeable gains as if the asset were acquired by company B for a consideration of such amount as would secure that neither a gain nor a loss would accrue to company A on the disposal.

[2] Schedule 1, Interpretation Act 1978 defines "*Corporation Tax Acts*" as "*the enactments relating to the taxation of the income and chargeable gains of companies and of company distributions (including provisions relating to income tax)*", and as such the definition includes TCGA 1992.

> (1A) The conditions referred to in subsection (1)(b) above are—
>
> (a) that company A is resident in the United Kingdom at the time of the disposal, or the asset is a chargeable asset in relation to that company immediately before that time, and
>
> (b) that company B is resident in the United Kingdom at the time of the disposal, or the asset is a chargeable asset in relation to that company immediately after that time.
>
> For this purpose an asset is a "chargeable asset" in relation to a company at any time if, were the asset to be disposed of by the company at that time, any gain accruing to the company would be a chargeable gain and would by virtue of section 10B form part of its chargeable profits for corporation tax purposes.
>
> …"

24. Accordingly:

    a. Section 171 TCGA 1992 applies when assets are disposed of from one group company (A) within the scope of UK tax to another group company (B) that is also within the scope of UK tax. The disposal is then treated as taking place for such consideration as gives rise to neither a gain nor a loss (such that B is treated as having acquired the assets at the same cost base as they were acquired by A);

    b. However, in some circumstances a tax charge may arise in the future if the assets are disposed of and give rise to a gain in circumstances where s.171 TCGA 1992 does not apply (e.g., if B disposes of the assets outside the group, or disposes of the assets to a company within the group that is outside of the charge to UK corporation tax). Furthermore, in certain circumstances a tax charge will be imposed if the transferee company (i.e. B) ceases to be a member of the group within six years of the disposal to it (s.179 TCGA 1992);

c. A tax charge (or the realization of an allowable loss) will therefore only arise if certain chargeable events occur. Furthermore, in some cases, there is no certainty that the amount of that tax charge (or the value of the loss accruing) will be equivalent to that which would have accrued on the original disposal. For example, where the future chargeable event is an onward disposal by B to a person outside the scope of the Group Transfer Rules, the computation of any gain (or loss) will be made by reference to the actual or deemed consideration for the onward disposal and the amount of any tax charge, if any, will depend on factors including the rate of corporation tax at that time and whether B has losses which may be offset against any chargeable gain.

25. The effect of s.171(1A)(b) TCGA 1992 is that the transferee must be within the scope of UK tax (either as a UK resident company, or because the asset is a "chargeable asset" in relation to a non-UK resident company by virtue of s.10B TCGA 1992). Section 171 TCGA 1992 did not apply in relation to the 2011 Disposal or 2014 Disposal because neither JTISA nor JTIH was within the scope of UK tax: if they had been, then the relief would have applied.

<u>Sections 775-776 CTA 2009</u>

26. These provisions are only relevant in relation to some of the assets disposed of in the 2011 Disposal (generally being intangible fixed assets created or acquired by GL or its associates since 1 April 2002).

27. Chapter 9 of Part 8 CTA 2009 contains provisions relating to disposals of intangible fixed assets between companies who are members of the same group. Groups are

defined within Chapter 8 of Part 8 CTA 2009 and ss.764-765 CTA 2009 state (and for the accounting period of GL relevant for the 2011 Appeal stated):

> "**764 Meaning of "company", "group" and "subsidiary"**
>
> (1) This Chapter applies for the purposes of this Part to determine whether companies form a group and, where they do, which is the principal company of the group.
>
> …
>
> **765 General rule: a company and its 75% subsidiaries form a group**
>
> (1) The general rule is that—
>
> (a) a company ("A") and all its 75% subsidiaries form a group, and
>
> (b) if any of those subsidiaries have 75% subsidiaries, the group includes them and their 75% subsidiaries, and so on.
>
> (2) A is referred to in this Chapter and in Chapter 9 as the principal company of the group.
>
> (3) Subsections (1) and (2) are subject to the following provisions of this Chapter."

28. Section 767 CTA 2009 states (and for the accounting period of GL relevant for the 2011 Appeal stated):

> "**767 Principal company cannot be 75% subsidiary of another company**
>
> (1) The general rule is that a company ("A") is not the principal company of a group if it is itself a 75% subsidiary of another company ("B").
>
> …"

29. It is common ground that, for the purposes of Part 8 CTA 2009 (as with s.170 TCGA 1992), JTIH, JTISA and GL are all members of a group of which JT is the principal company.

30. Section 775 CTA 2009 states (and for the accounting period of GL relevant for the 2011 Appeal stated):

> "**775 Transfers within a group**
>
> (1) A transfer of an intangible fixed asset from one company ("the transferor") to another company ("the transferee") is tax-neutral for the purposes of this Part if—
>
> > (a) at the time of the transfer both companies are members of the same group,
> >
> > (b) immediately before the transfer the asset is a chargeable intangible asset in relation to the transferor, and
> >
> > (c) immediately after the transfer the asset is a chargeable intangible asset in relation to the transferee.
>
> (2) For the consequences of a transfer being tax-neutral for the purposes of this Part, see section 776.
>
> …"

31. Section 776 CTA 2009 states (and for the accounting period of GL relevant for the 2011 Appeal stated):

> "**776 Meaning of "tax-neutral" transfer**
>
> (1) This section sets out the consequences of a transfer of an asset being "tax-neutral" for the purposes of this Part.
>
> (2) The transfer is treated for those purposes as not involving—
>
> > (a) any realisation of the asset by the transferor, or
> >
> > (b) any acquisition of the asset by the transferee.
>
> (3) The transferee is treated for those purposes—
>
> > (a) as having held the asset at all times when it was held by the transferor, and
> >
> > (b) as having done all such things in relation to the asset as were done by the transferor.
>
> (4) In particular—
>
> > (a) the original cost of the asset in the hands of the transferor is treated as the original cost in the hands of the transferee, and

(b) all such credits and debits in relation to the asset as have been brought into account for tax purposes by the transferor under this Part are treated as if they had been brought into account by the transferee.

(5) The references in subsection (4)(a) to the cost of the asset are to the cost recognised for tax purposes."

32. The term "chargeable intangible asset" is defined by s.741 CTA 2009. The latter provision states (and for the accounting period of GL relevant for the 2011 Appeal stated):

"**741 Meaning of "chargeable intangible asset" and "chargeable realisation gain"**

(1) For the purposes of this Part, an asset is a "chargeable intangible asset" in relation to a company at any time if any gain on its realisation by the company at that time would be a chargeable realisation gain.

(2) For the purposes of this Part, "chargeable realisation gain", in relation to an asset, means a gain on the realisation of the asset that gives rise to a credit required to be brought into account under this Chapter.

…

(4) For the purpose of subsections (1) and (2), ignore any question whether—

(a)…

(b) a transfer of an asset is tax-neutral for the purposes of this Part (see section 776)."

33. An asset was a "chargeable intangible asset" in relation to a company that was UK resident or which used the asset for the purposes of a trade carried on in the UK through a permanent establishment.

34. Accordingly:

a. If s.775 CTA 2009 applies, then no tax charge (or relief for a loss) arises when intangible fixed assets are transferred from one group company (A) that is within the scope of UK tax to another group company (B) that is also within the scope of UK tax. This is because B is treated as having held the asset at all times that it was held by A, and as having acquired the asset at the same base cost as A.

b. However, a tax charge (or relief for a loss) may arise in the future if the assets are disposed of in circumstances where s.775 CTA 2009 does not apply (e.g., if B disposes of the assets outside the group, or disposes of the assets to a company within the group that is outside the scope of UK tax). Furthermore, in certain circumstances a tax charge will be triggered if the transferee company (i.e. B) ceases to be a member of the group within six years of the disposal to it (s.780 CTA 2009);

c. Once again, a tax charge (or the realization of any loss) will therefore only arise if certain chargeable events occur. Furthermore, in some cases, there is no certainty that the amount of that tax charge (or the value of the loss accruing) will be equivalent to that which would have accrued on the original disposal. For example, where the future chargeable event is an onward disposal by B to a person outside the scope of the Group Transfer Rules, the computation of any gain (or loss) will be made by reference to the actual or deemed consideration for the onward disposal and the amount of any tax charge, if any, will depend on factors including the rate of corporation tax at that time and whether B has losses which may be offset against any gain.

35. Since JTISA was not within the scope of UK tax in relation to the relevant assets, s.775 CTA 2009 did not apply to relieve any profits (or limit any losses), but it would have done if JTISA had been within the scope of UK tax (in relation to the relevant assets).

The Applicable Double Taxation Conventions

36. The UK has entered into a wide network of treaties and conventions with other territories, typically based on the OECD Model Tax Convention, under which the territories have agreed that gains arising from the alienation of assets such as those that are relevant to the present proceedings are taxable only in the territory in which the alienator is resident (or in which the alienator is carrying on business through a permanent establishment).

37. Article 13(5) of the UK-Switzerland Double Taxation Convention is the provision relevant to the 2011 Disposal:

> "**Article 13 - Capital gains**
> …
> (5) Gains from the alienation of any property other than that referred to in paragraphs (1), (2), (3) and (4)[3] shall be taxable only in the Contracting State of which the alienator is a resident."

38. Article 25 of the UK-Switzerland Double Taxation Convention provides for the exchange of information between the competent authorities of the two Contracting States.

[3] The assets that are the subject of the present proceedings do not fall within paragraph (1), (2), (3) or (4).

39. Article 13(5) of the UK-Netherlands Double Taxation Convention is the provision relevant to the 2014 Disposal:

> "**Article 13 - Capital gains**
> …
> (5) Gains from the alienation of any property other than that referred to in paragraphs (1), (2), (3) and (4)[4] of this Article, shall be taxable only in the Contracting State of which the alienator is a resident."

Payment of corporation tax

40. Ordinarily corporation tax for an accounting period is payable nine months and one day after the end of the period (s.59D Taxes Management Act 1970 ("**TMA 1970**")):

> "**Section 59D — General rule as to when corporation tax is due and payable**
> (1) Corporation tax for an accounting period is due and payable on the day following the expiry of nine months from the end of that period.
> (2) If the tax payable is then exceeded by the total of any relevant amounts previously paid (as stated in the relevant company tax return), the excess shall be repaid.
> …"

41. Interest is chargeable under section 87A TMA 1970 on unpaid tax from the date on which it is payable.

42. Under sections 55-56 TMA 1970, where a decision of HMRC (including a partial closure notice) amending a company's return for a particular accounting period has been appealed to the FTT, payment of the tax charged may be postponed by agreement with HMRC (or by application to the FTT) such that it only becomes payable on the determination of the appeal to the FTT.

[4] The assets that are the subject of the present proceedings do not fall within paragraph (1), (2), (3) or (4).

The requirement under UK law to interpret domestic legislation consistently with EU law

43. Pursuant to section 2 of the European Communities Act 1972 ("**ECA 1972**"), a UK court will, if at all possible, interpret the national legislation so as to make it conform with EU law and to give effect to directly enforceable EU law rights (including rights conferred by Articles 49 and 63 TFEU). In seeking to apply a conforming construction, the national court is not constrained by conventional rules of statutory interpretation and adopts a "highly muscular" approach, analogous to the approach in *Marleasing*[5] so as to ensure national legislation conforms with the directly enforceable Treaty obligations of the UK.[6]

44. If it is unable to apply such a conforming construction to the legislation, the national court will 'disapply' it, which means that the legislation should be read as though there was a proviso that it was to be "without prejudice to the directly enforceable Community rights of nationals of any member state of the EEC"[7].

45. As a matter of domestic law a conforming construction or disapplication would, like any other interpretation of national legislation by a court or tribunal, provide an interpretation of what the law has always been, although, for the avoidance of doubt, it is unclear whether it is permissible as a matter of EU law for a remedy involving payments of tax in instalments to provide for retrospective payment dates (and

[5] Case 106/89 *Marleasing v La Comercial Internacional de Alimentación* [1990] ECR I-4135
[6] *Test Claimants in the Franked Investment Income Group Litigation v Commissioners of Inland Revenue* [2012] UKSC 19 at paragraph 176, per Lord Sumption.
[7] E.g. *R v Secretary of State for Transport, ex parte Factortame Ltd* [1990] 2 AC 85 at 140; *Fleming (t/a Bodycraft) v CCE* [2008] UKHL 2, [2008] 1 WLR 195 at paragraph 24.

guidance is requested from the Court of Justice of the European Union in this respect in the questions referred below).

THE NATIONAL PROCEEDINGS

46. HMRC issued decisions (partial closure notices)[8] determining the amount of chargeable gains and profits that accrued to GL in the relevant accounting periods in relation to the 2011 Disposal and the 2014 Disposal.

47. GL appealed to the FTT against the partial closure notices. Payment of the corporation tax was postponed pending determination of the appeals, as it was entitled to do pursuant to s 55 TMA 1970. Accordingly, GL have not been required to pay (and have not paid) any of the relevant corporation tax.

48. The FTT dismissed GL's appeal against the decision (the partial closure notice) relevant to the 2011 Disposal and upheld that decision (subject to an issue relating to the valuation of the assets disposed of which remains outstanding). The FTT allowed GL's appeal against the decision (the partial closure notice) relevant to the 2014 Disposal and set aside that decision. The parties' positions in the proceedings are summarised in the following positions.

2014 Appeal

49. GL submitted that (1) the absence of a right to defer payment of the tax charge was a restriction on JTIH's freedom of establishment, and (2) in principle (i.e. subject to proportionality) the UK was justified in taxing the accrued gains based on a balanced

[8] Issued on 6 February 2018 (for the 2011 Appeal) and 17 July 2018 (for the 2014 Disposal).

allocation of taxing powers, but (3) the requirement to pay the tax immediately without an option to defer payment was disproportionate.

50. HMRC accepted that there was a difference in treatment between JTIH and a company within the scope of UK tax, but submitted that there was a lack of objective comparability such that either there was no restriction or alternatively a restriction was justified (HMRC no longer contends that there was a lack of objective comparability). In any case HMRC submitted that the immediate imposition and collection of a tax charge was justified and proportionate.

51. The FTT held that there was a restriction (which in any case was common ground), that JTIH was objectively comparable to a company within the scope of UK tax (which is no longer in dispute), and that the absence of a right to defer payment of the tax charge was disproportionate. In principle the FTT considered that a remedy involving an option to defer on an instalment basis was compatible with EU law, but it could not give effect to this (since it was not for the FTT to decide on the precise details of an instalment plan) and instead the exit tax charge was disapplied.

52. HMRC appealed to the UT against the FTT's decision to allow the 2014 Appeal.

2011 Appeal

53. GL submitted that (1) the absence of a right to defer payment of the tax charge was a restriction on JTIH's freedom of establishment, (2) further or alternatively the absence of a right to defer payment of the tax charge was a restriction on JTIH's and/or GL's right to free movement of capital, and (3) in principle (i.e. subject to proportionality) the UK was justified in taxing the accrued gains based on a balanced

allocation of taxing powers but (4) the requirement to pay the tax immediately without an option to defer payment was disproportionate.

54. In relation to the freedom of establishment HMRC submitted that:

(1) There was no restriction, JTISA was not in an objectively comparable position to a company within the scope of UK tax (HMRC no longer contends that there was a lack of objective comparability), and in any case an immediate tax charge was justified and proportionate;

(2) JTIH was not treated differently when compared to a UK resident company because the same provisions apply regardless of the place of residence of the parent company; and

(3) In relation to the right of free movement of capital HMRC's primary argument was that the freedom could not be relied upon in relation to legislation (such as that in issue in the present case) that was only applicable to groups of companies which are under common control. In the alternative, HMRC submitted:

(a) although there was a movement of capital by JTIH, Articles 64 and 65 TFEU applied and in any case JTIH was not treated differently to a UK resident company;

(b) there was no movement of capital by GL, and in any case Articles 64 and 65 TFEU applied; and

(c) in any case if there was a restriction it was justified and proportionate.

55. The FTT held that there was no restriction on JTIH's freedom of establishment, although, if there had been, its views on justification, proportionality and the

appropriate remedy in relation to the 2014 Appeal would have applied (see above). In relation to the right to free movement of capital the FTT held that this could not be relied upon because the legislation only applied to group situations consisting of companies under common control. The FTT also expressed some views on what the position would have been if Article 63 TFEU could be relied upon, in particular: in relation to JTIH there was no restriction on the right to free movement of capital, although, if there had been, then Article 64 TFEU (but not Article 65 TFEU) would have applied; and in relation to GL there was a restriction on the right to free movement of capital, and neither Article 64 nor 65 TFEU applied.

56. GL appealed to the UT against the FTT's dismissal of the 2011 Appeal.

SUMMARY OF GL's SUBMISSIONS

Issues relating to breach of the freedom of establishment

57. It is convenient to first address the 2014 Disposal since this involved a disposal to a company resident within the EU, and to then turn to the 2011 Disposal.

2014 Disposal

58. It is common ground that there was a restriction on JTIH's freedom of establishment (because s.171 TCGA 1992 would have applied if JTIH had been resident in the UK instead of the Netherlands).

59. In relation to justification and proportionality, GL submits that in principle (i.e. subject to proportionality) the UK is justified in taxing the gains that accrued before the assets were disposed of to JTIH based on the balanced allocation of taxing powers, but the immediate imposition of a tax charge (i.e. the requirement to pay tax

immediately without an option to defer payment) was disproportionate. Numerous cases including *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond / kantoor Rotterdam* (Case C-371/10) ("***National Grid***"), *DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte* (Case C-164/12) ("***DMC***") and *Verder LabTec GmbH & Co. KG v Finanzamt Hilden* (Case C-657/13) ("***LabTec***") establish that it is proportionate for a Member State to determine the amount of tax at the time when assets are transferred outside of its tax net, but the immediate imposition of an exit tax charge without an option to defer is disproportionate. Furthermore, the fact that GL has not been required to pay tax in circumstances where it has proceeded with litigation is entirely irrelevant: in order for domestic law to have been compatible with EU law it must have contained an option to defer tax which was available irrespective of whether there was litigation.

2011 Disposal

60. GL submits that there was a restriction on JTIH's freedom of establishment, notwithstanding that the assets were disposed of to a company resident outside the EU (namely JTISA in Switzerland). In outline (but without limitation) this is for the following reasons.

61. There was a difference in treatment between JTIH and a UK parent company for two reasons and thus there was a restriction on the freedom of establishment.

62. One reason is that the Court of Justice of the European Union ("**CJEU**") has held that a proper comparison is between the actual facts and a wholly domestic situation, i.e. if GL had a UK parent *and* it transferred assets to a UK sister company: see, for example, *Société Papillon v Ministère du Budget, des Comptes publics et de la*

Fonction publique (Case C-418/07) at paragraphs 27 and 32. In the former scenario there was an immediate tax charge but there would not have been in the latter scenario. As such for JTIH it was the case that its subsidiary suffered an immediate tax charge, whereas, on the proper comparison, for a UK parent company it would have been the case that its subsidiary did not suffer an immediate tax charge: that was a difference in treatment between JTIH and a UK parent company.

63. Another reason why there was a difference in treatment is because a UK parent company *might* (and in many cases would) head a wholly domestic group, whereas JTIH's acquisition of GL *necessarily* involved a multinational group. Thus whilst both a UK parent and JTIH might want to move assets between group companies, in the former scenario the group *might* (and in many cases would) be wholly domestic in which case the transfer of assets would always be within the UK and thus benefit from a deferral of tax charge, whereas in the latter scenario the group was *necessarily* multinational and a transfer of assets to cross-border group companies would not benefit from a deferral of tax charge. The fact that if a UK parent company had acquired GL then it *might* (and in many cases would) have been the case that all transfers of assets between group companies would benefit from a deferral of tax charge, whereas in relation to JTIH this *necessarily* could not be the case, is a difference in treatment and thus a restriction on the freedom of establishment.

64. Furthermore, although there was in fact a difference in treatment, this is not actually necessary for a restriction on the freedom of establishment to exist. Instead, it is sufficient that the national measure "*render less attractive the exercise of the freedom of establishment*": see, for example, *National Grid* at paragraph 36. The fact that GL would not be able to transfer assets to group companies abroad without suffering an

immediate tax charge, despite the fact that the assets would remain in the same economic ownership, would render less attractive the exercise of the freedom of establishment by JTIH in acquiring GL and thus there was a restriction.

65. The existence of a restriction is reinforced by the various cases decided by the CJEU in relation to exit taxes. Broadly, these are cases where a tax charge arose on accrued gains if the residence of the taxpayer moved to another state, or if the assets were moved to another state, but there would have been no immediate tax charge if the taxpayer/assets remained within the first state. There are numerous such cases, and examples include *National Grid*, *DMC* and *LabTec* referred to above. The exit tax cases establish that, although the Member State is entitled to tax the gains accruing when the assets were within its tax net, the immediate imposition of tax was a restriction on the applicable freedom which was typically the freedom of establishment. As with the exit tax cases, in the present case the assets remained within the same economic ownership and there would not have been an immediate tax charge if the assets had remained within the UK's tax net. It follows from the exit tax case law that the UK was in principle entitled to tax the accrued gains, but the immediate imposition of tax was a restriction on the freedom of JTIH to establish in the UK (i.e. by acquiring GL).

66. The position is further reinforced by the CJEU's decision in *Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue* (Case C-524/04) ("***Thin Cap***"). The CJEU held that the freedom of establishment was restricted by limits on interest deductibility both if (1) loans were made from the EU parent of a UK subsidiary, or (2) loans were made from another subsidiary of the EU parent *wherever resident (i.e. even if outside the EU)*. The latter situation is analogous to the

2011 Disposal and demonstrates that the unavailability of deferral in relation to the 2011 Disposal restricts JTIH's freedom of establishment in acquiring GL, and the location of the sister company (JTISA) is irrelevant to the analysis.

67. If, as submitted, there was a restriction on JTIH's freedom of establishment, then GL submits that the immediate imposition of tax (i.e. the requirement to pay the tax immediately without an option to defer payment) was unjustified and/or disproportionate: the submissions on these points in relation to the 2014 Disposal (see above) apply *mutatis mutandis*.

<u>Issues relating to breach of the right to free movement of capital</u>

Interaction between the freedom of establishment and the right to free movement of capital

68. GL submits that in principle JTIH's and GL's right to the free movement of capital can be relied upon notwithstanding that the domestic legislation only applies in group situations.

69. In a number of cases, the CJEU has held that Article 63 TFEU may be relied upon where there is a controlling holding of shares in a company located in a third country (i.e. in a situation which would fall within the scope of the freedom of establishment but-for the fact that a third country is involved): see, for example, *Kronos International Inc v Finanzamt Leverkusen* (Case C-47/12) ("***Kronos***") at paragraph 39, and *EV v Finanzamt Lippstadt* (Case C-685/16) ("***EV***") at paragraphs 32-42.

70. The fact that the Group Transfer Rules only apply to group situations does not affect the foregoing for the following reasons.

71. It is clear from cases such as *Kronos* and *EV* that Article 63 TFEU can be relied upon in circumstances where legislation is not limited to controlling shareholdings, and that is so even if on the actual facts there is a controlling shareholding. GL submits that there is no relevant difference between such a scenario and one where the legislation only applies to controlling shareholdings, such that Article 63 TFEU should apply in the latter case. In any event, irrespective of whether the foregoing is correct, both JTIH's and GL's right to free movement of capital can be relied upon for the following reasons.

72. JTIH's right to free movement of capital can be relied upon because the present case involves two relevant shareholdings, namely one in GL and one in JTISA. There is no case in which the CJEU has stated that in circumstances such as the present, namely where a parent company resident in a Member State (JTIH) has two relevant shareholdings (GL and JTISA), that *both* must fall within the scope of the freedom of establishment. GL submits that given that the freedom of establishment was exercised in relation to JTIH's shareholding in GL, Article 63 TFEU can be relied upon in relation to JTISA.

73. So far as GL itself is concerned, there is no question of it having exercised the freedom of establishment vis-à-vis JTISA since it was in a sister company relationship, not in a parent-subsidiary relationship. Thus, there is no potential obstacle to Article 63 TFEU applying to GL (and a movement of capital from GL to JTISA).

Breach of JTIH's right to free movement of capital

74. It is common ground that there were movements of capital by JTIH, namely the establishment by JTIH of JTISA, the subscription of shares by JTIH in JTISA and the

making of loans by JTIH to JTISA (in relation to the financing of the consideration for the 2011 Disposal). GL submits that there was a restriction on JTIH's free movement of capital rights for similar reasons to those set out above in relation to the freedom of establishment.

75. Furthermore, GL submits that the standstill in Article 64 TFEU does not apply for various reasons. Article 64 TFEU only applies to certain types of movement of capital and for present purposes the relevant category is direct investments. GL submits that JTIH's movements of capital were not direct investments. Further or alternatively, to the extent they were direct investments, they were also types of movement of capital not referred to in Article 64 TFEU, and in such circumstances Article 64 TFEU cannot apply. In any case, in GL's submission, the relevant restrictions in the Group Transfer Rules did not exist on 31 December 1993[9].

76. In addition, GL submits that Article 65 TFEU does not apply.[10] The combined effect of Articles 65(1) and 65(3) TFEU is that the UK is in this regard in a similar position to that in which it is placed in relation to the freedom of establishment, i.e. it cannot treat differently two objectively comparable circumstances merely because, in one case but not the other, the capital is being moved out of the UK.

77. Finally, it is submitted that the restriction was unjustified and/or disproportionate for the same reasons as those set out above in relation to the freedom of establishment.

[9] The UT does not require guidance from the CJEU in relation to this point and thus the questions for the CJEU do not refer to this issue.
[10] The UT does not require guidance from the CJEU in relation to Article 65 TFEU and thus the questions for the CJEU do not refer to this issue, but for completeness submissions on the point are set out.

Breach of GL's right to free movement of capital

78. GL submits that the transfer of assets from GL to JTISA involved a movement of capital. This is supported by the Nomenclature of Capital Movements (annexed to Council Directive 88/361/EEC) which has been referred to frequently by the CJEU as containing an indicative (albeit non-exhaustive) list of capital movements. It is clear from the Nomenclature that the fact that each party to a transaction gives and receives equal consideration does not prevent there being a movement of capital, and also that there can be movements of capital in relation to intangibles (see paragraph D of Section XIII). In addition, the introductory paragraphs in the Nomenclature state that "*the capital movements listed in this Nomenclature are taken to cover…operations to…assign assets built up*" and the CJEU has confirmed that this is also a relevant capital movement (*Glaxo Wellcome GmbH & Co. KG v Finanzamt München II* (C-182/08) at paragraphs 42-43).

79. As such, GL exercised its free movement of capital rights when it transferred assets to JTISA. Plainly there was a difference in treatment between the situation if GL had transferred assets to a UK group company (in which case there would have been a deferral of tax), and the actual situation whereby GL transferred the assets abroad (which meant that there was an immediate exit tax charge). The imposition of an immediate charge to tax would deter such a transfer, when compared to a transfer by GL to a sister company resident in the UK. That difference in treatment constituted a restriction on the right to free movement of capital.

80. It is submitted that neither Articles 64 nor 65[11] TFEU apply for the same reasons as those set out above in relation to JTIH.

81. Furthermore, it is submitted that the restriction was unjustified and/or disproportionate for the same reasons as those set out above in relation to the freedom of establishment.

Issues relating to the appropriate or permissible remedy

82. The fundamental question is whether EU law requires that GL be provided with a remedy involving an option to defer on an instalment basis or on a realisation basis, and a number of specific points are relevant to this.

83. GL submits that although the CJEU considered an instalment basis to be proportionate in *DMC* and *LabTec* that was only because the option to pay in instalments already existed in domestic law in those cases, i.e. it would not have been proportionate for a remedy consisting of deferral on an instalment basis to be provided after the event. In any case it is submitted that the position was subsequently moved on in *Martin Wächtler v Finanzamt Konstanz* (C-581/17) ("***Wächtler***") such that, even if domestic law provides for deferral on an instalment basis, it is nonetheless necessary for taxpayers to be given the option of deferral on the realisation basis.

84. Furthermore, even if in principle deferral on an instalment basis might be proportionate, GL submits that as a matter of EU law it is necessary for national courts to provide a remedy which interferes with the protected EU law freedom to the least extent, as opposed to a remedy which, although proportionate, departs from the

[11] As per above the UT does not require guidance from the CJEU in relation to Article 65 TFEU.

existing national law to the least extent. This is another reason why a remedy involving deferral on an instalment basis is not possible.

85. If contrary to the foregoing points a remedy consisting of deferral on an instalment basis would be compatible with EU law in the present case, then GL submits that (a) as a minimum the deferral should be over a five year period, and (b) all the instalments must be prospective, i.e. if some or all of the instalments were due prior to the remedy being afforded then that would not be an effective remedy for EU law purposes.

SUMMARY OF HMRC's SUBMISSIONS

The 2014 Appeal

86. HMRC accept that JTIH has exercised the freedom of establishment under Article 49 TFEU by establishing and maintaining GL as its UK subsidiary. HMRC further accept that the Group Transfer Rules apply a different treatment to (1) the disposal of an asset by a group company within the scope of UK corporation tax to a group company outside the scope of UK corporation tax (such as JTIH) and (2) the disposal of an asset by a group company within the scope of UK corporation tax to another group company within the scope of UK corporation tax. In the present case, specifically, the disposal of the Galleon shares to JTIH gave rise to an immediate liability to corporation tax, without any option to defer payment of the tax, whereas, if JTIH had been within the scope to UK corporation tax, the transfer would have been tax neutral.

87. HMRC's primary case on the 2014 Appeal is that any restriction on freedom of establishment caused by the imposition of an immediate corporation tax liability, without any deferral option, is justified by overriding reasons in the public interest (in

particular the need for the balanced allocation of taxing powers). HMRC contend that it is proportionate for HMRC to collect the tax charged on the 2014 Disposal in the ordinary way, without giving the taxpayer company any option to defer payment.

88. The CJEU has recognised that safeguarding the balanced allocation of taxing rights justifies treating cross-border transactions differently to transactions within a single fiscal jurisdiction. The exit charge cases are typically concerned with legislation which imposes an immediate tax charge, based on the market value of assets leaving a fiscal territory in circumstances where either:

(1) the taxpayer itself becomes resident in another Member State: *National Grid* and Case C-646/15 *Trustees of the P Panayi Accumulation and Maintenance Settlements ("**Panayi**")*; or

(2) the taxpayer transfers an asset to a permanent establishment in another Member State: *LabTec*.

89. Exit charges of this kind are typically designed to tax unrealised capital gains generated within the territory of the Member State. Such a regime gives rise to a difference in treatment between the cross-border movement and an internal movement. Specifically, the cross-border movement entails the immediate taxation of the unrealised gain, whereas the internal movement does not. The CJEU has however consistently ruled that the restriction may be nevertheless be justified by the need to preserve the balanced allocation of powers of taxation between Member States: *National Grid* at paragraphs 46 and 94*; LabTec* at paragraph 47; *Panayi* at paragraph 53. Measures pursuing such objectives are necessary to preserve the fiscal principle of territoriality which entitles a member state to impose tax at the time of

transfer on capital gains generated within its territory: *National Grid* at paragraph 46, *LabTec* at paragraph 43[12].

90. Accordingly, the CJEU has confirmed that a Member State is entitled to tax the economic value generated by a capital gain in its territory, even if the gain has not yet actually been realised: *National Grid* at paragraph 49.

91. The justification for the immediate imposition of tax is consistently linked to the ability of the Member State to exercise its powers of taxation in relation to those gains: see *DMC* at paragraph 53; *LabTec* at paragraph 45. These decisions show that a Member State is justified in imposing an immediate charge to tax, even where the gains have not been realised, *in order to ensure those assets are taxed*. See also, in this regard, Article 5 of the Tax Avoidance Directive (Council Directive (EU) 2016/1164).

92. The case law has however recognised that the immediate recovery of the tax due on unrealised gains could produce cash-flow problems for the taxpayer: *National Grid* at paragraph 68. The CJEU has recognised that requiring a taxpayer to fund a tax charge out of hypothetical profits will necessitate the taxpayer obtaining the funds from other sources unconnected with the assets, or from borrowing. In those circumstances, the CJEU has held that offering the taxpayer the choice between paying the tax immediately or deferring payment for a period would be an appropriate and proportionate means of achieving the objective of ensuring the balanced allocation of the powers of taxation.

[12] Such measures may also be justified on grounds of fiscal coherence, but there is no need to rely on a separate justification: see the opinion of the AG in *National Grid* at paragraphs 91-100.

93. In the various exit-tax cases the objective of the imposition of the charge is to enable the Member State to protect itself against the *loss* of its taxing rights over the asset in question. The Member State is entitled to impose tax at the time of the exit, even though the asset has not been relevantly disposed of, but it would be disproportionate to require payment of that tax without some deferment option.

94. HMRC contend that, in the present case, the difference in treatment between (1) disposals to group companies within the scope of UK tax and (2) disposals to group companies outside the scope of UK tax is in principle justified by the same overriding reasons in the public interest as the exit tax cases. Turning to proportionality, the present case is, however, materially different. Both under domestic law and in accordance with the taxing rights allocated to the UK under the terms of its double taxation agreements, the UK is entitled to charge tax on actual disposals of assets made by companies which are resident in the UK for tax purposes in the year of disposal. The objective of the tax charge is to enable the tax to be charged and collected on that actual disposal in the ordinary way.

95. The Group Transfer Rules are not a special relief available to resident companies in the group, but are a mandatory treatment for members of such a group where both the transferor and the transferee are within the charge to UK corporation tax, irrespective of the territory in which the companies are resident. The UK scheme (in contrast to regimes in other Member States that provide for fiscal unity or fiscal consolidation) does not require fiscal results to be consolidated at the level of a domestic resident parent. Rather, they start from the definition of a group (in section 170 TCGA 1992 and Chapter 8 of Part 8 CTA 2009) that encompasses all companies, wherever resident, under the common ownership and control of a principal group company.

Various tax rules are then applied to companies within that group which are within the charge to corporation tax. Each of those companies, however, retains its independent fiscal 'identity' and is chargeable and assessable on its individual profits.

96. In the particular circumstances of the present case, all the conditions for the ordinary domestic charge are satisfied (there is an actual disposal of an asset by a company within the scope of UK corporation tax) and that domestic charge is one that is expressly allocated to the UK under the UK's Double Tax Conventions.

97. The 'exit tax' cases have identified a specific cashflow difficulty, namely that, in those cases, a requirement to fund payment of the relevant tax charge arises in circumstances in which there has not been an actual disposal and the taxpayer has not realised proceeds with which it might pay the tax. The existence of such a cashflow problem has led the CJEU to hold that 'exit tax' charges are not proportionate in circumstances in which the taxpayer is not granted a deferral to pay the relevant tax.

98. Contrary to the situation in the 'exit tax' cases, in the present case the gains *were* realised by the company (GL) making an actual disposal and receiving full market consideration (in cash). In the circumstances of the 2014 Appeal, GL transferred the Galleon shares to JTIH for consideration of £2,089,000, which was paid. Accordingly, the cashflow disadvantage identified in the 'exit tax' cases does not arise in the present case. In such circumstances, it is proportionate for tax to be charged and collected under the ordinary national legislation.

99. Contrary to GL's argument there is no requirement to treat the world-wide group as a single economic unit such that *JTIH* has not meaningfully "realised" the accrued gain

on the Galleon shares. GL is the entity which realised the gain and it realised that gain on the disposal of an asset at a time when it was UK resident.

100. The present case is also materially different from *DMC,* Case C-292/16 *A Oy* ("***A Oy***") and Case C-591/13 *Germany* ("***Germany***"). Those cases were not concerned with a straightforward disposal of an asset from one entity to another. The transfer of an interest in a partnership to a capital company (*DMC)* or the transfer of a permanent establishment to a company (*A Oy*) are both types of reconstruction, which the national provisions treated as giving rise to a charge on the <u>unrealised</u> gains on the underlying assets. *Germany* concerned a 'roll-over' relief under which the German rules tax a gain on which tax is due to be paid without deferral unless the conditions for the deferral relief are met. That treatment applied whether or not the original gain was realised or unrealised, so that whether or not the particular relief could be claimed did not depend on the nature of the initial gain. The regime gave rise to a cash flow disadvantage for the taxpayer comparable to the situation in which an immediate taxation of unrealised gains (e.g., as was the situation in *National Grid* and *Panayi*). The CJEU accordingly held that providing an option for deferral of the tax payment would be an appropriate measure. That decision provides no support for the proposition that the gains arising from a cross-border transfer of assets must be treated in the same way whether they are realised or unrealised.

<u>The 2011 Appeal (Switzerland)</u>

(i) The applicable freedom

101. As the 2011 Appeal concerns a disposal of assets by a UK resident company to a company resident in a third country the applicable freedom is of particular

significance. HMRC contend that the Group Transfer Rules fall only within the scope of freedom of establishment. On the facts of the present case, however, Article 49 TFEU may not be relied upon by GL as the tax charge arises on the disposal of an asset by a UK resident subsidiary to a sister company resident in a third country. There is no less favourable tax treatment applied to that disposal based on the residence or nationality of the common parent (JTIH).

102. HMRC contend that it is well-established that legislation targeted at relations within a group of companies primarily affects the freedom of establishment. Any restrictive effects of the free movement of capital must therefore be seen as an unavoidable consequence of any restriction on the freedom of establishment and therefore do not justify an independent examination of the relevant legislation in the light of Article 63 TFEU: Case C-196/04 *Cadbury Schweppes plc v IRC* at paragraph 32; *Thin Cap* at paragraph 33 and Case C-35/11 *Test Claimants in the FII Group Litigation (“**FII 2**”).*

103. Contrary to GL’s submissions, the factual situation of a controlling holding of shares does not determine which freedom applies. The relevant question is whether the legislative provisions under consideration are targeted at relations within a group (see cases cited in paragraph above). The Group Transfer Rules are targeted solely at relations within a group. It therefore follows that the Group Transfer Rules fall within the scope of Article 49 TFEU and an independent examination of these provisions in light of Article 63 TFEU is not justified.

104. For the same reason, it must also follow that the freedom to move capital has no application to the operation of the Group Transfer Rules, either in relation to a

movement of capital from a parent company resident in a member state to a subsidiary in a third country or to a movement of capital by a company resident in one member state to a sister company in a third country where both companies are subsidiaries of a parent company resident in another member state: see *Thin Cap*: paragraph 240.

105. The above analysis is not affected by the fact that, in the particular circumstances of this case, Article 49 TFEU does not apply (because the relevant disposal was made to a company established in a third country).

(ii) No restriction on the free movement of capital

106. Assuming that Article 63 TFEU does apply to the Group Transfer Rules, HMRC would contend that the imposition of a charge to UK tax on the disposal of the Brands by Gallaher to JTISA did not give rise to any restriction on the free movement of capital.

107. It is common ground that GL's Dutch-resident indirect parent company, JTIH, had made movements of capital both when establishing GL as an indirect subsidiary in the UK, and when establishing JTISA as a subsidiary in Switzerland (and HMRC contend that such movements of capital constitute 'direct investments' for the purposes of Article 64 TFEU).

108. However, the Group Transfer Rules did not constitute any restriction on the free movement of capital since the Group Transfer Rules did not treat GL less favourably by reason of the fact that its indirect parent was a national of the Netherlands, and resident in that state for tax purposes. The Group Transfer Rules would have applied in precisely the same way if JTIH had been a national of, or resident in the UK. Accordingly, the Group Transfer Rules did not give rise to any less favourable

treatment of the disposal to Switzerland based on the nationality or residence of the parent company.

109. Even assuming that the disposal by GL of the Brands to JTISA was itself a relevant movement of capital (which for the reasons explained below, HMRC contend it is not), the Group Transfer Rules would not constitute a restriction in relation to that movement of capital. The Group Transfer Rules did not give rise to any less favourable treatment of the transaction based on the nationality or residence of the parent company.

(iii) The sale of the Brands was not an independent capital movement

110. In any event, HMRC contend that the sale of a commercial asset such as the Brands does not itself constitute a movement of capital within the scope of Article 63 TFEU, which is essentially concerned with financial operations such as the investment of funds: see Joined Cases C-286/82 and C-26/83 *Luisi and Carbone v Ministero del Tesporo*. Contrary to GL's arguments, the notes of the Nomenclature do not require Article 63 TFEU to be interpreted so as to bring sales of commercial assets, which are <u>not</u> listed in the Nomenclature, within the scope of Article 63 TFEU. On the contrary, the notes simply make clear that *<u>"the capital movements listed in this Nomenclature</u>"* (e.g. "Direct Investments") cover operations to liquidate or assign assets built up as a consequence of such a listed movement.

(iv) Any restriction would fall within Article 64 TFEU

111. Furthermore, if the Group Transfer Rules did constitute a restrictive measure, HMRC would contend that the UK was in any event entitled under Article 64 TFEU to maintain those measures.

112. The referring court (the UT) has not referred any questions to the CJEU in relation to whether any restrictions were in existence on 31 December 1993 (within the meaning of Article 64 TFEU). This is because the UT does not require guidance on this point.

113. Article 64 TFEU applies notwithstanding that the disposal of the Brands in the present case was not itself a 'direct investment' (even assuming that the disposal of the Brands was a movement of capital). The sole restriction in the present case is said to arise because the Group Transfer Rules treated transfers of assets between subsidiaries within the UK more favourably than transfers of assets from a UK subsidiary to a non-UK subsidiary. In either case the subsidiary represents a 'direct investment' by the parent and, therefore, any restriction in respect of the movement of capital is a restriction involving direct investments within the meaning of Article 64 TFEU.

(v) Justification

114. In any event, even if the imposition of tax on the sale of the Brands gave rise to a restriction of Article 63 TFEU, HMRC submit that the UK legislation would be justified by overriding reasons in the public interest, namely the need to safeguard the balanced allocation of taxing rights. The reasons for this are the same as those set out more fully above in relation the 2014 Appeal – in the case of the 2011 Disposal, GL

realised £2,410,316,000 (in cash) in consideration for the disposal of the Brands. It follows that, even if the imposition of tax on the sale of the Brands gave rise to a restriction, that restriction is justified and the domestic regime is proportionate (or at least is capable of being interpreted to be proportionate) for the reasons set out below in relation to the 2014 Appeal.

(vi) Article 49 TFEU – Freedom of Establishment

115. It is common ground that JTIH has exercised its freedom of establishment, on the basis it exercises definite influence over its UK resident subsidiary, which acts as the holding company member of the UK resident members of the group. Article 49 TFEU therefore requires that the UK should apply the same conditions to JTIH as apply to companies incorporated in the UK: Case C-270/83 *Commission v France* [1986] ECR 273 at paragraph 14, *Thin Cap* at paragraph 37.

116. Insofar as the Group Transfer Rules imposed an immediate tax charge on the disposal of assets from GL to JTISA, the domestic rules applied in the same way as they would have done if JTIH had been resident in the UK. JTIH did not receive any less favourable treatment because it was incorporated and/or resident in the Netherlands.

117. The Group Transfer Rules treat a disposal of assets by a UK subsidiary of a *Netherlands* parent company to a company resident in Switzerland (or indeed to any company outside the scope of tax) in the same way as they treat a similar disposal of assets by a UK subsidiary of a *UK* parent company. In each case, the disposal by the subsidiary of the asset to a company outside the scope of UK corporation tax gives

rise to a tax charge. It follows that JTIH was not treated less favourably than if it had been UK resident and cannot complain of any restriction on freedom of establishment.

118. The Group Transfer Rules are materially different to the UK's thin capitalisation rules considered in *Thin Cap*, on which GL relies. The essential feature of the UK thin capitalisation regime was that it restricted the ability of a UK resident company to deduct interest paid to a direct or indirect parent company resident in another Member State (or another company controlled by such a company) in circumstances where it did not impose any such restrictions on interest payments made by a UK resident company to a UK resident parent company. The CJEU held that this difference in treatment applied to resident subsidiaries which is "based on the place where their parent company has its seat" constituted a restriction on freedom of establishment of companies established in other Member States: paragraph 61.

119. Because the difference in treatment under the thin cap rules was based on the place where the *parent company* had its seat, there was a restriction of the parent company's freedom, whether the interest was paid directly to the non-resident parent in another Member State or to another company controlled by the parent company (irrespective of where that company was resident): paragraphs 94-95.

120. By contrast, the application of the Group Transfer Rules to a transfer of assets by a UK resident subsidiary of a Netherlands parent to a 'sister' subsidiary resident in Switzerland does not give rise to any difference in treatment based on the place where the parent company has it seat. The Group Transfer Rules would apply in precisely the same way had the parent been incorporated/resident in the UK.

121. It follows that the imposition of the immediate tax charge on the sale by GL of the Brands to JTISA (and the immediate collection of that tax charge) did not entail any restriction of freedom of establishment. If, however, the imposition (and collection) of tax on the sale of the Brands gave rise to a restriction of the free movement of capital, HMRC submit that the UK legislation would be justified by overriding reasons in the public interest, namely the need to safeguard the balanced allocation of taxing rights. The reasons for this are the same as those set out above in relation the 2014 Appeal.

(vii) Remedy

122. If (contrary to the above) the Group Transfer Rules constitute a disproportionate restriction on GL's freedom of establishment, then the question of remedy falls to be considered by the national court applying guidance from the CJEU.

(a) Identification of the unlawful provisions

123. HMRC contend the appropriate remedy depends on the precise nature of any potential incompatibility. It is common ground that there was no breach of EU law in the United Kingdom <u>determining or fixing definitively</u> the amount of tax due on the capital gains that have arisen in its territory at the time when its power of taxation in respect of those capital gains ceases to exist, in this case being at the time that the relevant assets were removed from the UK's fiscal jurisdiction. This has been consistently confirmed by the CJEU, for example *National Grid* at paragraphs 52 and 77 and *Panayi* at paragraph 57. Rather, the alleged lack of proportionality in the UK

provisions (and therefore the potential breach of EU law) lay in the failure of the domestic legislation expressly to permit payment of the tax to be deferred.

124. Thus any potential breach would arise from the provision requiring immediate payment of the tax (section 59D TMA 1970) and not in the provisions charging corporation tax in relation to intra-group disposals of assets outside of the UK's fiscal territory (the Group Transfer Rules). Accordingly, it is the provision requiring immediate payment of tax that would fall to be interpreted in order to comply with EU law.

(b) The appropriate remedy

125. HMRC contend that the precise way in which any incompatibility of the Group Transfer Rules with EU law may be remedied is a matter of domestic law based on the guidance sought from the CJEU by the referring national court. In that regard, the UK courts are required by section 2 ECA 1972 to interpret domestic legislation, as far as possible, so as to give effect to directly enforceable EU law rights. Any such 'conforming construction' has the same declaratory effect as any other judicial interpretation of legislation.[13] If such an interpretation (known as a 'conforming construction') is not possible, then domestic legislation which is incompatible with directly enforceable EU law rights is required to be disapplied, again with declaratory effect.

126. HMRC contend that if the requirement to pay tax, without any option to defer payment, is incompatible with EU law then the national court can and should give a

[13] In other words, once the national court interprets the legislation that is the meaning that the relevant legislation has always had.

conforming construction to the domestic regime in order to ensure that it is compatible with EU law.

127. The jurisprudence of the CJEU, together with Article 5 of Council Directive 2016/1164 (the Tax Avoidance Directive), which codifies that jurisprudence[14], clearly establishes that a five-year deferral period would be proportionate: see the summary of the case law by Advocate General Kokott in *Panayi* at paragraphs 55 and 58. For completeness, Article 5(3) of the Directive also confirms that it would be proportionate for the UK to charge interest in accordance with the ordinary national regime (and therefore no conforming construction is required in this regard).

128. HMRC accordingly would contend that the national court can and should give the domestic regime a conforming construction under which a five-year deferral period is treated as read into the legislation in any case where the effect of the Group Transfer Rules would otherwise give rise to an immediate tax charge contrary to EU law. Such a construction would ensure that the domestic regime is compatible with EU law.

129. In the present case, GL would not obtain any benefit from such a conforming construction. But that is because GL has postponed payment of the corporation tax pending the determination of its appeal, as it was entitled to do under the national regime and thus has not been required to pay any tax to date (and more than five years

[14] This Directive would not apply directly in the present circumstances but does apply in relation to other charges in circumstances in which assets leave the fiscal territory of a member state. In *Panayi* the AG derived support from that Directive, recognising that it represented a codification of the CJEU's jurisprudence on exit taxes (at paragraph 2):

> "Over time, however, that case-law has formulated certain requirements to which exit taxation is subject. The EU legislature was itself guided by those requirements when it recently went so far as to introduce a similar obligation to tax the exit of assets in Article 5 of Directive (EU) 2016/1164, not applicable here"

has passed since the date on which the tax charge would otherwise have been payable).

130. HMRC further contend that EU law does not entitle a company such as GL to a conforming construction (or disapplication) of the domestic legislation that provides the company with an option to defer payment of the tax until the assets are disposed of outside the sub-group of which the 'transferee' company is resident (whether that company is resident in a member state or in a third country). As set out above, the CJEU has already confirmed (and as codified in the Tax Avoidance Directive) all that is required in such circumstances is for the taxpayer to be granted a deferral in relation to the payment of tax over five years – accordingly, EU law does not require that a taxpayer be granted an option to defer until the relevant assets are realised and/or disposed of outside of the sub-group.

131. HMRC further contend that such an entitlement (as is argued for by GL) would seriously disturb the balanced allocation of taxing rights and undermine the ability of the Member State in which the company making the disposal is resident to tax gains realised in its jurisdiction. The Member State would potentially be prevented from charging any corporation tax on gains arising on assets being moved out of its fiscal jurisdiction to another group company either within the EU, or in a third country, since the choice of whether and if any further disposal is to be made outside the sub-group would lie solely with the group. Moreover, the risk of non-payment of any tax would be borne by the Member State.

132. GL has further contended that EU law requires national courts to provide a remedy which interferes with the relevant EU law freedom to the least possible extent.

Accordingly, GL contends that the appropriate conforming construction is one that removes any difference in treatment and therefore it is entitled to defer payment of the tax until realisation (which may never occur). This is incorrect: EU law requires that directly effective EU law rights are protected. EU law rights are protected provided that the national law is compatible with EU law – which will be the case either if a conforming construction is given to the national legislation (in accordance with the relevant domestic approach) to render it compliant with EU law. EU law does *not* require the national court to provide a remedy which interferes with the relevant EU law right to the least possible extent.

133. In the present case, this would mean that, if there were a breach of Article 49 and/or Article 63 TFEU, EU law would simply require that the domestic legislation be subject to a conforming construction so as to provide GL with a deferral of payment of its tax over five years. For the avoidance of doubt, HMRC contend that this is what the referring court can provide through a conforming construction.[15]

134. GL has further argued (i) that deferral by instalments is only proportionate where the option to defer already exists in domestic law and (ii) it is impossible for the national court to apply a conforming construction where no such option already exists. The answer to this is that the national court is *obliged* to apply a conforming construction (with declaratory effect) that renders the legislation compliant with EU law and gives effect to the relevant directly effective rights.

135. Finally, on disapplication (which only arises if a conforming construction cannot be given) HMRC contend that the requirement to pay tax (under s59D TMA 1970)

[15] And, in fact, following the reference to the CJEU in *Panayi*, the referring court (the FTT), did apply this exact remedy.

should be disapplied such that the tax should not become payable until a date that respects the taxpayer's EU law right to defer payment (over five years). The same principles as those set out above apply as regards ensuring compatibility with EU law.

THE REASONS FOR A REFERENCE

136. The relationship between the relevant provisions of EU law and domestic law is that, if the domestic law applicable in this case gives rise to a breach of Articles 49 and/or 63 TFEU, then GL is entitled to a remedy. As such the UT requires guidance from the CJEU in relation to the questions referred (set out at the end of this document) to assist it in determining the appeals.

137. The UT released a decision on 14 December 2020[16] in which it held that a reference would be made to the CJEU, and in that decision the UT summarised its reasons for seeking a reference. It is convenient to quote the relevant passages:

> "84. As can be seen from our summary of the arguments that have been made before us, despite the existence of a material body of CJEU case law which relates to broadly analogous situations, there is no authority to which we have been referred, which deals directly with legislation such as this, which provides for tax neutral treatment of intragroup transfers of assets and can apply in cases where the taxpayer company has realized a full market value consideration for the transfer. As a result, in respect of many of these issues, it is possible reasonably to hold differing views as to the implications of the application of the existing CJEU case law to the facts of these appeals.
>
> 85. By way of example:
>
> > (1) in the context of the interaction of Article 49 and Article 63 TFEU and, in particular, whether Gallaher can rely on Article 63 in addition to or as an alternative to Article 49 in the context of legislation which applies only to groups of companies, Mr Baker raises material issues which are not addressed by the existing case law concerning the application of the existing case law to facts in which

[16] A copy of which is appended to this Request.

there may be more than one movement of capital by JTIH to which the freedom applies or to facts involving a potential movement of capital by a company (Gallaher) which cannot be exercising a freedom of establishment under Article 49;

(2) whether, on the facts of the 2011 Appeal, the implication of the reasoning in the *Thin Cap* case is that the Group Transfer Rules can represent a restriction on the exercise of JTIH's freedoms (under Article 49 or Article 63) even though the same immediate tax charge would have arisen on a disposal of the Brands and related assets by Gallaher to JTISA even if the parent company (JTIH) had been resident in the UK for tax purposes;

(3) in determining, on the facts of the 2011 Appeal or the 2014 Appeal, whether any restriction which is imposed by the Group Transfer Rules on the exercise of the treaty freedoms is justified and proportionate, whether it is appropriate to extend the principles in the exit tax cases (such as *NGI*) to cases where the taxpayer in question (Gallaher) has realized proceeds for the disposal of the asset equal to the full market value of the asset;

(4) in the context of the remedies available to this Tribunal, whether it is open to this Tribunal to provide, by conforming interpretation or disapplication, for the payment of tax by instalments where there was, at the time of the disposals in question, no applicable provision for the payment of tax by instalments in the Group Transfer Rules.

86. These are material issues of EU law, which are critical to our decision. Whilst we would ordinarily be quite prepared to reach a decision on them, we cannot resolve the issues "with complete confidence" as required by the test set out by Sir Thomas Bingham MR in *R v International Stock Exchange of the United Kingdom and the Republic of Ireland Ltd ex parte Else (1982) Ltd and another* [1993] QB 534 and referred to by Rose J in her decision in the *Coal Staff* case. The other issues to which we refer at [83] above are consequential questions which arise from them.

87. Furthermore, it seems to us that the decisions in these appeals are likely to have application beyond the particular facts of this case.

88. We note that, following the FTT decision in these appeals, the Government introduced legislation to permit UK resident companies to enter into payment plans and to pay tax by instalments in relation to intragroup transfers of assets to companies resident in EEA member states under various regimes which form part of UK tax law, including those covered by the

Group Transfer Rules. (Those provisions were introduced by s34 of and Schedule 7 to the Finance Act 2020 and are now found in s59FB TMA 1970 and Schedule 3ZC TMA 1970.) They apply to all accounting periods ending on or after 10 October 2018.

89. We have not heard argument on this point, but it seems to us that the responses of the CJEU to the questions that we have raised may well inform the interpretation of the new instalment regime. Even if the introduction of the new instalment regime is sufficient to ensure that the Group Transfer Rules are regarded as compliant with EU law for periods ending on or after 10 October 2018, there remains the question of the application of the Group Transfer Rules to the treatment of transfers in prior periods. Beyond the implications of the questions that we have raised for provisions of UK tax law, the transfer of assets between group companies is a relatively common transaction and we anticipate that the matters raised in this request for a preliminary ruling will be relevant to the interpretation of similar provisions in the domestic legislation of EU member states."

THE QUESTIONS REFERRED

(1) Whether Article 63 TFEU can be relied upon in relation to domestic legislation such as the Group Transfer Rules, which applies only to groups of companies?

(2) Even if Article 63 TFEU cannot more generally be relied upon in relation to the Group Transfer Rules, can it nonetheless be relied upon:

(a) in relation to movements of capital from a parent company resident in an EU member state to a Swiss resident subsidiary, where the parent company has 100% shareholdings in both the Swiss resident subsidiary and the UK resident subsidiary on which the tax charge is imposed?

(b) in relation to a movement of capital by a wholly-owned subsidiary resident in the UK to a wholly-owned Swiss resident subsidiary of the same parent company resident in an EU member state, given that the two companies are sister companies and not in a parent-subsidiary relationship?

(3) Whether legislation, such as the Group Transfer Rules, which imposes an immediate tax charge on a transfer of assets from a UK resident company to a sister company which is resident in Switzerland (and does not carry on a trade in the UK through a permanent establishment), where both of those companies are wholly-owned subsidiaries of a common parent company, which is resident in another member state, in circumstances where such a transfer would be made on a tax neutral basis if the sister company were also resident in the UK (or carried on a trade in the UK through a permanent establishment), constitutes a restriction on the freedom of establishment of the parent company in Article 49 TFEU or, if relevant, a restriction on the freedom to move capital in Article 63 TFEU?

(4) Assuming Article 63 TFEU can be relied upon:

(a) was the transfer of the Brands and related assets by GL to JTISA, for a consideration which was intended to reflect the market value of the Brands, a movement of capital for the purposes of Article 63 TFEU?

(b) did the movements of capital by JTIH to JTISA, its Swiss resident subsidiary, constitute direct investments for the purposes of Article 64 TFEU?

(c) given that Article 64 TFEU only applies to certain types of capital movement, can Article 64 apply in circumstances where movements of capital can be characterized as both direct investments (which are referred to in Article 64 TFEU) and also as another type of capital movement not referred to in Article 64 TFEU?

(5) If there was a restriction then, it being common ground that the restriction was in principle justified on overriding grounds in the public interest (namely, the need to preserve the balanced allocation of taxing rights), was the restriction necessary and proportionate within the meaning of the case law of the CJEU, in particular in circumstances in which the taxpayer in question has realized proceeds for the disposal of the asset equal to the full market value of the asset?

(6) If there was a breach of the freedom of establishment and/or of the right to free movement of capital:

(a) does EU law require that the domestic legislation be interpreted or disapplied in a manner which provides GL with an option to defer the payment of tax;

(b) if so does EU law require that the domestic legislation be interpreted or disapplied in a manner which provides GL with an option to defer the payment of tax until the assets are disposed of outside the sub-group of which the company resident in the other Member State is parent (i.e. "on a realization basis") or is an option to pay tax in instalments (i.e. "on an instalment basis") capable of providing a proportionate remedy;

(c) if, in principle, an option to pay tax by instalments is capable of being a proportionate remedy:

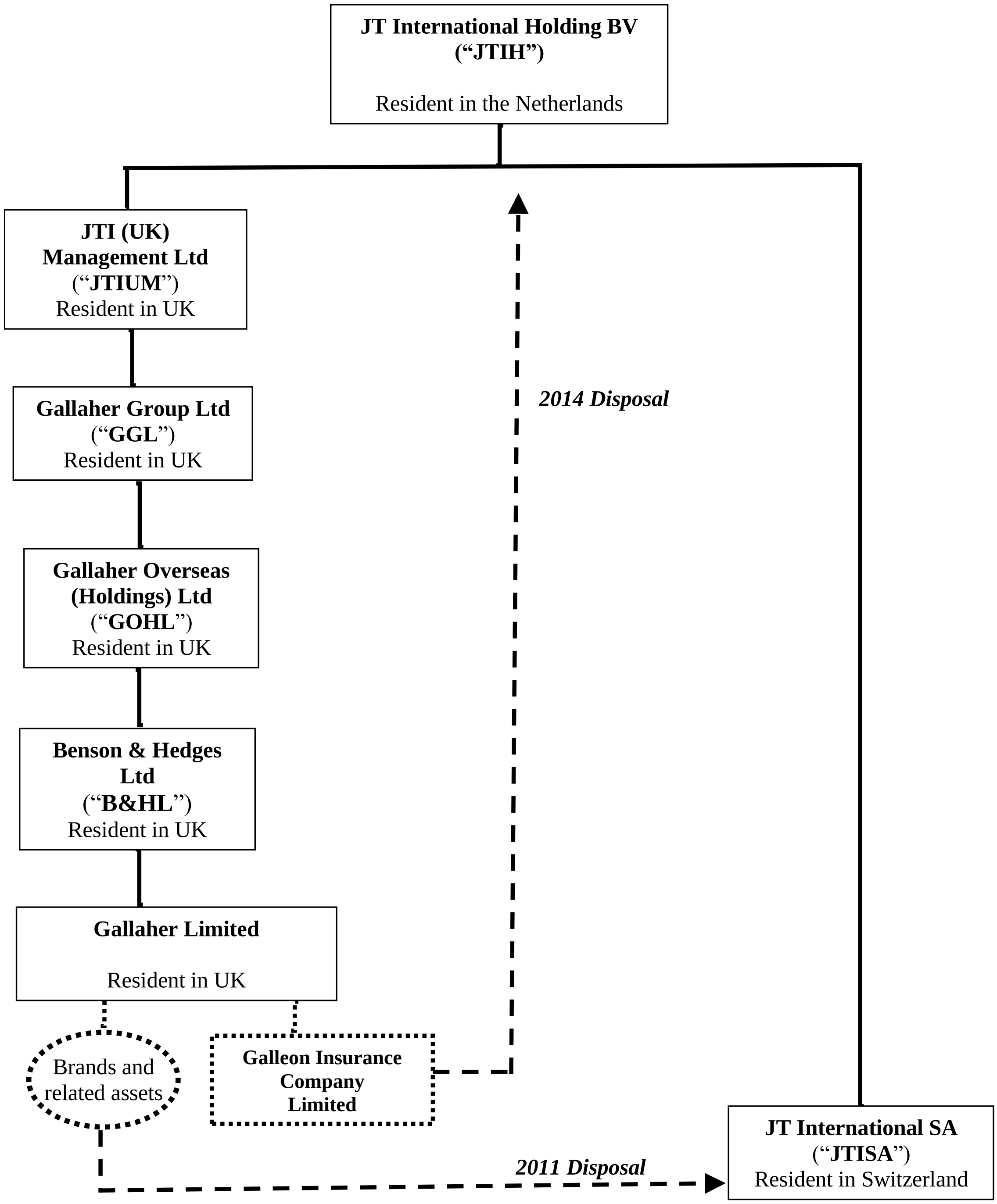
i. is that only the case if domestic law contained the option at the time of the disposals of assets, or is it compatible with EU law for such an option to be provided by way of remedy after the event (namely for the national court to provide such an option after the event by applying a conforming construction or disapplying the legislation);

ii. does EU law require national courts to provide a remedy which interferes with the relevant EU law freedom to the least possible extent, or is it sufficient for the national courts to provide a remedy which, whilst proportionate, departs from the existing national law to the minimum extent possible;

iii. what period of instalments is necessary; and

iv. is a remedy involving an instalment plan in which payments fall due prior to the date on which the issues between the parties are finally determined in breach of EU law, i.e. must the instalment due dates be prospective?

ANNEX – DIAGRAM OF RELEVANT JT GROUP STRUCTURE SHOWING THE 2011 AND 2014 DISPOSALS



MR JUSTICE MILES

UPPER TRIBUNAL JUDGE ASHLEY GREENBANK

RELEASED DATE: 29 December 2020