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Case No: HC-2003-000002
(Formerly: HC03C00446)

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Rolls Building
Royal Courts of Justice
Fetter Lane, London, EC4A 1NL

Date: 05/10/2016

Before:

MR JUSTICE HENDERSON

- -

Between:

(1) SIX CONTINENTS LIMITED **(2) SIX CONTINENTS OVERSEAS HOLDINGS LIMITED**	**Claimants**
- and -	
(1) THE COMMISSIONERS OF INLAND REVENUE **(2) THE COMMISSIONERS FOR HM REVENUE AND CUSTOMS**	**Defendants**

- -

Mr Jonathan Bremner (instructed by **Joseph Hage Aaronson LLP**) for the **Second Claimant**
Mr Rupert Baldry QC and Ms Barbara Belgrano (instructed by **the General Counsel and Solicitor for HMRC**) for the **Defendants**

Hearing dates: 4, 5 and 6 May 2016

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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MR JUSTICE HENDERSON

Mr Justice Henderson:

Introduction

1. In this action the second claimant ("Six Continents") claims restitution from the defendants ("the Revenue" or "HMRC") in respect of United Kingdom corporation tax unlawfully charged on certain dividends paid to it by a wholly-owned subsidiary incorporated and resident in the Netherlands, Six Continents International Holdings BV ("SCIH").

2. The dividends in question ("the Dividends") were paid to Six Continents by SCIH on various dates between 1993 and 1997. They formed part of the income profits of Six Continents chargeable to corporation tax in the UK under section 6 of the Income and Corporation Taxes Act 1988 ("ICTA 1988"). The amounts so chargeable were computed in accordance with the principles then applicable to the charge to income tax under Case V of Schedule D ("tax in respect of income arising from possessions out of the United Kingdom"): see sections 9 and 18 of ICTA 1988, as in force during the relevant years.

3. The unlawfulness under EU law of the Case V charge, in its application to dividends paid to a UK holding company by a subsidiary resident in another Member State, was definitively established on the second reference to the Court of Justice of the European Union ("the ECJ") in the FII group litigation: see Case C-35/11, Test Claimants in the FII Group Litigation v Revenue and Customs Commissioners [2013] STC 612 ("FII (ECJ) II"). Accordingly, there is no dispute in the present case about the unlawfulness of the Case V charge in relation to most of the Dividends in the hands of Six Continents. In relation to these Dividends, the only live issues (Agreed Issues 1 and 2) are of a computational nature, and concern the extent of the notional credit for foreign tax (at the Dutch standard rate of corporation tax) to which Six Continents must be treated as entitled in calculating the restitution which is due to Six Continents for the unlawfully levied tax.

4. Agreed Issue 3, however, is of a different nature. It applies to those parts of the Dividends paid in 1997 which had their source in the share premium account in a Dutch subsidiary of SCIH. The question here is whether EU law requires any tax credit at all to be notionally given to Six Continents in order to secure compliance with EU law. If there is no such requirement, the Case V charge was, to that extent, compliant with EU law, and this part of the claim must therefore fail.

5. It will be apparent from what I have already said that the issues which now divide the parties are, for the most part, both narrow and technical. The underlying facts have largely been agreed, and are recorded in a statement of agreed facts for trial ("the SAF") dated 5 April 2016. Much of the SAF is itself derived from the judgment which I handed down on 14 October 2015 ("the October judgment"), dismissing Six Continents' application for summary judgment, but granting its claim for an interim payment in relation to all of the Dividends except for those parts of the 1997 Dividends which were sourced from share premium account.

6. It is worth emphasising at this early stage how limited the areas of dispute in the present case are, when compared with the full range of issues in the FII group litigation. In the first place, this case is concerned only with the Case V charge to

corporation tax on the Dividends. No issues arise in relation to advance corporation tax, or special taxation regimes such as that applicable to foreign income dividends. Secondly, the Dividends were all paid by the same subsidiary, resident in a single Member State. Thirdly, the underlying profits distributed in the Dividends all had their source in the Netherlands, with the sole exception of some profits originating in Belgium the treatment of which is not in issue. Finally, HMRC agreed for the purposes of the trial that, save in relation to the three Agreed Issues, the court should apply the law on the basis of its decision in the FII quantification trial, judgment in which was given on 18 December 2014: see Test Claimants in the FII Group Litigation v Revenue and Customs Commissioners [2014] EWHC 4302 (Ch), [2015] STC 1471 ("FII (High Court) II"). HMRC reserve their position for a higher court, however, if the law as stated in FII (High Court) II is overruled or modified on appeal to the Court of Appeal and/or the Supreme Court. The current position is that the Court of Appeal heard argument in June 2016 on the appeals from FII (High Court) II, and judgment is awaited.

7. Subject to the above qualification, the agreed list of issues reads as follows:

> "1. Whether Six Continents is entitled to a credit at the Dutch standard rate of corporation tax for so much of the Dividends as was derived from adjustments to the pre-tax commercial (or accounting) profits, which in general prevent the recognition for tax purposes of revaluations (upwards or downwards) of capital assets before they are disposed of.
>
> 2. Whether Six Continents is entitled to a credit at the Dutch standard rate of corporation tax for so much of the Dividends which arose from the liquidation of a subsidiary of SCIH, and formed part of the accounting profits of SCIH for 1995.
>
> 3. Whether Six Continents is entitled to a credit at the Dutch standard rate of corporation tax for so much of the Dividends [*as was*] sourced from the share premium account in a Dutch subsidiary of SCIH."

I refer to these issues as Agreed Issues 1, 2 and 3 respectively.

The agreed facts

8. The following account is largely taken from the SAF, and adds little of substance to the October judgment at [7] to [11].

9. Six Continents was incorporated in England and Wales in 1991. In March 1992, it changed its name to Bass Overseas Holdings Limited, and in August 2001 it acquired its present name. Together with its immediate UK parent, the first claimant, Six Continents Limited, it is a member of the InterContinental Hotels Group of companies ("IHG"). IHG operates in the international hotel business across nearly 100 countries. In the UK, IHG is a successor to the Bass Plc Group.

10. Six Continents is enrolled as a member of the Controlled Foreign Company ("CFC") and Dividend Group Litigation Order ("GLO"), but the CFC component of its claim

was settled in 2012, and the claim relates only to certain dividends paid to Six Continents in the accounting periods ending 30 September 1993, 1996 and 1997 respectively (i.e. the Dividends) by SCIH.

11. The Dividends and their constituent parts are set out in full in Schedule 1 to the SAF. The total amounts of the Dividends in each accounting period are as follows:

    (a) 1993, one dividend of NLG 13,174,696;

    (b) 1996, four dividends of NLG 13,200,000, NLG 40,000,000, NLG 800,000, and NLG 5,000,000 respectively; and

    (c) 1997, four dividends of NLG 7,000,000, NLG 300,000, NLG 25,000,000 and NLG 13,000,000 respectively.

12. Six Continents seeks to recover corporation tax under Case V of Schedule D which it alleges was levied on the Dividends in breach of EU law, together with compound interest from the dates when the tax was paid until judgment. The claim relies on the Woolwich and mistake-based restitutionary causes of action in English law, as they have been developed and applied in the context of the FII group litigation so as to provide the test claimants in that group litigation with an effective remedy for recovering tax which the ECJ has held to be unlawfully levied.

13. Six Continents is not enrolled in the FII GLO. The three relevant accounting periods have been finally determined, and the years in question are therefore now "closed".

14. Between 1989 and 1991, the Bass Plc Group expanded into the international hotel business with the acquisition of the Holiday Inn Group. Six Continents (under its then name of Bass Overseas Holdings Limited) was the UK holding company for this international group. It was arranged that SCIH (then known as Bass International Holdings BV) would hold the non-UK interests.

15. At the material times, dividend income of a UK-resident parent company (such as Six Continents) from subsidiaries resident outside the UK (such as SCIH), including those resident in other EU Member States, was subject to UK corporation tax under Case V of Schedule D. The company was granted relief, creditable up to the amount of the UK corporation tax liability on the particular income, for foreign taxes paid. Such relief was given either unilaterally under domestic rules (section 790 of ICTA 1988) or under double taxation conventions entered into with other countries (section 788 of ICTA 1988). In contrast, dividend income received by a UK parent company from its UK-resident subsidiaries was exempt from corporation tax: see section 208 of ICTA 1988.

16. During the three relevant accounting periods, Six Continents received the Dividends from SCIH. The source of the Dividends was a mixture of SCIH's own profits and dividends received from its Dutch-resident subsidiaries, Holiday Inns International BV ("HII") and Bass Continental Finance NV ("BCF"). All of the relevant profits were of either Dutch or Belgian origin. It is agreed that SCIH and those subsidiaries were established in the Netherlands.

17. The Belgian profits were those of a Belgian co-ordination centre, which was a branch of HII. For the nature of Belgian co-ordination centres, and the computation of the appropriate tax credit at the Belgian nominal rate of tax on their distributed profits, see FII (High Court) II at [82] to [90]. There is no dispute between the parties about how the income of the Belgian co-ordination centre in the present case should be treated, and the appropriate credit in respect of such income is set out on page 2 of Schedule 1 to the SAF.

18. It is unnecessary for me to set out the procedural history of the present case, which may be found in the October judgment at [12] to [19].

19. The standard rates of Dutch corporation tax in force for the periods subject to the claim ranged from a high of 40% (in respect of the first NLG 250,000 of profits) in 1990/91, to 36% (in respect of the first NLG 100,000 of profits) in 1996/97, with profits in excess of the first tranche charged at a uniform rate of 35% throughout the whole period. These rates of tax were always higher than the equivalent UK rates of corporation tax.

The witnesses

20. The following witnesses of fact gave evidence on behalf of Six Continents, and were cross-examined by Mr Baldry:

    (a) Ms Anna Pack, who until recently was Vice President of Tax Reporting for the IHG Group. She first joined the tax department of Bass Plc in 1992. This department was responsible for the preparation of all the group's UK tax computations, and although Ms Pack was not herself directly involved in their preparation, she worked alongside colleagues who were. Her experience spans all of the computations which are now in issue.

    (b) Mr Colin Garwood, who is the head of tax for the IHG Group and a chartered accountant with 30 years' experience in the field of corporation tax.

    (c) Mr Roger Brands, who is a tax partner with Deloitte in the Netherlands and in that capacity has provided tax services to the IHG Group since October 1999. In the October judgment, at [36], I commented on the informal nature of the evidence about Dutch corporate tax law given by Mr Brands in his three witness statements. I now have the benefit of properly adduced expert evidence on Dutch law from experts instructed by each side, so his role at the trial was purely as a witness of fact, albeit one with detailed practical knowledge of corporate taxation in the Netherlands.

21. All of these witnesses clearly did their best to help the court, and there are no issues regarding the quality of their evidence.

22. The two witnesses of fact for HMRC were:

    (a) Mr Paul Icarus Lane, who is an officer in the Large Business group of HMRC's Business Tax directorate; and

(b) Mr James Philip O'Hara, who works as an international tax specialist in the same group.

Mr Lane was briefly cross-examined by Mr Bremner, while the evidence of Mr O'Hara was admitted as it stood. Again, there are no issues about the quality or reliability of Mr Lane's evidence.

The expert evidence

23. Six Continents' expert witness on Dutch tax law was Mr Nicolaas Blom. Mr Blom is a Dutch tax lawyer and a member of the Dutch Association of Tax Advisers. He graduated from Leiden University with a master's degree in law in 1991, and has continuously practised tax law since 1993, mainly in Amsterdam. He specialises in the tax aspects of many forms of financial and commercial transactions, and has wide practical experience. I have no doubt that he is well qualified to give evidence on the relevant aspects of Dutch tax law, and his views are clearly set out and explained in his two reports.

24. HMRC's expert is Professor Arie Cornelis Pieter Bobeldijk, who is a professor of corporate income tax at Nyenrode Business Universiteit in the Netherlands and a tax partner with Loyens & Loeff NV (a large legal and tax firm) in the Netherlands. He holds university degrees in business economics and tax law, and is a member of several professional associations. His work as a tax partner includes advising Dutch and foreign multinationals on Dutch corporate tax issues. He has held his chair at Nyenrode since 2010, and delivers lectures and seminars to a variety of audiences. Like Mr Blom, he is clearly well qualified to fulfil his role as an expert witness, and his views are clearly set out in his two reports.

25. Apart from their individual reports, the experts also provided a helpful joint statement dated 16 March 2016. This focused on the main area of disagreement between them, which is whether income that is not taken into account, or is exempted from Dutch taxation, on the basis of the so-called participation exemption in Article 13 of the Dutch Corporate Income Tax Act ("CITA"), initially forms part of the total profit, or not, of the company which benefits from the exemption. After summarising their respective opinions, paragraph 15 of the joint statement concludes by recording their agreement that for Dutch tax purposes the difference between them is of a "semantic" or "academic" nature, because profits which are not taken into account, or are exempt, on the basis of the participation exemption in Article 13 are, in the end, not included in the taxable profits under Article 7(3) of CITA.

Issue 1: is Six Continents entitled to a credit at the Dutch standard rate of corporation tax for so much of the Dividends as was derived from the Revaluation Adjustments?

26. I have already described the general nature of revaluation adjustments in the October judgment, at [38] and [41] to [43], drawing on the written evidence of Mr Garwood. As I said, at [38]:

> "These are adjustments to pre-tax commercial (or accounting) profits, which in general prevent the recognition for tax purposes of revaluations (upwards or downwards) of capital assets before they are disposed of. Substantial amounts of the

> Dividends paid in 1996 and 1997 were derived from upwards adjustments of this nature. The issue is whether Six Continents is entitled to a credit at the Dutch standard rate of corporation tax (being the relevant FNR) for so much of the Dividends as was derived from the adjustments."

27. More precisely, the issue concerns items in the financial statements of SCIH which were excluded for Dutch tax purposes. For the most part, these items arose from the revaluation of shareholdings (or "participations") held by SCIH in other group companies, but they also include certain foreign exchange differences and amounts derived from the release of a warranty provision. It is convenient to refer to all of the items in the financial statements which were thus excluded as "the Revaluation Adjustments", there being no suggestion on either side that any different principles apply to the relatively few non-participation adjustments.

28. The financial statements of SCIH for 1992/3 and all relevant subsequent periods included the following statement of the accounting principle which applied to the valuation of participations:

> "Participations in group companies and other participations:
>
> These participations are valued at cost, less provisions for diminution in value which is expected to be permanent.
>
> Participations which are in liquidation, or will be liquidated within the foreseeable future, are valued at realisable value, reflecting the (expected) liquidation proceeds.
>
> Differences between the at cost value and net realisable value are taken to the profit and loss account."

29. Details of the relevant Revaluation Adjustments in the financial statements of SCIH for the years ended 30 September 1993, 1994 and 1995 are set out in the SAF in paragraph 25, which I need not reproduce. It is also common ground (as set out in paragraph 27 of the SAF) that, in computing the UK tax liability of Six Continents under Schedule D Case V, the following dividends were regarded as paid from profits of SCIH which incorporated the Revaluation Adjustments:

    (a) from the SCIH profits of 1992/3, the whole of the second Dividend paid in 1996, part of the fourth Dividend paid in 1996, and part of the fourth Dividend paid in 1997; and

    (b) from the SCIH profits of 1994/5, part of the third Dividend paid in 1997, and part of the fourth Dividend paid in 1997.

    The total amount of these Dividends and parts of Dividends comes to approximately NLG 56.2 million.

30. With regard to the tax position in the Netherlands, I would summarise the effect of the expert evidence in the following propositions, none of which (I think) is controversial:

(1) A Dutch resident company such as SCIH is fully liable to Dutch corporate income tax on its worldwide income.

(2) For a domestic Dutch taxpayer, the corporate income tax is levied on "the taxable amount": Article 7(1) of CITA.

(3) The "taxable amount" is "the taxable profit earned in a year", less loss relief carried forward from previous years or carried back from later years: Article 7(2) and Chapter IV of CITA.

(4) The "taxable profit" is the "profit less deductible gifts": Article 7(3) of CITA. For present purposes, deductible gifts may be disregarded.

(5) "Profit" is defined in Article 8 of CITA, which in Mr Blom's English translation states that:

> "Profit shall be interpreted and determined on the basis of Article 7, 8(1)(a), (b) and (c), 8(2), 8(3), 8(a), 9 to 14(c) inclusive, 16 and 44(b) of the Income Tax Act 1964 save to the extent it has been determined otherwise by or pursuant to this Act …"

(6) The relevant Articles in the Dutch Income Tax Act 1984 ("PITA") are Articles 7 and 9. Article 7 says that:

> "Profit is the amount of all advantages, regardless of form or name, that are derived from a trade or business."

Article 9 says that:

> "The profit earned or accrued in a calendar year is based on sound business practice that is applied in a consistent manner independent from the anticipated result and this consistent manner can be changed only if it is justified by sound business practice."

According to Mr Blom, the Dutch expression which he translates literally as "sound business practice" is in practice best translated as meaning "tax accounting principles". He adds (paragraph 17 of his first report):

> "In practice all companies compute their profit based on the commercial balance sheets and the commercial profit and loss account, which profit is then converted to the annual profit for tax purposes in line with sound business principles."

31. Once the profit of a Dutch company has been computed in the manner set out above, various adjustments to it may be made. One such adjustment is the participation exemption, which is contained in Article 13(1) of CITA and provides that:

> "For the purposes of determining profit, no account shall be taken of the advantages derived from a participation or the expenses associated with that participation, unless it can be

> proved that these expenses are indirectly supportive to generating taxable profit in the Netherlands (participation exemption)."

The conditions which must be satisfied in order to qualify for the participation exemption are then set out in Article 13(2). In short, the taxpayer must own at least 5% of the paid-up capital of the company concerned, subject to certain exceptions (e.g. for foreign passive "portfolio" shareholdings).

32. According to Mr Blom (paragraph 24 of his first report):

> "The application of the participation exemption to the shares in a Dutch resident subsidiary does not specifically require that the subsidiary is liable to tax. However, as a practical matter a qualifying Dutch subsidiary is always liable to corporate income tax in the Netherlands."

Similarly, Professor Bobeldijk identifies as one of the rationales for the participation exemption that "the same profit should not be subject to double economic taxation" (paragraph 56 of his first report).

33. The experts are also in agreement (paragraph 6 of their joint statement) that income from qualifying shareholdings, which fall within the scope of the participation exemption, are benefits derived from an enterprise and as such fall within Article 7 of PITA and are therefore subject to the rules of sound business practice.

34. Against this background, the primary case advanced by Mr Bremner for Six Continents remains substantially the same as it was on the summary judgment/interim payment application, and which led me to conclude (in the October judgment at [52]) that Six Continents would succeed at trial on its claim to be entitled to a credit at the Dutch nominal rate of corporation tax on the Dividends in so far as they were sourced from distributable profits arising from the Revaluation Adjustments.

35. It is only in this way, submits Mr Bremner, that effect can be given to the reasoning of the ECJ in <u>FII (ECJ) II</u>, and the vice which the ECJ perceived in the UK tax system can be remedied. The problem lies in the lack of equivalence between the exemption system which the UK operated for domestic dividends, which had the consequence that a UK-resident company was able to pass the advantages of domestic reliefs and exemptions enjoyed by a UK subsidiary up the corporate chain, on the one hand, and the imputation system which the UK operated for foreign dividends, whereby the UK parent company was confined to a credit for the foreign tax actually paid in respect of the distributed profits, but was otherwise chargeable to tax on the dividends at the full UK rate, on the other hand.

36. Central to this analysis is the discussion by the ECJ in <u>FII (ECJ) II</u> of the differences between the techniques of exemption and imputation as methods of relieving the economic double taxation of distributed profits. At paragraphs 46 to 48, the Court said this:

> "46. Second, exemption from tax of dividends paid by a resident company and application to dividends paid by a non-

> resident company of an imputation method which, like that laid down in the rules at issue in the main proceedings, takes account of the effective level of taxation of the profits in the state of origin also cease to be equivalent if the profits of the resident company which pays dividends are subject in the member state of residence to an effective level of taxation lower than the nominal rate of tax which is applicable there.
>
> 47. The exemption of the nationally-sourced dividends from tax gives rise to no tax liability for the resident company which receives those dividends irrespective of the effective level of taxation to which the profits out of which the dividends have been paid were subject. By contrast, application of the imputation method to foreign-sourced dividends will lead to an additional tax liability so far as concerns the resident company receiving them if the effective level of taxation to which the profits of the company paying the dividends were subject falls short of the nominal rate of tax to which the profits of the resident company receiving the dividends are subject.
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> 48. Unlike the exemption method, the imputation method therefore does not enable the benefit of the corporation tax reductions granted at an earlier stage to the company paying dividends to be passed on to the corporate shareholder."

37. The Court then recorded that, in answer to the question which had been remitted to the national court on the first FII reference, it was apparent that the situation posited in paragraph 46 was the norm, rather than the exception, in the UK. Accordingly, application of the imputation method to foreign-sourced dividends did not ensure a tax treatment equivalent to that resulting from application of the exemption method to nationally-sourced dividends: see paragraph 52 of the judgment. The dual system for domestic and foreign dividends operated by the UK therefore constituted a restriction on the freedoms of establishment and capital movement guaranteed by Articles 49 and 63 TFEU, and would be permissible only if justified by an overriding reason in the public interest which satisfied the test of proportionality: see paragraphs 54 and 55.

38. On the issue of proportionality, the Court analysed the position as follows in paragraphs 60 to 62:

> "60. As to the proportionality of the restriction, whilst application of the imputation method to foreign-sourced dividends and of the exemption method to nationally-sourced dividends may be justified in order to avoid economic double taxation of distributed profits, it is not, however, necessary, in order to maintain the cohesion of the tax system in question, that account be taken, on the one hand, of the effective level of taxation to which the distributed profits have been subject to calculate the tax advantage when applying the imputation method and, on the other, of only the nominal rate of tax chargeable on the distributed profits when applying the exemption method.

> 61. The tax exemption to which a resident company receiving nationally-sourced dividends is entitled is granted irrespective of the effective level of taxation to which the profits out of which the dividends have been paid were subject. That exemption, in so far as it is intended to avoid economic double taxation of distributed profits, is thus based on the assumption that those profits were taxed at the nominal rate of tax in the hands of the company paying dividends. It thus resembles grant of a tax credit calculated by reference to that nominal rate of tax.
>
> 62. For the purpose of ensuring the cohesion of the tax system in question, national rules which took account in particular, also under the imputation method, of the nominal rate of tax to which the profits underlying the dividends paid have been subject would be appropriate for preventing the economic double taxation of the distributed profits and for ensuring the internal cohesion of the tax system while being less prejudicial to freedom of establishment and the free movement of capital."

39. It is also relevant to note the further observations which the Court made at paragraph 64 of its judgment:

> "64. It is true that calculation, when applying the imputation method, of a tax credit on the basis of the nominal rate of tax to which the profits underlying the dividends paid have been subject may still lead to a less favourable tax treatment of foreign-sourced dividends, as a result in particular of the existence in the member states of different rules relating to determination of the basis of assessment for corporation tax. However, it must be held that, when unfavourable treatment of that kind arises, it results from the exercise in parallel by different member states of their fiscal sovereignty, which is compatible with the Treaty …"

40. It is clear from the reasoning of the Court, and in particular from paragraphs 62 and 64, that the imputation system operated by the UK for foreign-sourced dividends would have satisfied the test of proportionality, and would therefore have been compliant with EU law, if the UK parent company had been granted a tax credit at the relevant foreign nominal rate ("FNR") of corporation tax "to which the profits underlying the dividends paid have been subject". There is no doubt in the present case that the relevant FNR is the Dutch standard rate of corporation tax. The critical question, therefore, is whether the accounting profits of SCIH derived from the Revaluation Adjustments were in principle subject to the Dutch standard rate of corporation tax, notwithstanding the elimination of those profits in the hands of SCIH from the amounts actually charged to tax on the footing that they should not be recognised for Dutch tax purposes. If the answer to that question is affirmative, Six Continents should have received such a tax credit in respect of the relevant parts of the Dividends, and the restitution due to Six Continents from HMRC should be calculated accordingly.

41. This brings me to the one significant area of disagreement between the experts. It is the view of Mr Blom that the Revaluation Adjustment accounting profits were in principle subject to Dutch corporation tax, whereas Professor Bobeldijk considers that they were not.

42. Mr Blom finds support for his view in the sequence of the relevant articles in CITA, and in the approach adopted by the Dutch Supreme Court in two recent cases. As to the first point, he acknowledges that there are two views on the question whether shares that benefit from the participation exemption have to be valued according to the tax accounting principles of Article 9 of PITA, but, according to the view which he favours, he says in paragraph 27 of his first report:

> "… as a first step the annual profit has to be determined based on tax accounting principles, which is followed by the application of an exemption such as the participation exemption. Therefore tax accounting principles of article 9 are relevant for the valuation of shares that benefit from the participation exemption. This is largely based on the set-up of the CITA. Article 8 CITA, taking into account article 7 (total profit) and article 9 (annual profit) of the Dutch Income Tax Act 1964, determines the total profit and the annual profit based on tax accounting principles. After the determination of the annual profit, adjustments are made for limitations and exemptions included in later articles such as the participation exemption of article 13 CITA.
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> It follows from legislative history … that tax accounting principles are relevant for shares that qualify for the participation exemption."

43. Mr Blom then refers to the first of the Supreme Court cases, as follows:

> "In a recent Supreme Court case (HR 29 March 2014, nr.13/02818) a taxpayer acquired a participation in 2004. The acquisition price was approximately €35 million. At the end of 2009, the value of the participation amounted to approximately €14 million. The taxpayer sold the participation in 2010 for an amount of approximately €22 million. As of 1 January 2010, the participation exemption no longer applied.
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> Dutch Revenue argued that the taxpayer had to value the participation at €14 million at the end of 2009. The decrease in value from €35 million to €14million would not be deductible pursuant to the participation exemption. Upon the sale in 2010, the taxpayer would realise a profit of €8 million that was taxable since the participation exemption no longer applied.
>
> The Supreme Court ruled:
>
> "*Tax accounting principles do not require changes to the tax book value of an asset, if the outcome of that change does not*

> *need to be recognised when determining the taxable profit of a year in which that change should take place."*
>
> The taxpayer was allowed to keep its tax book value at €35 million and consequently he realised a taxable loss of €13 million in 2010.
>
> The Supreme Court seems to imply that the tax accounting principles are relevant for shares that qualify for the participation exemption. One authoritative commentator believes that the Supreme Court did not clearly rule that tax accounting principles are relevant for shares that qualify for the participation exemption. However, he also notes that he will not be surprised if the Supreme Court will issue such ruling without reservations in a future case."

44. The second Supreme Court ruling upon which Mr Blom relies was delivered on 10 July 2015 (HR 10 July 2015, nr.14/03102). This case concerned the exemption for income from agricultural activities, but according to Mr Blom that exemption, like the participation exemption, is an "object exemption", by which he means an exemption of certain income as opposed to a "subject exemption" which exempts the subject taxpayer. In paragraph 4 of his second report, Mr Blom quotes the following passage from the ruling of the Supreme Court:

> "*On the basis of article 3.8 Dutch Income Tax Act 2001 the profit from an enterprise is the amount of all advantages, regardless [of] form or name, that are derived from a trade or business ... On the basis of article 3.25 Dutch Income Tax Act 2001 the profit earned or accrued in a calendar year is based on sound business practice that is applied in a consistent manner independent from the anticipated result ...*
>
> *Changes in the value of land forming part of the business assets, also insofar these changes are excluded pursuant to article 3.12 Dutch Income Tax Act 2001 for income tax purposes, are by their nature benefits that are received from an enterprise. They fall within the definition of article 3.8 Dutch Income Tax Act 2001 and are therefore subject to the rules of sound business practice stipulated in article 3.25 Dutch Income Tax Act 2001.*"

Mr Blom points out that the Articles of the Dutch Income Tax Act 2001 which the Supreme Court was there considering are in materially similar terms to Articles 7 and 9 of PITA. He therefore finds support in this decision, in a closely analogous context, for his view that changes in the value of assets, even if they benefit from an exemption, are by their nature benefits which fall within the scope of Dutch income tax.

45. In cross-examination, Mr Baldry QC put to Mr Blom a linguistic argument based on the wording of Article 8 of CITA. Under Article 8, profit is to be determined on the basis there specified, including Articles 7 and 9 of PITA, "save to the extent it has

been determined otherwise by or pursuant to this Act". Since the participation exemption in Article 13 of CITA says that, for the purposes of determining profit, no account shall be taken of the advantages derived from a qualifying participation, is that not (asked Mr Baldry) an express determination "otherwise" which takes profits within Article 13 out of the computation of profit under Article 8? Mr Blom did not agree with this argument, and repeated his view that the logic of the Supreme Court cases is that the benefits in question are first included in the total profit (under Article 7) and are then allocated to the appropriate year, and it is only at that stage that the participation exemption takes them out of charge to tax.

46. I now turn to the contrary view of Professor Bobeldijk. In his first report, he develops the argument that provisions in CITA, such as the participation exemption, which states that certain benefits and costs "are not taken into account" for the purposes of profit determination, have the result that those benefits and costs do not form part of the total profit. He cites decisions of the Dutch Supreme Court as authority for the proposition that the total profit is attributable to years by application of the rules of sound business practice, and that the total of the annual profits is in principle equal to the total profit over the whole lifetime of the taxpayer. He then continues:

> "32. Accordingly, benefits which are not included in the profit for tax purposes, such as benefits derived from a participation, are neither included in the total profit, nor in the annual profit.
>
> 33. The question could arise with regard to a benefit which is not subject to tax according to the so called participation exemption … whether (1) it is part of the total profit and subsequently eliminated from the total profit or (2) it is not part of the total profit at all. In literature both views are defended. Please note that for Dutch tax purposes this is in principle a pure academic discussion.
>
> 34. In my opinion the second view is correct; the benefits under the participation exemption are not part of the total profit at all.
>
> 35. In my opinion the first view implies a broad (gross) total profit concept, which after several eliminations results in the (net) total profit. A gross total profit concept is in my view a "contradiction in terminis" as the *total* profit cannot include more than the *total* profit.
>
> 36. More important is, that in my opinion follows from the wording of the law that "not taking into account" certain benefits is part of the *determination* of the profit. The law doesn't "exempt income", doesn't "reduce the profit", but "doesn't take into account" when determining the profit. As the profit determination is one calculation, it should not be split in a gross and net profit."

47. Later in his first report, when discussing the participation exemption, Professor Bobeldijk draws a further distinction between "not taking into account" on the one

hand, and a "non-event for tax purposes" or "tax nothing" on the other hand. He says in paragraph 59:

> "An advantage benefiting from the participation exemption, like a capital gain or dividend, is a benefit for the taxpayer, but it is not taken into account for determining the profit. In case of a revaluation in the financial statements there is not even a benefit for the taxpayer; there is "nothing" for tax purposes."

48. A further encapsulation of Professor Bobeldijk's opinion may be found in paragraph 13 of the experts' joint statement:

> "13. Bobeldijk is of the opinion that there is only one "profit" concept. The total of the annual profits is in principle equal to the total profit of the taxpayer. Accordingly, benefits which are not included in the profit for tax purposes, such as benefits derived from a participation, are neither included in the total profit, nor in the annual profit. The profit is calculated in accordance with the provisions of the law. It is not possible to say that some profits (or costs) are first "in the profit" and then "out the profit". There is only "one profit" … The fact that sound business practice is applied to exempt assets, does not alter that in his view."

49. In his oral evidence in chief, Professor Bobeldijk repeated that in the academic world there are two views about how the participation exemption works, and whether or not exempted benefits are included in the total profit. In cross-examination, it was put to Professor Bobeldijk that in another recent Supreme Court case dealing with the agricultural exemption (Case HR2015/1780 of 24 April 2015) the Advocate General to the Court had, in his formal written advice to the Court, expressed views which were essentially the same as Mr Blom's. In particular, in paragraphs 7.3 and 7.4 of his advice Advocate General Niessen had said this:

> "7.3 Earnings can be had from assets from the company capital that are exempted (art. 3.11-3.13 Income Tax Act 2001). Such earnings in principle do belong to the taxable profit; after all, if they did not they would not have to be exempted.
>
> 7.4 Of such (exempted) advantages, it must be determined in which year they were realised. After all, depending on that it must be determined what legal provisions apply to them. Moreover, it must be reviewed if the advantages meet the requirements the law sets if they want to qualify for exemption. This all implies – as remarked under 7.3 – that the respective advantages in principle are part of the company result, and only "after that" are eliminated from the total profit by application of the exemption provision …"

50. Professor Bobeldijk at first appeared reluctant to accept that the views expressed by Advocate General Niessen were the opposite of his own, but at the third time of asking he agreed that the Advocate General held "more or less the same view as Mr

Blom does", and that this was inconsistent with his own view. He also acknowledged that case law is a recognised source of law in the Netherlands, and that the opinion of the Advocate General is an important document, although the court is not obliged to follow it. He added that one of the other Advocates General supported his own view.

51. Having reviewed the evidence of the two experts on this question, I must now state my conclusion. Although the question is clearly not settled in the Netherlands, I prefer the analysis and conclusion of Mr Blom. His reasoning seems to me to fit better with the structure of the relevant provisions of CITA, and with the approach adopted by the Dutch Supreme Court in the two cases upon which he relies. In addition, his view finds clear support in the opinion of Advocate General Niessen in Case HR2015/1780 of 24 April 2015. Against this, the linguistic point which Mr Baldry put to Mr Blom in cross-examination seems to me to carry little weight. The words "save to the extent it has been determined otherwise by or pursuant to this Act" in Article 8 of CITA can in my view perfectly well be read as referring to the later stage when exemptions are applied to the total profits, rather than as a threshold elimination which prevents their inclusion in principle in the taxable profit. There is much force in the simple point made by Advocate General Niessen that, if the exempted advantages did not "belong to the taxable profit", they would not need to be exempted. For similar reasons, I am not much impressed by Professor Bobeldijk's semantic argument that "not taking into account" certain benefits is part of the determination of the profit as a single and indivisible process. I accept that this is a possible way of looking at the matter, and one that enjoys respectable academic support in the Netherlands, but it strikes me as a rather formalistic approach which lacks any clear support in the case law to which I was referred.

52. HMRC seek to draw a distinction between cases where an amount is eliminated from the tax computation as a result of the Revaluation Adjustments, and cases where an amount is eliminated as a result of the participation exemption. In the former type of case, they submit, the amount is simply irrelevant for Dutch tax purposes, and falls to be disregarded as a "tax nothing". In my opinion, however, the two types of case should be treated alike. In each situation, the amount in question should be regarded as falling within the commercial profit which is in principle subject to Dutch corporation tax, although it is then eliminated. This, as I understand it, was the thrust of Mr Blom's evidence: see in particular the quotation from paragraph 17 of his first report in [30] above. The removal from the total profit of amounts attributable to the Revaluation Adjustments is merely an example of the various ways in which the commercial profit of a Dutch company is converted into its annual profit for tax purposes.

53. A further attraction of Mr Blom's approach, in my judgment, is that it reflects and gives effect to the reasoning of the ECJ in FII (ECJ) II in a way which Professor Bobeldijk's approach does not. The whole thrust of the ECJ's reasoning is that giving a tax credit at the relevant FNR will mitigate, if not necessarily eliminate, economic double taxation in cases where exemptions and/or reliefs from tax have the effect of narrowing the tax base, and thus reducing the effective rate of taxation on the underlying profits which are passed up the corporate chain. This objective will not be achieved if a narrow interpretation of domestic tax law in a Member State is adopted, whereby the underlying profits which are subject to the relevant FNR are defined in such a way that the reduced tax base coincides with the amount which is in principle

subject to tax. To the extent, therefore, that Dutch tax law may admit of two different approaches to the question, it seems to me that I may, and indeed should, prefer the approach which better accords with the requirements of EU law as expounded by the ECJ.

54. For these reasons, I conclude that Six Continents' primary argument is well founded, and that Agreed Issue 1 should be determined in its favour.

55. This conclusion makes it unnecessary for me to deal with Six Continents' alternative argument, which is that, on the facts, the Dividends attributable to the Revaluation Adjustments were in any event paid out of profits which had in fact been taxed in the Netherlands in earlier years. The evidence relating to the underlying facts on this issue is not entirely clear, and Six Continents' analysis of it had to undergo considerable modifications in the light of further investigations carried out following receipt of the Revenue's skeleton argument. In view of these complexities, and the last minute evolutions of Six Continents' case on the issue, I think it is preferable to leave the question unresolved. I would hope, in the event of an appeal from my conclusion on Issue 1, that the parties would by then have been able to reconsider the evidence and the inferences which may legitimately be drawn from it, and reached agreement on a question of fact which should not, in principle, be either controversial or difficult to determine.

Issue 2: is Six Continents entitled to a credit at the Dutch standard rate of corporation tax for so much of the Dividends as arose from the liquidation of a subsidiary of Six Continents, and formed part of the accounting profits of Six Continents for 1994/5?

56. The subsidiary of Six Continents to which Agreed Issue 2 relates is BCF. It is common ground that each of the third and fourth Dividends paid in 1997 was paid partly out of profits arising from the liquidation of BCF in 1995, and that these profits benefited from the participation exemption in Article 13 of CITA in the hands of SCIH. The relevants amounts were NLG 3,084,706 for the third Dividend, and NLG 1,116,294 for the fourth Dividend.

57. The question raised by Issue 2 is in substance the same as that raised by Issue 1. Were the liquidation profits derived from BCF subject to Dutch corporation tax in the hands of SCIH, notwithstanding their exemption by Article 13 of CITA? In the October judgment, I said at [54] that the answer to this question followed from the answer to Issue 1:

> "The profits derived from the liquidation of the subsidiary were in principle within the charge to Dutch corporation tax, although they were excluded from the taxable amount by virtue of the participation exemption. This is therefore another example of an exemption which narrowed the tax base and reduced the effective rate of Dutch tax. As such, it falls squarely within the reasoning of the ECJ in FII (ECJ) II, and a credit at the Dutch nominal rate of corporation tax is needed in order to remedy the unlawful impact of the Case V charge on the dividend in the UK."

58. I also pointed out, at [55], that the issue was in principle indistinguishable from the Henri Wintermans sale which I had considered in FII (High Court) II at [75] to [77]. In that case, without the benefit of any evidence of Dutch tax law, I had concluded, with some hesitation, that it was preferable to regard the capital gain arising from the sale as a receipt which prima facie formed part of the taxable profits of the Dutch company which paid the dividend and was in principle subject to tax at the nominal rate, even though the effect of the exemption was to narrow the tax base by removing it from charge.

59. I now have the benefit of expert evidence on Dutch tax law, and for the reasons which I have given under Agreed Issue 1 I prefer the approach and conclusions of Mr Blom. Accordingly, I determine Agreed Issue 2 in favour of Six Continents.

Issue 3: is Six Continents entitled to a credit at the Dutch standard rate of corporation tax for so much of the Dividends as was sourced from the share premium account in a Dutch subsidiary of SCIH?

60. In relation to this issue, the relevant subsidiary of SCIH is HII. Unlike BCF, HII was at all material times included in a "fiscal unity" together with SCIH and certain other subsidiaries of SCIH. The effect of this, as the expert evidence makes clear, is that the members of the fiscal unity were treated as a single taxable entity, and transactions between the members are disregarded for Dutch tax purposes.

61. The Dividends to which this issue relates are the first and third Dividends paid in 1996, and the first and second paid in 1997. Each of these Dividends was sourced, wholly or in part, from the share premium account of HII. The relevant amounts were:

(a) Dividend 1, 1996: NLG 8,976,000.

(b) Dividend 3, 1996: NLG 800,000.

(c) Dividend 1, 1997: NLG 2,972,000.

(d) Dividend 2, 1997: NLG 300,000.

62. In paragraph 108 of his first report, Professor Bobeldijk describes the effect of the fiscal unity regime in article 15 of CITA on the relevant distributions from share premium account made by HII to SCIH:

> "Under the fiscal unity regime (art 15 CITA), HII is deemed to be absorbed in the parent company of the fiscal unity, SCIH. As a consequence, for tax purposes there is only one taxable entity; HII has ceased to exist for tax purposes. This means that transactions between SCIH and HII are non-existent for tax purposes. Accordingly, the dividend distribution from the share premium reserve is a non-event for tax purposes and therefore does not result in a taxable profit."

The evidence of Mr Blom, in paragraph 28 of his first report, is to similar effect.

63. In the light of this expert evidence, Six Continents accepts that the return of share capital by HII to SCIH did not generate any profit for Dutch tax purposes in the hands of SCIH. It follows that the reasoning of the ECJ in FII (ECJ) II can have no direct application to these parts of the Dividends, because on no view were there any underlying profits which were subject to Dutch tax. Instead, Six Continents advances an entirely different argument of principle which, it says, leads to the conclusion that a tax credit at the Dutch nominal rate should be available.

64. The argument runs as follows. The dividends paid from the share premium account of HII are, in substance, a return of capital made by a non-UK resident company. That return of capital was initially made by HII to SCIH, with an effective rate of tax on the return of zero. The money was then distributed (by way of dividend) by SCIH to Six Continents. In a purely domestic UK context, the UK does not tax a dividend paid by a UK-resident company to its UK-resident parent, even where the effective rate applicable to the subsidiary is zero. This follows from the exemption contained in section 208 of ICTA 1988. Thus, in the present case:

(a) had HII and SCIH been UK-resident companies, the UK tax system would have allowed the benefit of the lower effective rate of tax to pass up the corporate chain to Six Continents; whereas

(b) in contrast, in a cross-border situation (such as the present case) the UK system generates a tax charge.

65. Six Continents goes on to submit that this differential treatment of a return of capital by UK-resident and non-UK resident companies respectively constitutes unlawful discriminatory treatment, which breaches the rights to freedom of establishment and free movement of capital under the EU treaty. This unlawful discrimination arises whether or not the return of capital has in fact suffered economic double taxation. The vice in the UK system does not lie in its failure to grant relief for economic double taxation, but rather in its failure to treat a dividend sourced from a return of capital made by a non-resident company in an equivalent manner to a dividend sourced from a return of capital made by a resident company. The remedy for this unlawful treatment, submits Six Continents, is that either the dividend must be exempt, or a credit should be available at the nominal rate of Dutch corporation tax applicable to SCIH.

66. The Revenue's answer to this argument is that it rests on a false foundation, because the return of capital by a non-UK resident company to its non-UK resident parent is wholly outside the scope of UK tax. As Mr Baldry and Ms Belgrano put it in their skeleton argument (at paragraph 45):

> "The only UK tax charge on the dividend paid by SCIH arose because the UK operated an imputation system for foreign dividends (irrespective of their source), which it was justified in doing, subject to providing a tax credit to the extent that the dividends were sourced from profits which were subject to tax. As the evidence makes clear, the share premium was not subject to tax so that no credit is due."

67. In his brief oral submissions on this issue, Mr Baldry emphasised the point that, according to FII (ECJ) II, the UK was in principle justified in applying an imputation system to foreign dividends, even though it applied an exemption system to domestic dividends. The ECJ did not say that the appropriate way of dealing with the problem would have been for the UK simply to exempt all foreign dividends. On the contrary, the Court said in paragraph 40 of its judgment that:

> "… each Member State remains free to organise its system for taxing distributed profits, provided, however, that the system in question does not entail discrimination prohibited by the FEU Treaty. An obligation on the Member State where the company receiving dividends resides to exempt foreign-sourced dividends from corporation tax would affect the competence of the Member State concerned to tax, in compliance with the principle of non-discrimination, the profits thereby distributed at the rate prescribed by its own legislation."

68. This passage provides support for the Revenue's case, as far as it goes, but it does not answer the question whether the UK system of taxing returns of share capital involves discrimination against non-UK resident companies. In my opinion the answer to this question is that it does not, for the reason given by the Revenue. It is not the case that the UK taxes returns of capital made by UK-resident companies more advantageously than it taxes similar returns of capital made by non-resident companies. The position is, rather, that returns of capital by a non-UK resident company are outside the scope of UK tax altogether.

69. To the extent that such returns of capital are passed on up the corporate chain by way of distribution, a comparison may then be made between the UK tax treatment of such distributions by resident and non-resident companies. But at this stage of the analysis the principles of FII (ECJ) II come into play, and the difference of treatment is justified because there are no taxable profits which underlie the relevant parts of the Dividends paid by SCIH to Six Continents. Accordingly, there are no profits in respect of which EU law requires a tax credit at the Dutch nominal rate (or any other rate) to be given to Six Continents. In short, the Case V charge on the Dividends is, to this extent, compliant with EU law.

70. For these reasons, I determine Issue 3 in favour of the Revenue.

Conclusion

71. In the event, I have decided Issues 1 and 2 in favour of Six Continents, but Issue 3 in favour of the Revenue. In these circumstances, it is common ground (see paragraph 22 of the SAF) that the principal amount of unlawful tax is £7,104,450. Six Continents is entitled to judgment accordingly.

72. Six Continents is also entitled to compound interest on the principal amount of £7,104,450, computed in accordance with the principles applied in FII (High Court) II. The order should, however, preserve the right of either side to apply for the interest calculation to be revisited in the event that the principles applied in FII (High Court) II are modified as a result of appeals to the higher courts in that case and/or the Revenue's pending appeal to the Supreme Court in the Littlewoods case.