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TAX, STATE AID AND DISTORTIONS OF COMPETITION.

UK NATIONAL REPORT

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Question 1 *Does your country offer the possibility for any degree of advance legal certainty in tax matters given by the tax authorities? If so, are there any specific requirements to be eligible for such certainty in advance?*

Advance Legal Certainty given by HMRC

Broadly speaking, there are two methods of achieving advance legal certainty in tax matters which are granted by the tax authority in the UK, Her Majesty's Revenue and Customs ("HMRC"). In the first place, there are formal rulings available from HMRC, the basis for which is set out in statute. These are sometimes described as statutory clearances. In the second place, there are informal clearance procedures, which operate differently and provide a different level of certainty.

We will consider statutory clearances first.

HMRC Guidance[1] "Seeking clearance or approval for a transaction" sets out the following categories of tax legislation in respect of which statutory clearance or approval is available:

- Transfer Pricing advance pricing agreements ("APAs"), under Part 4 of TIOPA 2010 and Statement of Practice ("SP") 2/2010 and the earlier SP3/1999. Further detail on transfer pricing APAs is set out below.
- Capital Gains Tax:
    - Share exchanges pursuant to section 138(1) of the Taxation of Chargeable Gains Act 1992 ("TCGA 1992")
    - Reconstruction involving the transfer of a business pursuant to section 139(5) TCGA 1992
    - Collective Investment Schemes: Exchanges, Mergers and Schemes of Reconstruction pursuant to section 103K TCGA 1992
    - Transfer of a UK trade between EU Member States, pursuant to section 140B TCGA 1992 and section 140D TCGA 1992.

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[1] https://www.gov.uk/guidance/seeking-clearance-or-approval-for-a-transaction

- Purchase of own shares by unquoted trading companies, pursuant to section 1044 of the Corporation Tax Act 2010 ("CTA 2010")
- Demergers pursuant to section 1091 CTA 2010
- Enterprise Investment Scheme shares, in particular their acquisition by a new company, pursuant to section 247(1)(f) of the Income Tax Act 2007 ("ITA 2007")
- Company reorganisations involving intangible fixed assets, pursuant to section 831 CTA 2009
- Transactions in securities, pursuant to section 748 CTA 2010 and section 701 ITA 2007
- Confirmation of the customer's view of the tax consequences of assigning a lease granted at under value
- Loan relationships, as to transfers pursuant to sections 426 and 427 CTA 2009, and as to mergers pursuant to section 437 CTA 2009
- Derivative contracts, as to transfers pursuant to section 677 CTA 2009 and as to mergers section 686 CTA 2009
- Capital Gains tax targeted anti-avoidance rule, pursuant to sections 184G and 184H TCGA 1992
- Cross border transfer of a loan relationship, derivative contract or intangible fixed assets under section 117(4) TIOPA 2010
- Continuity of Seed Enterprise Investment Scheme relief under section 257HB ITA 2007, as updated by Finance Act 2012
- Qualifying life assurance policies, as set out in Schedule 15 of the Income and Corporation Taxes Act 1998 ("ICTA 1988")
- Transactions in shares or debentures, as set out in section 765 and section 765A of ICTA 1988. This regime, repealed by Finance Act 2009, concerned the requirement to obtain HM Treasury's consent prior to the migration of a company, and was the subject of Case 81/87 *Daily Mail* [1988] ECR 5483.

In addition to the above provisions, it is to be noted that the historic thin capitalisation regime allowed for Advance Thin Capitalisation Agreements ("ATCA"), in respect of which HMRC set out guidance in SP 4/2007 which was replaced with SP 1/2012[2]. The application of the ATCA was limited, under SP1/2012[3] to tax treatment for transfer pricing purposes only (rather than as to any other tax deductions). It was also noted that the ATCA could apply to current, future and historic periods, and HMRC encouraged use of a model agreement.

As to non-statutory clearance or approval, HMRC's Guidance identifies the following categories of tax in respect of which non-statutory clearance is available:

- As to company migrations, notification of a company's migration and approval of arrangements for the payment of tax liabilities, pursuant to sections 109B to 109F of the Taxes Management Act 1970 ("TMA 1970"), and SP 2/1990
- Clearances in relation to Controlled Foreign Companies ("CFC") legislation, pursuant to Part 9A of Taxation (International and Other Provisions) Act 2010 ("TIOPA 2010")

[2] https://www.gov.uk/government/publications/statement-of-practice-1-2012
[3] https://www.gov.uk/hmrc-internal-manuals/international-manual/intm520085

as regards the CFC rules currently in force and pursuant to sections 747 to 756 and Schedules 24 to 26 of ICTA 1988 in respect of the CFC rules previously in force.

- A series of schemes for investment in the UK:
    - Inward Investment Support service, in respect of which HMRC will "discuss the tax implications of your investment"
    - Business Investment Relief Provisions, in respect of which there is a Business Investment Relief Advance Assurance checklist available, and HMRC may be contacted by way of an application for advance clearance
    - Industries termed "Creative Industries" to which a relevant scheme may apply may contact HMRC's Creative Industries unit for "advice on the workings of the scheme as it applies…" The legislative schemes which are included under this grouping are Film Tax, Animation Tax, High-end Television Tax and Video Games Development Reliefs.
    - Enterprise Investment Scheme ("EIS"), Seed Enterprise Investment Scheme ("SEIS"), and Venture Capital Trust scheme ("VCT"). HMRC says that staff in the relevant team may advise on the workings of the schemes "as well as providing non-statutory advance assurance to companies seeking investment under these schemes."

HMRC also notes in the Guidance that where a bank has adopted the Code of Practice on Taxation for Banks (under which banks commit not to undertake any tax planning which achieves a tax result contrary to the intentions of Parliament), the bank should not be involved in any arrangements to which the GAAR might apply. The Guidance goes on to say that there may be arrangements to which the GAAR does not apply, which HMRC nonetheless consider to be unacceptable under the Code of Practice on Taxation for Banks. Therefore, when HMRC is approached by a bank as to compliance with the Code of Practice on Taxation for Banks, it will provide its view of that compliance.

The same Guidance sets out that HMRC will not give a clearance, whether formal or informal, to the effect that the General Anti-Abuse Rule does not apply. HMRC draws a distinction between commercial arrangements (in respect of which it will engage directly with large businesses and individuals), and is prepared to confirm in those circumstances that it does not regard those circumstances as tax avoidance. The Guidance sets out its position in the following way:

> "HMRC has always made it clear that no assurances about the tax treatment of a transaction will be given in any situation where, in HMRC's view, the arrangements constitute tax avoidance. Because the GAAR will only apply to abusive avoidance arrangements, this applies equally to any arrangements which might be caught by the GAAR. As part of its model of direct engagement with large businesses and wealthy individuals, HMRC discusses commercial arrangements and confirms where appropriate that it doesn't regard particular arrangements as tax avoidance. In these cases, HMRC intends that open discussions with taxpayers about commercial transactions should continue."

Additional Requirements for Eligibility

In addition to the requirements of compliance with the relevant statute and in addition to the specific points noted in the section above, HMRC gives Guidance[4] on the Non-statutory clearance service, on how a clearance might be obtained.

HMRC say they prior to approaching the clearance service, the taxpayer must have first checked that the transaction is not covered by a more appropriate clearance or approval route, and that the taxpayer must have considered HMRC's guidance "to see if this answers your question".

HMRC will not approve on a non-statutory clearance basis a matter for which there is a statutory clearance applicable to the transaction. HMRC will provide advice where the taxpayer has considered the relevant guidance, has not been able to find the requisite information and remains uncertain about HMRC's interpretation of tax legislation. In these circumstances, HMRC say they will set out their advice in writing.

Under this guidance HMRC note that there are certain circumstances where they will not provide advice, which include:

- Where the necessary information has not been provided
- Where HMRC do not consider there to be genuine points of uncertainty. In this case HMRC will direct the taxpayer to the relevant online guidance.
- Where HMRC is being asked to give tax planning advice or to approve tax planning products or arrangements
- Where the application concerns transactions for the purposes of avoiding tax
- Where HMRC is enquiring into the taxpayer's tax position
- Where the tax return for the period is final
- Where the situation concerns Chapter 5 Part 5 Income Tax (Trading and Other Income) Act 2005, which concerns settlements, or the tax consequences of executing non-charitable trust deeds or settlements

HMRC have set out in a number of checklists the information required for various types of application. The annexes are:

- "Annex A for all transactions other than Business Investment Relief, Business Property Relief and VAT (see below) - please head your letter 'Clearance service'
- Annex B for advance assurance on Business Investment Relief for non-domiciled persons taxed on the remittance basis - please head your letter 'Advance Assurance for Business Investment Relief'
- Annex C for Inheritance Tax Business Property Relief clearances
- Annex D for VAT clearances
- Annex E for post transaction clearances connected to an offshore disclosure"

[4] https://www.gov.uk/guidance/non-statutory-clearance-service-guidance

The guidance says that HMRC will usually reply within 28 days unless a matter is difficult or complicated.

An application for a non-statutory clearance does not interfere with the ordinary time limits within which a taxpayer must pay tax or file its tax returns. HMRC does allow amendments to tax returns where advice has been sought from HMRC but the response has not been received before the deadline to file the tax return. However, ordinary limitation periods for amendment of the tax returns continue to apply.

Transfer Pricing APAs

Specific rules for advance pricing agreements are set out under Part 4 of TIOPA 2010. Section 218 defines an advance pricing agreement as a written agreement that is "made by the Commissioners with any person ("A") as a consequence of an application by the person, under section 223 of TIOPA 2010, which relates to specific matters and which declares that an agreement is made for the purposes of the legislation.

The specific matters in respect of which an advance pricing agreement may be made are:

1) If A is not a company, the attribution of income to a branch or agency through which A has been carrying on a trade in the UK, or is proposing to do so
2) If A is a company, the attribution of income to a permanent establishment through which A has been carrying on a trade in the UK, or is proposing to do so
3) The attribution of income to any permanent establishment of A's, wherever situated, through which A has been carrying on a business, or proposes to do so
4) The extent to which income that has arisen or may arise to A is to be taken for any purpose to be income arising in a country or territory outside the UK
5) The treatment for tax purposes of any provision made or imposed, whether before or after the date of the agreement, between A and any associate of A
6) The treatment for tax purposes of any provision made or imposed, whether before or after the date of the agreement, as between an oil-related ring-fence trade carried on by A and any other activities carried on by A.

As set out above, HMRC has agreed tax rulings on transfer pricing in the form of APAs since 1999. SP 3/99 was replaced by SP 2/10, which was itself last updated on 8 November 2016[5]. We will refer to it in its updated form as SP 2/10.

SP 2/10 sets out the following key points as to how the regime is intended to work:

1. An APA will be a written agreement which determines "a method for resolving transfer pricing issues in advance of a return being made." (paragraph 1)
2. The matters which may be dealt with by way of an APA are set out in s218(2) TIOPA 2010, and concern the following broad situations (paragraph 3):
    a. Transfer pricing between separate business enterprises, specifically the interpretation of the arm's length provision in the legislation
    b. The attribution of profit or income between parts of a business enterprise operating in more than one country, where questions arise to the attribution of taxable income
    c. The UK oil-related ring-fence

[5] https://www.gov.uk/government/publications/statement-of-practice-2-2010/statement-of-practice-2-2010

3. APAs may cover one transfer pricing issue or all of a business' transfer pricing issues. It may also be out in place in respect of pre-existing issues (paragraph 4).
4. No determination is made as to the existence of a permanent establishment (PE) in the context of the APA legislation, nor is there scope under the legislation or guidance for any determination regarding the Diverted Profits Tax legislation (paragraphs 5 & 6).
5. Three forms of APA are provided for, being unilateral, bilateral and multi-lateral.
6. A unilateral APA is one between a UK business and HMRC, pursuant to section 218 TIOPA 2010. A unilateral APA therefore settles the tax treatment of the transaction in the UK, but not in any other relevant country (paragraph 9).
7. In order to ensure the relief of double taxation in respect of transfer pricing issues where a double taxation agreement ("DTA") exists between the UK and the relevant company, and where such DTA contains a provision for a mutual agreement procedure, it is necessary for HMRC to agree the tax position with the relevant tax administration in the other country. HMRC refers to these agreements as bilateral APAs or MAP APAs (paragraph 9).
8. Multilateral APAs are described as APAs involving all the tax administrations affected by transfer pricing issues. Multilateral APAs may include the use of multilateral instruments for exchanging information (paragraph 11).
9. HMRC indicates a preference for bilateral rather than unilateral APAs because unilateral APAs are of less value both to HMRC and to potential applicants, and provide less transparency (paragraph 13).
10. APAs may be requested by any UK resident business (including a partnership) with transactions to which Part 4 TIOPA 2010 applies, to any non-resident trading in the UK through a PE and any UK resident trading through a PE outside the UK (paragraph 15).
11. As to how an APA request will be considered, HMRC states the following:

    "16. Every APA request will be considered on the basis of its particular facts and features, but generally HMRC will be looking at the following factors taken together, whether:

    - the transfer pricing issues are complex rather than straightforward. To HMRC 'complex' means there is real doubt as to how the arm's length standard should be applied. Conversely, where market comparables can be readily identified for the transaction(s) in point in accordance with the OECD Transfer Pricing Guidelines HMRC is likely to regard such a situation as 'straightforward'. HMRC will be willing to consider an innovative proposal providing that there is not a more appropriate and straightforward method, it is compliant with OECD Guidelines, and not one that HMRC considers it or its Treaty Partners would regard as being overtly tax aggressive
    - without an APA there is a high likelihood of double taxation
    - HMRC consider that it is a good use of taxpayer and governmental resources"
12. HMRC note that because small and medium enterprises are exempt from the UK's transfer pricing legislation (pursuant to section 166 TIOPA 2010), there are fewer occasions on which an APA is relevant for smaller businesses.
13. HMRC also refer specifically to the (lack of) need for APAs in UK to UK transactions in the following way:

    "18. Since April 2004 UK-to-UK transactions have been subject to transfer pricing legislation: but, HMRC does not generally see such transactions as likely to warrant an APA. However, some UK-to-UK transactions, for example oil-related ring fenced trades, are specifically provided for in legislation."
14. The process by which an APA may be agreed involves an initial contact by the business by way of an expression of interest, to discuss plans informally, prior to presentation

of a formal application (paragraph 20). The APA expression of interest may be made to the APA lead in the CT International & Stamps Directorate ("CTIS"), and where the taxpayer has a customer relationship manager ("CRM"), the CRM should be made aware of and be copied into correspondence in respect of the proposed APA (paragraphs 20 – 21).

15. Entry into the APA programme is not automatic (paragraph 24).
16. The formal written APA application should be made within 6 months of the expression of interest meeting or correspondence (paragraph 30) and should include the information set out in annex 1 to SP 2/2010.

<u>Question 2</u> *Do your country's tax authorities systematically verify the facts mentioned in a request for a ruling, either prior to issuing a ruling (ex-ante) or prior to issuing the annual tax assessment (ex-post)? If so, could you explain the procedure in place*?

Verification of the facts set out in a request for a ruling

In respect of transfer pricing APAs, the updated version of SP 2/2010 sets out the following information as to how it will evaluate the application made to it:

> "34. On receipt of an application HMRC will evaluate its contents and will seek clarification and further information from the business as necessary. The examination of the application should be a co-operative process in which the transfer pricing issues are discussed openly and access to relevant supporting information and documentation is made available. Lack of co-operation in these respects may result in HMRC declining to give any further consideration to the application.
>
> 35. Where a bilateral APA is being sought, HMRC will expect the business to continue to make relevant information available at the same time to each Administration involved, and in turn will itself keep the treaty partner informed about the progress of its examination of the APA request, will seek to discuss with the treaty partner key issues arising at the earliest opportunity and will keep the business informed about the progress of the bilateral process. Whilst the finalizing of a bilateral agreement with a treaty partner is a government-to-government process, HMRC is generally prepared to participate in, and encourages, joint meetings involving the business and the other Administration(s) to assist in the exploration and evaluation of key factual issues."

The terms of the APA will usually include a commitment from the business to provide an annual report on compliance with the APA, as required by section 228 TIOPA 2010. The annual report will typically accompany the taxpayer's tax return, and be sent to the CRM (but not to CTIS).

The UK operates a system for taxpayers to self-assess their liability to corporation tax (known as Corporation Tax Self-Assessment or CTSA), pursuant to Schedule 18 to the Finance Act 1998. The UK's CTSA system applies to periods ending on or after 1 July 1999. Prior to that, taxpayers provided information to HMRC, who then made an assessment to corporation tax. As such, under the current system, the taxpayer files its tax return, following which HMRC has a period of time within which it may open an enquiry into the details of the tax return. The enquiry period ends when a closure notice is issued by HMRC, pursuant to paragraph 32 of Schedule 18 to Finance Act 1998. As such, it is possible that a taxpayer might file a tax return on the basis of its continued compliance with its APA. HMRC may enquire during the enquiry period into facts arising from the tax return, including whether the taxpayer in fact continues to comply with its APA.

There are also some provisions which entitle HMRC to look into tax returns, for limited reasons, after the period in which they may open an enquiry has expired. One example of this is that HMRC may make a discovery assessment, pursuant to paragraph 41 of Schedule 18 to Finance Act 1998, where HMRC makes a discovery that tax has been underpaid in respect of an accounting period for which HMRC is out of time to adjust the tax liability through an enquiry. There are additional periods within which HMRC may look into the period if a return has been filed negligently or fraudulently.

In terms of what information HMRC may request from a taxpayer during the course of an enquiry, HMRC may request information relevant to the taxpayer's tax position. These information powers are set out in further detail at question 3 below.

Question 3 *Do anti-avoidance provisions require your tax authorities to verify the treatment given to a payment/transaction by the other country, as part of a tax audit or prior to issuing a tax assessment? If so, could you explain the procedure in place?*

We note the UK's general system of CTSA, enquiry into tax returns and subsequent procedures set out in answer to Question 2.

The UK has a general anti-abuse rule ("GAAR") and many targeted anti-abuse rules ("TAARs").

The GAAR is set out in Part 5 of and Schedule 43 to Finance Act 2013, and new schedules 43A to 43C to Finance Act 2013, which were inserted by Finance Act 2016. There are also additional provisions applying the GAAR to National Insurance Contributions in sections 10 and 11 of the National Insurance Act 2014.

The GAAR applies where there is an arrangement that gives rise to a tax advantage, in respect of a tax to which the GAAR applies, where it would be reasonable to conclude that the obtaining of a tax advantage was (one of) the main purpose(s) of the arrangement, and where the arrangement is abusive.

If the GAAR applies such that tax arrangements are considered to be abusive, then the tax advantage resulting from the abuse must be counteracted (either by the taxpayer or by HMRC) by making adjustments which are "just and reasonable", pursuant to section 209 Finance Act 2013.

It is for the taxpayer to self-assess its compliance with the GAAR.

The list of taxes to which the GAAR applies is:

- Corporation tax
- Income tax
- Capital Gains Tax
- Inheritance Tax
- Diverted Profits tax
- Apprenticeship Levy
- National Insurance Contributions

- Stamp Duty Land Tax
- Petroleum Revenue Tax
- The annual tax on enveloped dwellings ("ATED")
- The application of double tax treaty provisions

As will be seen, the GAAR applies, in principle, to several taxes in respect of which there exist statutory clearance procedures or non-statutory clearance procedures.

The GAAR is broad in its terms and does not require HMRC to enquire into the tax treatment afforded to a transaction by another country.

When HMRC does enquire into a tax return, it has broad powers to do so. Its power of enquiry "extends to anything contained in the return, or required to be contained in the return, including (a) any claim or election included in the return, (b) any amount that affects or may affect (i) the tax payable by that company for another accounting period, or (ii) the tax liability of another company for any accounting period…", pursuant to paragraph 25 of Schedule 18 to Finance Act 1998.

In the course of an enquiry, HMRC has the power, pursuant to paragraph 1 of Schedule 36 to Finance Act 2008, to require a company to produce information or documents which it reasonably requires for the purpose of checking the taxpayer's tax position. The documents must be in the taxpayer's possession or power. Failure to comply with such a request on a taxpayer's part may result in liability to pay penalties, pursuant to part 7 of Schedule 36 to Finance Act 2008. HMRC also has powers to require information about a taxpayer from a third party, pursuant to paragraph 2 of Schedule 36 to Finance Act 2008, and paragraph 5A to Schedule 26 to Finance Act 2008.

As such, there is no general legislation which requires HMRC to check the tax treatment of a transaction in another country, either as part of an audit or prior to issuing a tax assessment, but HMRC has broad powers to check into the circumstances which relate to anything which is in the tax return.

<u>Question 4</u> *Could you please elaborate in what circumstances tax authorities would (not) be bound by a ruling or any other type of advance certainty provided?*

Circumstances in which tax authorities would not be bound by a ruling

Section 221 of TIOPA 2010 provides that an APA "does not have effect" in relation to any determination of a question where any of the following conditions are met:

a) A time to which the question relates is after a time as from which an officer has revoked the agreement in accordance with the agreement's terms
b) The question relates to at time after, or in relation to which there has been a failure by a party to the agreement to comply with a significant provision of the agreement
c) The question relates to a matter as respects which a key condition has not been met or is no longer met.

Where HMRC has agreed a statutory clearance procedure, such as an APA, HMRC may revoke the APA, in accordance with section 225 of TIOPA 2010. That provision states that an agreement may provide for the modification or revocation of an agreement, by the

Commissioners or an officer of HMRC, to take effect from the date determined by the Commissioners or officer of HMRC. Pursuant to section 226 of TIOPA 2010, an APA may also be annulled where the taxpayer who has entered into the agreement has fraudulently or negligently provided HMRC with information (in connection with the agreement) which is false or misleading. The consequence of such annulment is that the agreement is to be treated as never made and HMRC may impose a penalty of not more than £10,000.

In its guidance, HMRC describes the basis on which an agreement may no longer be relied upon as being "where the business does not comply with the terms and conditions of the agreement, or where the identified critical assumptions cease to be valid", as set out in paragraph 46 of SP 2/2010. The guidance does note that in practice, when HMRC is considering nullifying, revoking or cancelling a bilateral APA, it will consult both the taxpayer and the Competent Authority of the relevant treaty partner.

Similar guidance is set out in SP 1/2012, in respect of ATCAs, in which paragraph 32 states that:

> "Where HMRC believes that the business entering into the agreement has fraudulently or negligently provided false or misleading information in connection with the making of the agreement or otherwise in the preparation of the agreement, TIOPA 2010, section 266 gives HMRC the power to annul the ATCA, i.e. to treat it as if it had never been made. When considering using this power HMRC will take into account the extent to which the terms of the agreement would have been different in the absence of the misrepresentation."

The English courts have also considered circumstances in which a taxpayer can rely on a ruling. Such principles demonstrate also when a tax authority is not bound by a ruling.

In *R v IRC ex p MFK Underwriting Agencies* [1990] 1 WLR 1545, a taxpayer seeking a ruling must "pull all his cards face upwards on the table", must make plain that fully considered guidance is sought and as to what that guidance is sought, and indicate the use intended to be made of the guidance, including whether the taxpayer proposes to tell others of it.

The English courts have continued to place emphasis on the taxpayer's disclosure of the relevant facts, for example in *R v IRC ex p Matrix Securities Ltd* [1994] 1 WLR 334, in which the House of Lords held that HMRC was not bound by the clearance for reasons including that HMRC had not had the facts fully disclosed to them. In addition, the judgment also noted that the legal issues relating to the clearance had not been clearly set out, that the taxpayer had knowingly not applied to the correct level of authority in HMRC and had requested that the clearance, which concerned very complicated material, be given within a day.

In a similar way, the principle of full disclosure of the relevant facts was central to the High Court's rejection of the taxpayer's application to judicially review HMRC's decision to withdraw a VAT ruling in *R (The Medical Protection Society Ltd) v HMRC* [2009] EWHC 2780 (Admin).

A contrary principle which must be taken into account is the public law principle of legitimate expectation, where, based on a representation by a government body (here HMRC), a claimant might have a legitimate expectation of particular treatment. In *R (GSTS Pathology LLP) v HMRC* [2013] EWHC 1823 (Admin), the High Court decided that the taxpayer had a legitimate expectation that it would receive the treatment in its earlier ruling, as HMRC had been given full disclosure of the information and the ruling was unequivocal.

HMRC provided guidance, "When you can rely on information or advice provided by HM Revenue and Customs"[6], in which HMRC notes that the information or advice only applies to the applicant, regardless of whether the application has been made by an advisor, and only applies to the subject matter of the request. The guidance also notes that in order for the advice to be binding, the taxpayer must set out all the relevant facts and draw attention to all the issues. Reference is also made to changes in the law following HMRC advice negating the binding nature of the advice that was previously given.

The guidance also addresses the situation where HMRC has provided by incorrect information or advice, and notes that HMRC will be bound by it despite its incorrect nature, provided the advice is clear and the taxpayer can demonstrate that they relied on the advice, that they fully disclosed all relevant facts and applying the law would result in the taxpayer's financial detriment.

<u>Question 5</u> Does your country check whether any remaining income will be taxed by another country? If so, does your country allow for any correction mechanism to ensure that any remainder will still be taxed at home as to avoid double non-taxation?

As set out above, in relation to transfer pricing, where the income is regulated by a bilateral or multilateral APA, HMRC will agree the tax position with the competent authorities of other relevant countries. According to HMRC guidance set out above, a unilateral APA is unlikely to be accepted in the APA programme unless it can be shown that a unilateral APA is suitable for the circumstances.

Where income can properly be attributed to the UK it will be the subject of UK corporation tax rules, which may include the apportionment of income under the Controlled Foreign Company ("CFC" rules). Similarly, the UK has operated thin capitalisation rules, debt cap rules and continues to operate interest deductibility rules and transfer pricing rules.

Mechanism

The procedural mechanism by way of which an adjustment may be made is through the process referred to above for an enquiry into a tax return.

Once an enquiry process has ended, HMRC must provide the taxpayer with a closure notice, which confirms that the statutory enquiry process has ended, and which sets out the outcome, pursuant to paragraph 32 of Schedule 18 to Finance Act 1998. A taxpayer may ask the tax tribunal for a direction that the enquiry should be closed, if HMRC do not do so, pursuant to paragraph 33 of Schedule 18 to Finance Act 1998.

The tax tribunal must determine the application to close the enquiry unless it is satisfied that there are "reasonable grounds for not giving a closure notice within the specified period.". Pursuant to paragraph 34 of Schedule 18 to Finance Act 1998, a closure notice must either state that in HMRC's opinion, no amendment is required of the return, or it must make the amendments of that return that are required to give effect to the conclusions stated in the notice. If amendments are required to other company tax returns delivered by the company to give effect to the conclusions stated in the closure notice, then HMRC may issue a further notice to the company to make those amendments. The amendments may be appealed by the taxpayer, provided notice of that appeal is given in writing, within 30 days after the

[6] https://www.gov.uk/guidance/when-you-can-rely-on-information-or-advice-provided-by-hm-revenue-and-customs

amendment was notified to the company, and is made to the officer of HMRC by whom the closure notice was given.

Question 6 *Does your country apply any kind of default rule when allocating profits?*

There is no general rule allocating corporate profits as a matter of corporation tax, although there are rules as to the allocation of profits and losses amongst partners in a partnership. There are specifically targeted rules which apportion profits deemed to be incorrectly allocated between related companies, such as the CFC rules, and the Diverted Profits Tax is designed to counter aggressive tax planning schemes used to divert profits from the UK.

Question 7. Did your country adopt any kind of at arm's length pricing / transfer pricing principle, either by means of formal rules or by applying it in practice? In either case, do they have any practical or formal link to the OECD 's transfer pricing guidelines?

Current Transfer Pricing Rules

For accounting periods ending on or after 1 April 2010, the UK's transfer pricing rules are contained in part 4 of TIOPA 2010.

Section 164 of TIOPA 2010 addresses the application of OECD principles in relation to transfer pricing. The section provides that part 4 of TIOPA 2010 is to be read in such a manner as best secures consistency between the effect given to the legislation and "the effect, which, in accordance with the transfer pricing guidelines, is to be given, in cases where double taxation arrangements incorporate the whole or any part of the OECD model, to so much of the arrangements as does so." The legislation goes on to make reference to the version of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations approved by the OECD on 22 July 2010, as revised by the BEPS reports published by the OECD on 5 October 2015, or any other document later published by the OECD, as designated by HM Treasury.

Broadly speaking, the rules permit HMRC to adjust, for transfer pricing purposes, the price paid for goods and services sold or supplied between associated persons, when intra-group transactions take place on a non-arm's length basis, to be replaced by what would be applicable if the arm's length provision had been made or imposed instead of the actual provision.

The transfer pricing rules only apply if the "participation condition" is met (sections 147 and 148 TIOPA 2010).

As regards financing arrangements (which are defined as those made for or providing or guaranteeing or otherwise in connection with any debt, capital or other form of finance), the participation condition is met where, at the time of the actual provision (or within 6 months of the provision being made), one of the affected persons was directly or indirectly participating in the management, control or capital of the other, or the same person (or persons) was directly or indirectly participating in the management, control or capital of each of the affected persons (condition A).

As regards provisions not relating to financing arrangements, the participation condition is met where at the time of the actual provision, one of the affected persons was directly or indirectly participating in the management, control or capital of the other, or the same person (or persons) was directly or indirectly participating in the management, control or capital of each of the affected persons (condition B).

Historic Rules

The UK's transfer pricing rules for accounting periods before 1 April 2010 were found in Schedule 28AA to ICTA 1988.

<u>Question 8</u> *Does your country allow for unilateral adjustments of profits both upwards as well as downwards?*

We have set out above the procedural mechanism through which an adjustment of figures included in a CTSA return may be adjusted.

In addition to the procedural mechanism, the UK has operated controlled foreign corporation ("CFC") rules which allow for profits declared to arise in another country to be apportioned to the UK and taxed as if they arose in the UK. The UK also has attribution of capital profits to the UK under section 13 of the Taxation of Chargeable Gains Act 1992 ("TCGA 1992").

Historic CFC regime

Different CFC rules applied to CFCs with accounting periods beginning before 1 January 2013 ("the old CFC rules"). The old CFC rules were introduced in 1984. A company was a CFC if it was resident outside the UK for tax purposes, subject to a lower level of taxation and either controlled by persons resident in the UK or at least 40% controlled by a UK person and at least 40% (but not more than 55%) controlled by a non-UK person (pursuant to section 747 ICTA 1988). Broadly speaking, where a company was a CFC and did not fit within an exemption, then the total profits of the CFC and any tax credits were apportioned between those who had an interest in the CFC.

The exemptions referred to above were as follows.

1) If a CFC pursued an acceptable distribution policy ("ADP"), then the profits would be exempt. The ADP required the CFC to distribute at least 90% of the CFC's net chargeable profits to UK residents within 18 months of the end of its accounting period.
2) CFCs undertaking exempt activities were automatically taken outside the scope of the CFC rules. Exempt activities required a CFC to have a business establishment in its territory of residence, its business affairs to be effectively managed in its territory of residence and its main business must not consist of certain precluded activities (such as investment business or dealing in goods for delivery to or from the UK).
3) There was no apportionment of profits where the transactions of the CFC achieve "a reduction in UK tax", provided that a reduction in UK tax by diversion of profits from the UK was not a main reason for the CFC's existence, and it was not a main purpose of the transaction to achieve the reduction.
4) Subject to several conditions, there was an exemption for a company whose shares were quoted and traded on a recognised stock exchange, where 35% or more of the voting power was owned by ordinary shareholders.
5) Where the taxable income profits were £50,000 or less, no apportionment was required.

6) The Controlled Foreign Companies (Excluded Countries) Regulations 1998 (SI 1998/3081) operated to provide a "white list" of countries which were wholly or partly outside the CFC rules.

Some additional exemptions were provided for by way of interim reform, which included one for trading companies with a limited UK connection and companies exploiting IP with a limited UK connection.

Current CFC regime

The new CFC regime, introduced by section 180 of and Schedule 20 to Finance Act 2012, applies to accounting periods beginning on or after 1 January 2013.

Under the new regime, a CFC is a non-UK resident company controlled (within the meaning of Chapter 18 of TIOPA 2010) by a UK resident person (pursuant to section 371AA (3) and (6) of TIOPA 2010). The rules provide for establishing the residence of the CFC, by way of either (in order of priority), the territory in which the CFC is liable to pay tax by reason of domicile, residence or place of management, where the CFC is UK incorporated and deemed to be non-UK resident under relevant double taxation arrangements the territory set out in those arrangements, and the territory in which the CFC is incorporated or formed (pursuant to sections 371TA and 371TB TOPA 2010).

There are three tests, any of which may be satisfied, as to who controls the foreign company. The tests are as to legal control, economic rights and accounting principles.

In addition, there are rules as to where a UK resident controller has interests, rights and powers representing at least 40% of the controllers' holdings (and where a joint non-UK resident controller has interests, rights and powers greater than 40% but less than 55% of the controllers' holdings) (section 371RC TIOPA 2010).

A CFC charge applies where there is a CFC with chargeable profits for the relevant accounting period, there is a chargeable company, and none of the exemptions apply (sections 371BA and 371BC TIOPA 2010).

Exemptions exist as follows:

1) Exempt period exemption which allows a period of time before the CFC rules apply to newly acquired foreign companies (Section 371JB TIOPA 2010)
2) The excluded territories exemption for (broadly) where companies operating in countries with a corporate tax regime similar to the UK's, and where headline rates of tax are greater than 75% of the UK's rate
3) The low profits exemption where the CFC's accounting profits, or its assumed taxable total profits, are not more than £500,000 and not more than £50,000 is non-trading income (section 371LB of TIOPA 2010)
4) The low profit margin exemption where the CFC's accounting profits before interest deduction are not more than 10% of the CFC's operating expenditure for accounting purposes (excluding certain costs) (section 371MB of TIOPA 2010
5) Finance company exemptions (Chapter 9) are provided in relation only to the profits of the CFC that qualify for the exemption (as opposed to the exemptions above, which are made in relation to the entity, rather than specific profits). Finance company exemptions are available as either a full or partial exemption on profits from all of the CFC's qualifying loan relationships that are made out of qualifying resources.

The European Commission announced on 26th October 2017 that it has opened an in-depth investigation into an exemption from the CFC rules. The exemption concerned is that which exempts certain financing income. The European Commission notes in its press release[7] that the exemption operates to exempt from UK tax financing income received by an offshore subsidiary from another foreign group company, which has the effect that the multinational in the UK can provide financing to a foreign group company via an offshore subsidiary, paying little or no tax on the profits of those transactions. The concern raised by the European Commission is that little or no tax on the financing income is paid in the country where the offshore subsidiary is based, and the income is also not (or only partially) reallocated to the UK for taxation, because of the operation of the exemption.

Attribution of Capital Gains

Generally speaking, capital gains which accrue to a company are taxable in the hands of the company, and not in the hands of its shareholders. However, if a company meets the definition of a "close company" if it were resident in the UK, chargeable gains are attributed to any shareholder with an interest in the company where the shareholding or interest exceeds 25% (or 10% for disposals made before 6 April 2012), pursuant to section 13 TCGA 1992.

Section 62 of Finance Act 2013 amended the legislation to the effect that gains may only be attributed to participators with a participation exceeding 25%, gains are not attributable if the asset was used only for the purposes of economically significant activities carried on by the company wholly or mainly outside the UK, and gains are not attributable if neither the disposal, the acquisition or holding of the asset by the company was part of a scheme or arrangements for the avoidance of capital gains tax or corporation tax.

Diverted Profits Tax

In addition to the above mechanisms, the UK has put in place a diverted profits tax, which is a new tax which came into effect on 1 April 2015. It is not regarded by HMRC corporation tax and it has a separate mechanism, being a tax imposed on a taxpayer, rather than a self-assessed tax. However, its stated aim was to "introduce a new tax to counter the use of aggressive tax planning techniques used by multinational enterprises to divert profits from the UK"[8].

Question 9 *Suppose the buyer is a resident of your country. Under which conditions would your tax authorities normally accept the transfer pricing result of the other country – an increase in deductible costs – and adjust the level of taxable profit downwards?*

As set out above, where an APA is in place in the UK, HMRC prefers to have a bilateral APA where the pricing is agreed both in relation to the UK and in relation to the other relevant countries.

A claim may be made to HMRC for the deduction of interest following a transfer pricing adjustment in another country. The usual rules of such claims would apply, such as those for time limits, interest and other ancillary matters.

[7] http://europa.eu/rapid/press-release_IP-17-4201_en.htm
[8] See HM Treasury: Autumn Statement 2014: Green book, paragraph 2.142

Where another country deems a distribution to have been made, the dividend will now be exempt in the hands of the UK recipient if it is EU sourced.

<u>Question 10</u> *Does your country have a GAAR? If so, does your law allow it to be applied in a case of abuse as a back-up to lex specialis that turns out to be ineffective in a given case?*

The UK has a GAAR. We have set out the provisions of the GAAR in answer to question 3.

The GAAR is an overriding legal rule and operates independently of other tax legislation. It may, therefore, be relevant where a targeted anti-avoidance rule ("TAAR") also applies.

Part II

<u>Question 11</u> *Briefly describe whether, and if so, which rules have been implemented in your country to ensure the effective and timely recovery of (fiscal) state aid, once ordered by the European Commission*.

There are no specific rules in place for the recovery of fiscal state aid, once ordered by the European Commission or once held by an English Court. The High Court (Queens Bench Division) Administrative Court deals with judicial review actions, which include state aid cases.

HMRC may adjust a tax return in line with the legislation set out above, and may do so even up to ten years later, provided that an enquiry has been opened in time to do so, or provided that the adjustment to the tax return fits within one of the other provisions for an adjustment (such as a discovery assessment).

However, in circumstances where an enquiry has not been opened, and where alternate routes of adjusting a tax return are not available to HMRC (such as in relation to fraud, negligence or discovery assessments), HMRC (and possibly the Department for Business Energy and Industrial Strategy "BEIS") would be required to rely instead on taking litigation steps available under the common law.

<u>Question 12</u> *Have there been any examples in your country where national judges refused to allow for the (immediate) recovery of state aid? If so, please describe those situations*.

There has not been, at least to our knowledge, a case in the UK where a national judge has refused to order recovery of State aid, following a decision of the European Commission that state aid should be recovered. Actually, there has been no determination in the UK's national courts that State aid must be recovered. The only time the issue was discussed before a domestic court was in *DTI v British Aerospace and Rover* (1991) 1 CMLR 165. In the DTI case, the Commission found that the aid received by British Aerospace to assist with its purchase of Rover constituted illegal state aid. Following the Commission's decision to order recovery, the UK government brought an action against British Aerospace before the High Court. These proceedings were stayed pending the outcome of an action for annulment of the Commission's decision. The Commission ultimately made a new recovery order, which was effected directly by the UK government without a court action.

It is to be noted that, the UK courts however found that tax discriminatory measures amount to unlawful aid at least in two cases: *R v Attorney-General, ex parte ICI* (1987) 1 CMLR 72 (CA) and *R v Commissioner for Customs and Excise, ex parte Lunn Poly* (1999) EuLR 653 (CA).

The UK has a current case being litigated by way of judicial review, in respect of whether a transaction involving a sporting arena amounted to State aid. The case had an earlier incarnation, *Sky Blue Sports & Leisure Ltd & Anor, R (on the application of) v Arena Coventry Ltd & Anor* [2016] EWCA Civ 453. The claimants in the case argue that illegal State aid was given and that the court should order recovery of the State aid. While the Courts consistently held in that case that there was no State aid, there was nothing in the judgments in those cases, which suggested that the English courts did not have the jurisdiction to order recovery of illegal State aid.

<u>Question 13</u> *Is your country subject to international obligations involving the protection of property or the protection of foreign investments? If so, please identify them*

The UK has one of the largest networks of bilateral investment treaties, which protect foreign investment. The UK has about 106 bilateral investment treaties, which are either currently in force or which are signed but not in force. Of those, 11 are signed but not in force. The UK has also terminated 4 bilateral investment treaties, three of which were replaced with new versions.[9]

The UK also has the right to protection of property in the context of the Human Rights Act 1998. There is a small amount of case law in respect of the application of the right to protection of property in the context of tax.

<u>Question 14</u> *What position do the Courts in your country take on how to deal with conflicting obligations of European Union law and international law (including bilateral agreements with non-EU Member States)?*

This is a rather complex question to cover exhaustively especially with the deluge of commentary brought upon us by Brexit. We would simply note that despite all the interest generated, the UK Supreme Court decision in *R (on the application of Miller and another) v Secretary of State for Exiting the European Union* [2017] UKSC 5, is a very traditional confirmation that:

1) the government is vested with prerogative powers to make treaties and to withdraw from them. Both powers are 'exercisable without legislative authority' and are non-reviewable by the courts. Treaties are not part of UK law and create no legal rights in a dualist system. This protects the sovereignty of Parliament.

2) the European Communities Act of 1972, the act of accession to the then EEC and its modifications, has a '*constitutional character*' and makes EU law capable of overriding conflicting national law. It also provided '*a new constitutional process for making law* in the UK. The 1972 Act finally '*provided that rights, duties and rules derived from EU law should apply in the UK*'. Applying the well-known *Solange* rationale, the Supreme Court held that as long as the UK is in the EU, EU law must be applied in the UK.

[9] For a full list of extra-EU BITs (those with a third country outside the EU), including with Albania, Serbia, and Turkey among the EU candidate states see https://www.crowell.com/files/20160927-Annex-2-Extra-EU-UK-BITs.pdf. For a full list of intra EU- BITs see https://www.crowell.com/files/20160927-Annex-1-Intra-EU-UK-BITs.pdf.

English courts, generally, have been taking their EU obligations extremely seriously. With reference, to the relationship between international law obligations and EU law there has been, however, a prolonged discomfort caused by the position taken by EU law on the question of anti-suit injunctions, a typical common law remedy that prevents an opposing party from commencing or continuing a proceeding in another jurisdiction or forum. In the C-185/07 *West Tankers* ECLI: EU: C: 2009:69, the CJEU held that anti-suit injunctions should not be available to prevent proceedings in other European member state courts being brought in breach of an arbitration agreement under Brussels Regulation, because it '*necessarily amounts to stripping that court of the power to rule on its own jurisdiction*' and '*runs counter to the trust which the Member States accord to one another's legal systems and judicial institutions*'. After the entry into force of the Recast Brussels Regulation (Regulation (EU) No. 1215/2012) that clarified that that prohibition did not apply to arbitration, in case C-536/13 *Gazprom* ECLI: EU: C: 2015:316, the CJEU, despite allowing the possibility of anti-suit injunctions in that context, refused to question *West Tankers,* thus implicitly rejecting the possibility of a general admissibility of anti-suit injunctions. English courts – despite not formally challenging the CJEU case law, barely hidden their contrariety and in several cases attempted to protect arbitration agreements by enforcing declaration of awards despite the possibility of inconsistent judgments in other Member states, for instance in West *Tankers Inc v Allianz SPA & Generali Assicurazione Generali SPA* [2012] EWCA Civ 27. Further, in *Samengo-Turner v J&H Marsh & McLennan (Services) Ltd*, [2008] ICR 18, the Court of Appeal had no hesitation in granting an anti-suit injunction restraining the proceedings in New York. In that case, the Court considered the effect of the Brussels Regulation, which provides that an employer can only sue an employee on matters relating to individual contracts of employment in their country of domicile. The Court held that this extended to companies in the multinational group of which the employer formed part. It also dismissed as of no relevance that fact that it was possible that the courts in some other EU Member States did not have equivalent powers to grant anti-suit injunctions. The same approach was confirmed in *James Petter v EMC Europe Limited and EMC Corporation* [2015] EWCA Civ 828. The UK Supreme Court in *Ust-Kamenogorsk Hydropower Plant JSC (Appellant) v AES Ust-Kamenogorsk Hydropower Plant LLP* [2011] EWCA Civ 647 also held that that English courts have jurisdiction to grant an injunction in order to restrain foreign proceedings brought in breach of an arbitration agreement, where there is no existing or proposed arbitration. It also added that, however, where court proceedings are brought in a jurisdiction within the European regime of the Brussels Regulation (EC) No 44/2001 or the Lugano Convention, English courts will not grant an antisuit injunction.

Another interesting example is *Micula & others v Romania* [2017] EWHC 31 (Comm), concerning UK obligations under EU and the Convention on the International Centre for Settlement of Investment Disputes (the ICSID Convention). This is yet another chapter of the now rather famous Micula saga on the question on the enforceability of a ICSID award in circumstances where the European Commission had determined that implementation or execution of the award would constitute new State aid.[10] In 2014 the English courts registered the award as required by national law, the Arbitration Act of 1966 that embodies Article 54 of the ICSID Convention, which requires the UK to recognize and enforce an award as if it were a final judgement of its own courts. Romania, supported by the European Commission, applied to the courts to have the registration revoked. In a case defined of "exceptional nature", the High Court refused Romania's application, to set aside the registration, as there was no risk of conflicting outcomes with EU law. The English court opined that in the first

[10] See further European Commission Decision (EU) 2015/1470 of 30 March 2015 on State aid SA.38517 (2014/C) (ex 2014/NN).

place the registration of the award did not really put Romania in danger of infringing its EU law obligations. It drew a rather formalistic distinction between registering an award and execution of that judgment. As the Court observed '*registration is not necessarily a precursor to execution, though it may lead to it*'. In the case at hand, there was still no 'execution' that would have put Romania in conflict with the award. Secondly, as to avoid any possible conflicts, it granted a stay of enforcement proceedings in the United Kingdom pending the decision of the EU General Court in an action on the annulment of the Commission decision.[11] According to the High Court, the registration of an award should be equated to a final domestic judgment and as such subject to the same rules and conditions applicable to a judgment of a national court, including the EU law derived obligations. Thus, because of the European Commission position on the presumed illegality of the original award with the state aid regime, the High Court found that it could not proceed to enforcement. It also added that because of the pending General Court decision on annulment, there was a "*material risk of conflict*" with that decision. The English court decision is indeed 'Solomonic': on the one hand, it attempts to preserve the UK obligations under the ICSID Convention and on the other is striving to comply with its EU obligation.

In these tempestuous times, it may thus appropriate to conclude this report with King Salomon's words: '*the rivers run into the sea; yet the sea is not full'*.

[11] T-704/15, *Micula v Commission*, pending.