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Dorsey London Tax Update

4 February 2010

Upcoming and Anticipated Dates

FII GLO	Court of Appeal (judgment)	Ca Feb 2010
M&S (Group Relief)	Upper Tribunal (hearing)	Ca Mar 2010
ACT Classes 2 & 4	High Court (judgment)	Ca Mar 2010
Prudential (portfolio dividends, FII and life assurance)	High Court (judgment)	Ca Mar 2010
FID Litigation (cash tax credits)	First Tier Tribunal (judgment)	Ca Mar 2010
VIC GLO (Compound Interest)	Court of Appeal (judgment/reference)	Ca Mar 2010
CIP Litigation (Compound Interest)	Court of Appeal (hearing)	Ca July 2010
Thin Cap GLO	Court of Appeal (hearing)	Ca Oct 2010
Accor case (avoir fiscal)	ECJ (hearing)	Ca Dec 2010

Seminars and Presentations

Tax Litigation- How to win in the new Landscape	24 March 2010	Lexis Nexis	London
The Impact of ECJ Case Law on National Direct Tax Systems	29-30 April '10	Academy of European Law (ERA)	Madrid

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CFCs - Vodafone 2 – Supreme Court refuses leave to appeal

Unsurprisingly Vodafone 2 have been refused leave to appeal to the Supreme Court. The case now returns to the First tier Tribunal for it to establish whether the Vodafone circumstances amount to "wholly artificial arrangements intended to escape the national tax normally payable." Vodafone had argued that the ECJ's conclusion in the Cadbury Schweppes case (finding the UK CFC provisions incompatible with Community law) meant that those provisions could not apply to any EU circumstances, even tax abusive structures, so that no review of Vodafone's facts was needed.

With the final failure of that line, this litigation turns to factual determinations specific to Vodafone. An end to Vodafone 2 looks a long way off yet.

CFC Discussion Document – 26 January 2010

On 26 January 2010, HMRC published a discussion document outlining proposed reform of the CFC rules, with the intention of legislating in FA

Contacts

- Michael Anderson
- Kelly Coutinho
- Gaynor Dunmall
- Paul Farmer
- Philippe Freund
- Savina Kanagasabay
- Alison Last
- Nathan Simmons
- Simon Whitehead

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Paul Farmer named **Tax Lawyer of the Year 2006** by Lexis Nexis

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2011. It is proposed that transfer pricing principles will apply in the new rules in the following way:

- Notional income deemed to arise from the CFC will be imputed to the CFC's UK corporate shareholders where the CFC is "thickly capitalised" with excess equity;
- The excess equity will be recharacterised as debt with interest being imputed to the UK parent.

CFCs will be covered by the regime unless specifically exempted. Proposals to allow for proportionality include:

- the possible exemption of companies narrowly missing exemption requirements or falling outside of an exemption because of a one-off commercial transaction;
- the increase of the de minimis threshold;
- the temporary suspension of the regime after a commercial acquisition of a new sub group from a third party;
- a possible exemption for situations where the CFC is established in a country with a similar statutory rate and tax base as the UK;
- Reinsurance and Property subsidiaries may also be exempted, as might group treasury companies.

A new motive test is also proposed, where other exemptions are not available, which will allow a company to demonstrate the non-tax related rationale for a transaction or the role of the overseas subsidiary as a member of the group. The changes proposed may mean that new charges arise under the proposed system which would not have done under the current rules.

Questions arise as to whether the debt to equity ratios to be applied will be reasonable and as to the criteria for artificiality to be applied in the new motive test.

The immediate issue will be whether the provisions protecting commercial arrangements will genuinely protect the commercial or will simply repeat the arm's length test and thus still fall foul of the Thin Cap judgment. The proposals are not necessarily incompatible with Community law, but the devil is in the detail. Draft legislation is awaited.

Compound Interest – Latest Developments

Parallel claims have been brought in the High Court and statutory tribunal to establish whether compound interest is available for VAT claims and through which jurisdiction. Both sets of claims failed at first instance in 2009. The High Court concluded that compound interest was available but that the claims were out of time. The Upper Tribunal held that there was no statutory entitlement to compound interest and, in any event, those claims were also out of time.

Both sets have been appealed to the Court of Appeal. The appeal in the High Court claims was heard in January with the parties proposing references to the ECJ. A decision is awaited. The other proceedings have yet to be heard

Until we receive a judgment, the most prudent course of action remains to issue claims in both jurisdictions and stay the claims until the litigation has been resolved.

C-311/08 SGI – Transfer Pricing

This case concerned what the ECJ (and the Belgian revenue and courts) appeared to regard as an uncommercial tax scheme. A Belgian company granted interest free loans to its 62% French subsidiary in circumstances where the subsidiary did not need the cash and the loans put severe financial pressure on the lender. The Belgian lender then paid excessive directors' remuneration to its 34% parent. This fell foul of Belgian transfer pricing provisions as amounting to abnormal, unusual or gratuitous advantages granted to non resident affiliated companies. No such adjustment would arise domestically.

The case is perhaps worth noting for its conclusion that a interest sufficient to amount to direct influence (so that old article 43 applies) can descend to at least 34%. Otherwise the case is a repetition of the case law judgment concluding that the Belgian provisions are permissible provided they protect genuine commercial arrangements.

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