SLAUGHTER AND MAY/

# TAX NEWS

## PODCAST

October 2024

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| **Zoe Andrews** | Welcome to the October 2024 edition of Slaughter and May's "Tax News" podcast. I am Zoe Andrews, PSL Counsel & Head of Tax Knowledge. |
| **Tanja Velling** | And I am Tanja Velling, Tax PSL Counsel.<br><br>This podcast is going to be rather caselaw-heavy (although there will be a few other news items at the end). We have two CJEU judgments on tax and State aid and three cases from the UK, and - even more excitingly, for the discussion of one of them, we will be joined by our colleague, tax associate Alex Sim.<br><br>The podcast was recorded on the 8th of October 2024 and reflects the law and guidance on that date.<br><br>There's a lot to get through, so let's dive in. It's been an exciting month for State aid, hasn't it? |
| **Zoe Andrews** | It certainly has - there are two important judgments of the CJEU to discuss: one in the *Apple* case and the other in the *UK CFC rules* case. One was a significant win for the European Commission, the other a loss. We only have time here for a high-level commentary on these cases and the underlying rulings and are unable to get into the detailed nuances of the cases. Bearing that in mind, let's take the win for the Commission first.<br><br>In the *Apple* case, the CJEU took some people by surprise with its final decision that Apple had been granted illegal State aid by Ireland. Let me recap the facts briefly. Two subsidiaries of Apple, ASI and AOE, were Irish incorporated, but not tax resident there or anywhere else and so with stateless head offices. Both companies did, however, have operations in Ireland; each carried on a trade through an Irish branch. They also held valuable IP licences. The key question was then: how much of the companies' profit is taxable in Ireland as profits of those branches?<br><br>The Irish tax authority granted rulings in favour of ASI and AOE in 1991 and in 2007 under which the Irish branches were taxed on a cost-plus basis. The vast majority of the profits realised by ASI and AOE were thereby allocated to the stateless head offices of these companies significantly reducing their tax base in Ireland.<br><br>But the Commission challenged these rulings, didn't it? |
| **Tanja Velling** | Yes. The Commission decided that the rulings constituted unlawful State aid from which the Apple Group as a whole had benefited and that had to be recovered. The branches had been taxed on an amount significantly below the profits that should have been attributed to them on a proper application of the authorised OECD approach (or AOA). On appeal by Apple and Ireland, the General Court annulled the Commission's decision. On the Commission's appeal to the CJEU, however, the Advocate General suggested that the CJEU should overrule the General Court's |

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| | decision and remit the case to the General Court. The CJEU indeed struck down the General Court's decision but decided to make a final decision itself within the limits of the matter before it.<br><br>We don't have time to go into the technical detail, but the CJEU basically took the application of the AOA as a given and ruled that the companies' profits had to be allocated based on the actual distribution of functions, assets and risks between the various parts of each company (i.e. between the branch and the head office). As there were minimal activities at the head offices, by default most of the profits booked in the non-resident companies should be allocated to the Irish branches and therefore taxed in Ireland. That it was really another company, Apple Inc., which carried out the activities that generated the profits had to be left out of account. |
| **Zoe Andrews** | So, Ireland now has the enviable task of deciding how to spend around €13 billion! The recovered State aid has been sitting in an escrow account for some time and, whilst the Commission's initial decision envisaged that the amount of aid could be reduced to the extent that other countries could claim taxing rights over the profits, third country adjustments were made on only two occasions (for €455 million in total) and no further claims are expected.<br><br>And what has been the tax community's reaction to the CJEU's decision? |
| **Tanja Velling** | Many tax practitioners are (for various reasons) displeased with the result. I think the most important point is that *Apple* is hard to reconcile with the CJEU's decisions in *Engie*, *Fiat* and *Amazon* which had confirmed Member States' sovereignty in tax matters. Whether an entity had been granted State aid through the tax system had to be determined by reference to the rules and administrative practice of the Member State. According to those cases, international rules could be taken into account only to the extent incorporated into the national law and there was no free-standing EU arm's length principle on which the Commission could rely.<br><br>*Apple* seems different. That the rulings were unlawful State aid was determined by reference to the arm's length test under the AOA. But at the relevant time, Ireland had not adopted the arm's length principle into its domestic legislation and the AOA had not even been introduced by the OECD.<br><br>Granted, as I said before, the CJEU took the application of the AOA as a given because Apple and Ireland had not cross-appealed the General Court's finding that the reference framework permitted the use of the arm's length principle under the AOA. That would be one way to distinguish Apple, although not entirely satisfactory given a similar procedural point in *Amazon* was not treated in the same way.<br><br>Another way of looking at *Apple* which would limit its impact is that this is really a case about allocating profits to a permanent establishment, and not about transfer pricing. In answering the question of what profits are attributable to a company's branch, one does not look at the wider group and takes the company's overall profits as given – even if they're in excess of what that company should have earned on an arm's length basis. This is a way of distinguishing *Apple* form the earlier State aid cases. |
| **Zoe Andrews** | It's also worth noting that the *Apple* structure is a thing of the past because of changes to Irish as well as US tax laws and the creation of substance requirements in offshore territories which has |

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| | led to IP onshoring. But Tanja, tell us about the second important judgment - the one the Commission lost. |
| **Tanja Velling** | Sure. The main question – whether the pre-2019 version of what is commonly referred to as the “Group Financing Exemption” in the UK’s controlled foreign company (or CFC) rules constituted illegal State aid – is mostly of historical interest (although the CJEU’s decision in favour of the UK and ITV that it doesn’t constitute illegal State aid will have come as a relief for those other taxpayers relying on the exemption whose cases were stayed behind the main case).<br><br>But it is also significant from a more general fiscal State aid perspective as another case where the Commission failed to identify the correct reference framework and its decision was annulled for error of law. |
| **Zoe Andrews** | The Commission (and the General Court in an appeal by the United Kingdom and ITV against the Commission’s decision) had taken the CFC rules on their own as the reference framework and concluded that the Group Financing Exemption was an unjustified derogation from the CFC framework. But the CJEU found that, when the CFC rules are taken as a whole, in particular, the way they treat non-trading finance profits, they supplemented and formed an integral part of the UK’s corporate tax system. The CFC rules follow the same logic according to which profits with a sufficient territorial link with the United Kingdom are subject to tax. The approach taken in the CFC rules is based on the assessment of the risks that CFC’s profits pose for the taxation of companies in the UK. ITV had used a fishing analogy to explain the largely territorial nature of the general corporate tax system, pointing out that the CFC rules cast a wide net, but the holes in the mesh are large: only relevant fish (of a certain size) are caught. However, one would not describe the holes in a fishing net as a separate tool. Instead, they are a conscious and deliberate part of the net itself. Thus, the CJEU concluded that the reference framework had to be the UK’s corporate tax system as a whole.<br><br>The case also shows that the Commission cannot reinterpret the purpose of provisions in a Member State’s tax system if the Member State’s interpretation is compatible with the wording of the national legislation. The UK maintained that the purpose of its CFC rules was both to prevent profit shifting and base erosion, but the Commission had accepted only the former. The Advocate General’s opinion was very clear on the point; she said: “I consider the Commission’s assertions unconvincing and, in any event, insufficient to overrule the Member State’s interpretation of the purpose of its national law.” The CJEU itself said that “the Commission is in principle required to accept the interpretation of the relevant provisions of national law given by the Member State concerned”. |
| **Tanja Velling** | The *UK CFC* decision is also not that easy to square with *Apple* then.<br><br>But Zoe, I have a question for you. |
| **Zoe Andrews** | Go ahead. |
| **Tanja Velling** | Does your boss control you? |

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| **Zoe Andrews** | Not unduly. I mean - would a hospital manager intervene in the performance of an operation being carried out in a competent manner, or the manager of an opera house in the conductor's performance to direct them to change the tempo? |
| **Tanja Velling** | That's a line you've adapted from paragraph 70 of the Supreme Court's decision in *Professional Game Match Officials Limited*! |
| **Zoe Andrews** | Yes! |
| **Tanja Velling** | Do you want to tell us briefly us about the case? |
| **Zoe Andrews** | Sure. Professional Game Match Officials Limited is the company which provides referees for the Premier League, FA Cup and English Football League, and the case concerned the question whether these referees were employees of the company (such that the company must deduct income tax and national insurance contributions from the match fees under the PAYE scheme).<br><br>The test to determine this is multi-factorial, but the Supreme Court was concerned with only two factors which are necessary, but not sufficient.<br><br>• The first was mutuality of obligation. The employee must provide their personal service for payment to the employer; it may be fulfilled even if the obligations subsist only while the work is being carried out (here, both the company and the referee could cancel at any time before the referee arrived on the ground).<br><br>• The second was control. You're looking for sufficient framework of control; an employer need not "have a contractual right to intervene in every aspect" of the work.<br><br>The Supreme Court concluded that both factors pointed towards employment here and remitted the case to the First-tier Tribunal to re-apply the multi-factorial test in light of this conclusion. |
| **Tanja Velling** | So, contrary to what some newspaper headlines have proclaimed, the Supreme Court hasn't decided that the referees are employees; we'll have to wait for the FTT to decide that point.<br><br>But let's then move on to our next case, the Upper Tribunal's decision in *Muller*, and to discuss this, we're joined by Alex Sim, one of our tax associates. Alex, do you want to take us through the facts? |
| **Alex Sim** | Sure. The *Muller* case concerns the interaction of the corporation tax rules for partnerships and for intangible fixed assets. This has generally been a complex area for taxpayers, as the intangible fixed asset rules in Part 8 of the Corporation Tax Act 2009 do not fit neatly with the rules for partnerships.<br><br>The facts in *Muller* are fairly straightforward. In 2013, three UK companies in the Muller group established a UK limited liability partnership and transferred their trades (including various intangible assets and, in particular, goodwill) to the LLP in return for membership units in the LLP. The assets were recorded at fair value in the LLP's accounts and the intangible assets were |

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| | amortised over five years on a straight-line basis. In computing the LLP's profits for the purposes of the corporate members' tax returns, deductions were claimed for the amortisation expense.<br><br>HMRC denied these tax deductions for each of the years from 2014 to 2017. |
| **Zoe Andrews** | And what were the points in dispute? |
| **Alex Sim** | So, under section 882 of the Corporation Tax Act 2009, a deduction would only be available for the amortisation expense if the intangible assets acquired by the LLP were not treated as acquired from a "related party". The focus in *Muller* was therefore on the definition of "related party" and how this interacts with section 1259 of the Corporation Tax Act 2009, which sets out how to calculate the profits of a partnership for corporation tax purposes before those profits are then apportioned between the partners.<br><br>The taxpayers argued that the "related party" definition could not apply to partnerships because it sets out the circumstances in which a person is a related party in relation to a company and the LLP was not a company. Under section 1259, the LLP's profits were to be calculated as though it were a company carrying on the same trade as the LLP, but the taxpayers argued that this did not go so far as to make any assumptions about the ownership of the notional company – it simply assumed that the notional company was carrying on the same trade as the LLP.<br><br>However, the Upper Tribunal agreed with HMRC that the notional company fiction did allow the LLP to be treated as a company for these purposes and it did not then have any problems applying the related party definition to the LLP.<br><br>The "related party" rules were actually changed for these purposes with effect from 2016 so that they do work better for partnerships and the remainder of the case concerned whether the deductions would be denied from 2016 onwards in any case, if the Tribunal was wrong about the first "related party" point. Similarly, the Tribunal found in HMRC's favour that the 2016 rules applied to expenses after 2016 even where the transfer occurred before 2016 and had no trouble correcting a clear error in the statutory drafting. |
| **Zoe Andrews** | So if most of the *Muller* case relates to legislation that was changed in 2016, why is it relevant today? |
| **Alex Sim** | Well, although the main legislation being disputed in *Muller* has now changed, the issue of how the notional company fiction for partnerships interacts with the rules on intangible fixed assets does come up regularly in practice. There are other parts of these rules that still use a "related party" definition that does not cater properly for partnerships and it is not always clear how transactions between partnerships and partners, or indeed other partnerships, should be taxed.<br><br>*Muller* is a useful decision for taxpayers trying to navigate their way around these provisions, although it certainly doesn't answer every question! |
| **Tanja Velling** | Thank you, Alex. |

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| | We don't often talk about stamp duty land tax on this podcast, but the First-tier Tribunal's decision in *Brindleyplace* is worth a mention. The Tribunal's purposive construction of the relevant statutory provisions favoured the taxpayer, and it applied recent case law on purpose tests in an SDLT context.<br><br>There were two central issues. And I propose that we share a simplified version of the facts as relevant to each issue. Do you want to start with the first? |
| **Zoe Andrews** | Yes. The taxpayer owned 99.8% of a Jersey Property Unit Trust, or JPUT, with an interest in a property-holding partnership (the other 0.2% was held by the taxpayer's sister company). The taxpayer subscribed for further units in the JPUT, the JPUT contributed the consideration to the partnership, and the partnership used the contribution to pay off a bank loan. The JPUT was then collapsed and its interest in the partnership transferred to the taxpayer.<br><br>So, the question here is: did the taxpayer have to pay SDLT on the transfer of the partnership interest as contended for by HMRC?<br><br>The answer turned on the question whether there were arrangements under which a partnership interest was transferred – yes – and consideration was provided by or on behalf of the acquirer – to which the Tribunal said "no". It conceded that, on a literal reading of the statute, the consideration requirement may be met; after all, the issue of new JPUT units was part of the arrangement, and the taxpayer provided consideration for those. But on a purposive reading of the legislation, it was not the right sort of consideration. Parliament intended the reference to mean consideration for the partnership interest, as expressly confirmed in the Explanatory Notes. That's it for the first issue. |
| **Tanja Velling** | As to the second issue: after the JPUT was collapsed and its interest in the property-holding partnership transferred to the taxpayer, the partnership's property was then transferred to the taxpayer, the taxpayer claimed group relief on the transfer, and HMRC denied it and assessed the taxpayer to SDLT. Was that right?<br><br>One of the provisions relied on by HMRC denies group relief where the transaction forms part of arrangements with a main tax avoidance purpose. The Tribunal considered that this provision had to be interpreted in line with the Court of Appeal's decisions in *Delinian*, *BlackRock*, *Kwik-Fit* and *JTI* on purpose tests in the capital gains tax and the loan relationship rules. But, in the end, it didn't even need to apply the test because – wait for it – there was no avoidance!<br><br>Parliament chose to impose SDLT on the transfer of real estate, but not on the transfer of units in a JPUT. It also chose to provide a relief for intra-group transactions. So, each choice made by the taxpayer here (to buy units in a JPUT and to use group relief) cannot be tax avoidance – at least not, if each is considered in isolation. Does it then make a difference if (as was the case here) the choices were put together, one shortly after the other as part of a plan? The Tribunal said no: "Putting the two steps…together…does not…mean that the parties are not facing the economic consequences of their decision or using a tax relief for a purpose or way not intended by Parliament. The parties are not, in the sense required at least, thereby engaged in 'tax avoidance'."<br><br>Quite an extraordinary decision and one that, I think, HMRC will likely appeal. |

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| | But what else has been going on? |
| **Zoe Andrews** | HMRC's governance framework for resolving tax disputes has been updated to reflect the establishment of a Contentious Issues Panel to consider points of law or practice which "might have a significant and far-reaching impact on HMRC policy, strategy or operations, affect multiple cases, result in major litigation". This panel would decide the approach to major contentious issues as a matter of principle; specific cases would still need to be referred to the relevant governance board and their remits have been updated accordingly. For instance, reference to the performance of an internal advisory function have been removed from the description of the Tax Dispute Resolution Board's remit. |
| **Tanja Velling** | HMRC has also issued Guidelines for Compliance (GfC7) on transfer pricing. For businesses required to prepare a master and local file, the "guidelines should be read as best practice approaches to compliance planning, analysis and supporting information in preparing master and local files." It goes through an annual transfer pricing lifecycle from upfront planning over regular checks to year-end analysis and filing of the return and sets out what HMRC considers to be common errors, including ways in which transfer pricing documentation is too high level and errors arise in calculating the correct prices.<br><br>There is also an annex with examples of "helpful contemporaneous records and evidence" that HMRC recommends businesses retain, including organisational charts, signed agreements and internal communications updating staff on any reorganisation. Not all of the recommended documents will necessarily be available in each scenario, but it is a helpful indication of what HMRC may expect to see in an enquiry scenario.<br><br>Finally, it's worth noting that the guidelines are part of HMRC's known position for the purpose of the notification of uncertain tax treatment for large business. |
| **Zoe Andrews** | More statistics came out, too: The Corporation Tax Statistics (which cover not just corporation tax, but also other corporate taxes) show a 10% increase in corporate tax receipts from financial year 2023 to financial year 2024, due to an increase in the main rate of corporation tax and the introduction of the Electricity Generator Levy. Looking only at corporation tax proper, the Financial and Insurance sector was the biggest contributor, accounting for 24% of receipts. More details on that sector's contribution to the Exchequer can be found in separate statistics on "PAYE and corporate tax receipts from the banking sector". |
| **Tanja Velling** | And finally, moving away from the UK, on the 19th of September, nine countries signed the multilateral convention on the "subject to tax rule" (or STTR), developed by the OECD as part of Pillar Two, and another ten countries were listed as having expressed their intent to sign the convention. The STTR overrides existing treaties and allows source countries to tax interest, royalties and certain other income (including consideration for services) if they are subject to tax at below 9% in the residence country. |
| **Zoe Andrews** | As to what's coming up, I suppose we should mention that the 23rd of October is the closing date for comments on further multinational and domestic top-up tax guidance published by HMRC. |

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| | But it is really the upcoming Budget that overshadows all other UK tax news. The government needs to raise money and speculation on how they may do so seems never-ending. Will they increase capital gains tax? But the Treasury's own forecast (published back in June) suggests that a significant increase would be revenue negative. Recent newspaper coverage suggests that, in order to avoid a decrease in tax revenues, the government may propose less wide-ranging changes to the non-dom regime than previously indicated. Scaling back tax relief on pension contributions is another much talked-about option, but would it be wise in the long term to make it less attractive to save for retirement? |
| **Tanja Velling** | And that leaves me to thank you for listening. If you have any questions, please contact Zoe, Alex or me, or your usual Slaughter and May contact. Further insights from the Slaughter and May Tax department can be found on the European Tax Blog - www.europeantax.blog. |

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Published to provide general information and not as legal advice. Slaughter and May, 2024.
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