Appeal number: TC/2018/01443; TC/2018/05432

CORPORATION TAX – whether the UK legislation in relation to intra-group disposals is compliant with EU law – consideration of the applicable freedoms, whether or not the provisions in question restrict a freedom, whether or not the provisions can be justified by the lack of objective comparability of situation or by reference to the balanced allocation of taxing powers between Member States, the proportionality of the restriction, the doctrines of conforming interpretation and disapplication – consideration of movements of capital – in relation to the disposal of shares to the Dutch resident parent company, disapplication of the restriction limiting no gain/no loss disposals to transferees within the UK tax net – in relation to the disposal of intangible assets to the Swiss resident sister company, UK legislation compatible with EU law

FIRST-TIER TRIBUNAL
TAX CHAMBER

GALLAHER LIMITED	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Respondents**

TRIBUNAL: JUDGE TONY BEARE

Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1R 4QU on 29, 30 and 31 January 2019 and 1 February 2019

Mr Philip Baker QC and Mr Imran Afzal, instructed by Freshfields Bruckhaus Deringer LLP, for the Appellant

Mr Rupert Baldry QC and Mr Ben Elliott, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. INDEX

Glossary of cases

2. This decision contains references to the following cases:

Case abbreviation	Full name of case and reference
A Oy	*A Oy* (Case C – 292/16)
Autologic	*Autologic Plc v Inland Revenue Commissioners* [2005] 1 WLR 52
BT Pension Scheme	*Trustees of the BT Pension Scheme v The Commissioners for HMRC* [2013] STC 1781
Cadbury Schweppes	*Cadbury Schweppes plc v Inland Revenue Commissioners* [2006] STC 1908
Class IV ACT	*Test Claimants in Class IV of the ACT Group Litigation v Inland Revenue Commissioners* (Case C – 374/04)
Denmark	*Commission v Kingdom of Denmark* (Case C – 261/11)
DMC	*DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte* (Case C – 164/12)
EV	*EV v Finanzamt Lippstadt* (Case C – 685/16)
Felixstowe	*Felixstowe Dock and Railway Company and others v Commissioners for HMRC* (Case C – 80/12)

FII 1	*Test Claimants in the FII Group Litigation v Inland Revenue Commissioners* (Case C – 446/04)
FII 2	*Test Claimants in the FII Group Litigation v R&RC (No 3)* (Case C – 35/11)
Fleming	*Fleming (t/a Bodycraft) v Customs and Excise Commissioners* [2008] UKHL 2
Germany	*Commission v Germany* (Case C – 591/13)
Ghaidan	*Ghaidan v Godin-Mendoza* [2004] 2 AC 557
Glaxo	*Glaxo Wellcome GmbH & Co. KG v Finanzamt München II* (Case C -182/08)
Holböck	*Holböck v Finanzamt Salzburg-Land* (Case C – 157/05)
IDT	*The Commissioners for HMRC v IDT Card Services Ireland Ltd* [2006] EWCA Civ 29
Konle	*Konle* (Case C – 302/97)
Kronos	*Kronos International Inc v Finanzamt Leverkusen* (Case C – 47/12)
LabTec	*Verder LabTec GmbH & Co. KG v Finanzamt Hilden* (Case C – 657/13)
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Marleasing	*Marleasing SA v La Comercial Internacional de Alimentacion SA* (Case C – 106/89)
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Oy AA	*Oy AA* (Case C – 231/05)

Panayi	*Trustees of the P Panayi Accumulation and Maintenance Settlements v The Commissioners for HMRC* (Case C – 646/15)
Papillon	*Société Papillon v Ministère du Budget, des Comptes publics et de la Fonction publique* (Case C – 418/07)
Philips	*The Commissioners for HMRC v Philips Electronics UK Ltd* (Case C – 18/11)
Picart	*Christian Picart v Ministre des Finances* (Case C – 355/16)
Pickstone	*Pickstone v Freemans plc* [1989] AC 66
Portugal 1	*Commission v Portugal* (Case C - 182/08)
Portugal 2	*Commission v Portugal* (Case C - 38/10)
Prudential	*Prudential Assurance Co Ltd v The Commissioners for HMRC* [2014] STC 1236
Routier	*Routier v The Commissioners for HMRC* [2018] STC 910
Thin Cap	*Test Claimants in the Thin Cap Group Litigation v Inland Revenue Commissioners* (Case C – 524/04)
Vodafone 2	*Vodafone 2 v The Commissioners for HMRC* [2010] 2 WLR 288
Wächtler	*Martin Wächtler v Finanzamt Konstanz* (Case C – 581/17)
X AB and Y AB	*X AB and Y AB v Riksskatteverget* (Case C – 200/98)
X and Y	*X and Y v Riksskatteverget* (Case C – 436/00)
X Holding BV	*X Holding BV v Staatssecretaris van Financiën* (Case C – 337/08)

Introduction

3. This decision relates to two appeals by the Appellant which give rise to a common issue of law – namely, whether provisions in the UK's domestic tax legislation which relate to intra-group disposals are compliant with the requirements of European Union ("EU") law and, if not, the manner in which such provisions should be applied.

4. Each appeal is against a partial closure notice (a "PCN") issued under paragraph 32(1) of Schedule 18 to the Finance Act 1988. The first PCN (the "2011 PCN") was issued by the Respondents on 6 February 2018 and relates to the Appellant's tax return for the accounting period ending 31 December 2011. The second PCN (the "2014 PCN") was issued on 17 July 2018 and relates to the Appellant's accounting period ending 31 December 2014. The appeals against the two PCNs are referred to in this decision as the "2011 Appeal" and the "2014 Appeal" respectively and, together, they are referred to in this decision as the "Appeals".

5. The 2011 Appeal relates to the conclusion in the 2011 PCN that the Appellant is liable to pay corporation tax in respect of its accounting period ending 31 December 2011 on gains arising in respect of a disposal of certain intangible assets by the Appellant to a Swiss resident company in the same group as the Appellant ("JTISA") which took place in that accounting period (the "2011 Disposal"), whilst the 2014 Appeal relates to the conclusion in the 2014 PCN that the Appellant is liable to pay corporation tax in respect of the accounting period ending 31 December 2014 on the gain arising in respect of a disposal of shares in one of its subsidiaries, Galleon Insurance Company Limited ("Galleon") by the Appellant to its indirect parent company, JT International Holding BV ("JTIH"), a company resident in the Netherlands, which took place in that accounting period (the "2014 Disposal", and, together with the 2011 Disposal, the "Disposals" and, each, a "Disposal").

The relevant facts

6. The parties have agreed that the facts in relation to the 2011 Disposal are as follows:

(a) the Appellant is a UK resident company and is a member of the Japan Tobacco Inc. ("JT") group of companies (the "JT Group"). JT is a publicly-listed company resident in Japan. The JT Group is a global tobacco group and distributes products in 130 countries worldwide. The Appellant and JT were incorporated in, respectively, England & Wales and Japan;

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

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

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

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

(f) JTISA has been based in Geneva since its incorporation in 1999;

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

(h) all of the Brands continue to be owned by JTISA;

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

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

(ii) JTISA paid the Consideration to the Appellant;

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

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

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

(k) as a consequence of the 2011 Disposal and contemporaneous contractual arrangements agreed between the Appellant and JTISA, the Appellant's role in relation to the Brands was to act as:

(i) a manufacturer in respect of the Brands; and

(ii) a limited risk distributor of the products bearing the Brands in the UK; and

(l) following the 2011 Disposal, the Appellant continued to own the Mayfair brand rights (worldwide rights) and the rights to use certain other brands in Ireland and eastern Europe.

7. The parties have agreed that the facts in relation to the 2014 Disposal are as follows:

(a) the Appellant is a UK resident company and is a member of the JT Group. JT is a publicly-listed company resident in Japan. The JT Group is a global tobacco group and distributes products in 130 countries worldwide. The Appellant and JT were incorporated in, respectively, England & Wales and Japan;

(b) the Appellant became a member of the JT Group in 2007 when the shares in its UK resident parent company, GGL, were acquired by a JT Group UK resident company – that is to say, JTIUM;

(c) JTIUM is owned by JTIH, a company resident in the Netherlands. JTIH does not have a permanent establishment within the UK, nor is it within the charge to UK corporation tax;

(d) following a restructuring that took place in 2009 and 2010, B&HL became the Appellant's immediate parent company. In turn, GOHL became the immediate parent company of B&HL;

(e) thus, the Appellant is an indirect wholly-owned UK resident subsidiary of JTIH, which holds its interest in the Appellant through its wholly-owned UK resident subsidiaries JTIUM, GGL, GOHL and B&HL;

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

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

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

8. In addition to the above agreed facts, I have been provided with witness statements from three employees of the JT Group, Mr Charles Cunningham-Reid, Mr James Boxford and Mr Diederik Ex, and heard oral evidence from both Mr Boxford and Mr Ex, in relation to the background and circumstances of the two Disposals. Mr Cunningham-Reid (in his witness statement) and Mr Boxford (in both his witness statement and his oral evidence) testified to the reasons for the 2011 Disposal, whilst Mr Ex (in both his witness statement and his oral evidence) testified to the reasons for the 2014 Disposal.

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

10. Given that the Respondents have not sought to challenge the evidence of the witnesses or submitted that, contrary to the evidence of the witnesses, one or both of the Disposals was or were tax-motivated, I do not propose to summarise the evidence of the witnesses in any detail. Suffice it to say that, based on the evidence of the witnesses, I find as facts that there were good commercial reasons for each Disposal, that neither Disposal formed part of wholly artificial arrangements which did not reflect economic reality and that neither Disposal had the avoidance of tax as its main purpose or one of its main purposes.

<u>The relevant issues</u>

11. Each of the 2011 Appeal and the 2014 Appeal gives rise to a common issue, which is whether (in the case of the 2011 Disposal) the fact that the Appellant was unable to rely, in relation to the Disposal, on Section 171 of the Taxation of Chargeable Gains Act 1992 (the "TCGA") ("Section 171") and Sections 775 and 776 of the Corporation Tax Act 2009 (the "CTA 2009") (together, "Section 775" and, together with Section 171, the "Group Transfer Rules") in such a way as to avoid an immediate liability to pay corporation tax in respect of the accounting period ending 31 December 2011 on the gains arising as a result of the 2011 Disposal and (in the case of the 2014 Disposal) the fact that the Appellant was unable to rely, in relation to the Disposal, on Section 171 in such a way as to avoid an immediate liability to pay corporation tax in respect of the accounting period ending 31 December 2014 on the gain arising as a result of the 2014 Disposal is compatible with EU law. This issue is referred to in this decision as the "EU Law Issue".

12. In relation to the EU Law Issue, it worth noting that neither of the Group Transfer Rules is, in itself, a charging provision. In the case of both Disposals, the liability to pay corporation tax stems from the fact that, because the relevant Disposal is precluded from falling within the ambit of the Group Transfer Rules (by virtue of the fact that the Group Transfer Rules apply only to intra-group disposals to

transferees which are within the scope of corporation tax), the Appellant is liable to tax pursuant to other provisions of the UK legislation which have the effect that the Disposals – as transactions between related entities - are treated as disposals or realisations for tax purposes and are deemed to have taken place at market value.

13. It is also worth noting that, in relation to each Disposal, the Appellant is not contending that the Group Transfer Rules should simply apply to the Appellant in the same way as they would have done if the transferee had been within the scope of corporation tax. Instead, the Appellant is contending that the deficiency in the Group Transfer Rules is that they do not allow for a deferral of the corporation tax liability in the circumstances of the relevant Disposal.

14. In addition to the EU Law Issue, the 2011 Disposal (but not the 2014 Disposal) gives rise to a further issue, which relates to the value of the assets which were the subject of the 2011 Disposal, given that the Disposal was between related entities and was therefore deemed to take place at market value, as noted above. This issue is referred to in this decision as the "Valuation Issue". The Valuation Issue does not arise in relation to the 2014 Disposal because, although that was also deemed to take place at market value, the parties have agreed on the value of the shares in Galleon at the time of the 2014 Disposal.

15. The parties have agreed that:

(a) the EU Law Issue should be determined by the First-tier Tribunal as a preliminary issue because, depending on the outcome of the EU Law Issue, the Valuation Issue may not be relevant to the dispute between the parties; and

(b) if, after a decision on the EU Law Issue has been reached, the Valuation Issue remains relevant to the dispute, then the parties will seek to agree figures and, if agreement cannot be reached, they will revert to the First-tier Tribunal.

16. This decision is therefore confined to the preliminary matter of determining the EU Law Issue in relation to each Appeal.

<u>The relevant law</u>

The relevant provisions of the UK domestic legislation

17. Part VI of the TCGA contains provisions which relate to the transfer of chargeable assets within a group of companies and which are therefore relevant to both the 2011 Disposal and the 2014 Disposal.

18. Section 170 of the TCGA states (and for each of the accounting periods of the Appellant which is relevant to the 2011 Appeal and the 2014 Appeal stated) as follows:

"(1) This section has effect for the interpretation of sections 171 to 181 except in so far as the context otherwise requires...

(2) Except as otherwise provided—

(a) ...

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

(c) ...

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

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

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

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

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

...

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

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

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

19. Section 1154 of the Corporation Tax Act 2010 (the "CTA 2010") states (and for each of the accounting periods of the Appellant relevant for the 2011 Appeal and the 2014 Appeal stated) as follows:

"(1) Subsections (2) to (4) define, for the purposes of the Corporation Tax Acts, the circumstances in which a body corporate ("B") is a 51% subsidiary, a 75% subsidiary or a 90% subsidiary of another body corporate ("A").

…

(3) B is a 75% subsidiary of A if at least 75% of B's ordinary share capital is owned directly or indirectly by A.

…

(6) In this Chapter references to ownership are to be read as references to beneficial ownership."

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

21. Chapter 6 of Part 5 of the CTA 2010, modified as described in Section 170(8) of the TCGA, applies for the purposes of determining the beneficial ownership of profits and assets in relation to Section 170(6) of the TCGA.

22. Section 171 states (and for each of the accounting periods of the Appellant relevant for the 2011 Appeal and the 2014 Appeal stated) as follows:

"(1) Where—

(a) a company ("company A") disposes of an asset to another company ("company B") at a time when both companies are members of the same group, and

(b) the conditions in subsection (1A) below are met,

company A and company B are treated for the purposes of corporation tax on chargeable gains as if the asset were acquired by company B for a consideration of such amount as would secure that neither a gain nor a loss would accrue to company A on the disposal.

(1A) The conditions referred to in subsection (1)(b) above are—

(a) that company A is resident in the United Kingdom at the time of the disposal, or the asset is a chargeable asset in relation to that company immediately before that time, and

(b) that company B is resident in the United Kingdom at the time of the disposal, or the asset is a chargeable asset in relation to that company immediately after that time.

For this purpose an asset is a "chargeable asset" in relation to a company at any time if, were the asset to be disposed of by the company at that time, any gain accruing to the company would be a chargeable gain and would by virtue of section 10B form part of its chargeable profits for corporation tax purposes.

..."

23. Part 8 of the CTA 2009 contains provisions which relate to the tax treatment of certain intangible fixed assets and which are therefore relevant to the 2011 Disposal.

24. Sections 764, 765, 766 and 767 of the CTA 2009 state (and for the accounting period of the Appellant relevant for the 2011 Appeal stated) as follows:

"764 Meaning of "company", "group" and "subsidiary"

(1) This Chapter applies for the purposes of this Part to determine whether companies form a group and, where they do, which is the principal company of the group.

...

765 General rule: a company and its 75% subsidiaries form a group

(1) The general rule is that—

(a) a company ("A") and all its 75% subsidiaries form a group, and

(b) if any of those subsidiaries have 75% subsidiaries, the group includes them and their 75% subsidiaries, and so on.

(2) A is referred to in this Chapter and in Chapter 9 as the principal company of the group.

(3) Subsections (1) and (2) are subject to the following provisions of this Chapter.

766 Only effective 51% subsidiaries of principal company to be members of group

(1) A group of companies does not include any company (other than the principal company of the group) that is not an effective 51% subsidiary of the principal company of the group…

767 Principal company cannot be 75% subsidiary of another company

(1) The general rule is that a company ("A") is not the principal company of a group if it is itself a 75% subsidiary of another company ("B").

..."

25. Sections 771 and 772 of the CTA 2009 and Chapter 6 of Part 5 of the CTA 2010 apply for the purposes of determining an "effective 51% subsidiary".

26. Section 775 of the CTA 2009 states (and for the accounting period of the Appellant relevant for the 2011 Appeal stated) as follows:

"775 Transfers within a group

(1) A transfer of an intangible fixed asset from one company ("the transferor") to another company ("the transferee") is tax-neutral for the purposes of this Part if—

(a) at the time of the transfer both companies are members of the same group,

(b) immediately before the transfer the asset is a chargeable intangible asset in relation to the transferor, and

(c) immediately after the transfer the asset is a chargeable intangible asset in relation to the transferee.

(2) For the consequences of a transfer being tax-neutral for the purposes of this Part, see section 776.

..."

27. Section 776 of the CTA 2009 states (and for the accounting period of the Appellant relevant for the 2011 Appeal stated) as follows:

"776 Meaning of "tax-neutral" transfer

(1) This section sets out the consequences of a transfer of an asset being "tax-neutral" for the purposes of this Part.

(2) The transfer is treated for those purposes as not involving—

(a) any realisation of the asset by the transferor, or

(b) any acquisition of the asset by the transferee.

(3) The transferee is treated for those purposes—

(a) as having held the asset at all times when it was held by the transferor, and

(b) as having done all such things in relation to the asset as were done by the transferor.

(4) In particular—

(a) the original cost of the asset in the hands of the transferor is treated as the original cost in the hands of the transferee, and

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

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

28. The term "chargeable intangible asset" is defined by Section 741 of the CTA 2009. The latter provision states (and for the accounting period of the Appellant relevant for the 2011 Appeal stated) as follows:

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

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

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

...

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

(a)...

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

29. In terms of the territorial scope of corporation tax, it should be noted that, pursuant to Section 5 of the CTA 2009, a company is subject to corporation tax if it is a UK resident company, or a non-UK resident company carrying on a trade in the UK through a permanent establishment (in which case it is the profits attributable to the permanent establishment that are within the scope of corporation tax). Similarly, an asset is a "chargeable intangible asset" if it is held by a company which is UK resident or which uses the asset for the purposes of a trade carried on in the UK through a permanent establishment.

30. I would make the following observations in relation to the provisions described above:

(a) first, it can be seen that each of JTIH, JTISA and the Appellant is, and was, at the time of each Disposal, a wholly-owned indirect subsidiary of JT and therefore, pursuant to the definition of "group" set out in each of Section 170 of the TCGA and Section 765 of the CTA 2009, members of the same group – that is to say, a group of which JT was the principal company;

(b) secondly, where Section 171 applies in relation to a disposal of assets, then no tax charge arises when assets are transferred from one company in the group (A) to another (B). This is because the disposal in question is deemed to be effected for such consideration as gives rise to neither a gain nor a loss for A, which means that B is treated as acquiring a base cost in the relevant assets which is equal to A's base cost in the relevant assets. However, a tax charge may arise in the future if the assets are the subject of a disposal in circumstances where Section 171 does not apply – for example, if B sells the assets outside the group. Furthermore, in certain circumstances, a tax charge will be imposed if the transferee company (i.e. B) ceases to be a member of the group within six years of the disposal to it (see Section 179 of the TCGA 1992);

(c) thirdly, where Section 775 applies in relation to a disposal of intangible fixed assets, then no tax charge arises under Part 8 of the CTA 2009 when the assets in question are transferred from one company in the group (A) to another (B). This is because B is treated as having held the relevant assets at all times when the relevant assets were held by A and as having done all such things in relation to the relevant assets as were done by A. Consequently, the original cost of the relevant assets in the hands of A is treated as the original cost of the relevant assets in the hands of B and all such credits and debits as have been brought into account for tax purposes under Part 8 of the CTA 2009 by A are treated as if they had been brought into account by B. However, a tax charge may arise in the future if the assets are the subject of a disposal in circumstances where Section 775 does not apply – for example, if B sells the assets outside the group. Furthermore, in certain circumstances, a tax charge will be triggered if the transferee company (i.e. B) ceases to be a member of the group within six years of the disposal to it (see Section 780 of the CTA 2009); and

(d) finally, it should be noted that, whilst the effect of both the application of Section 171 and the application of Section 775 is to defer the crystallisation, for tax purposes, of the gain on the assets which are the subject of the relevant disposal, the two provisions operate in slightly different ways. In the case of Section 171, the disposal in question is recognised for tax purposes but is deemed to have taken place for such amount as gives rise to neither a gain nor a loss for A, whereas, in the case of Section 775, the disposal in question is treated as not having taken place and, instead, B steps into the shoes of A.

31. There are other provisions of the UK domestic tax legislation which, although not the primary subject of this decision, are nevertheless relevant to the determination of the EU Law Issue.

32. Those include the provisions in Section 59FA of, and Schedule 3ZB to, the Taxes Management Act 1970 (the "TMA"), which state that a company which has a right to the freedom of establishment protected by Article 49 of the Treaty on the functioning of the European Union (the "TFEU") (or established by Article 31 of the Agreement on the European Economic Area (the "EEA Agreement")), which ceases to be resident in the UK and which, upon ceasing to be so resident, becomes resident in, and carries on business in, another state in the European Economic Area (the "EEA") and is not treated as being resident in a territory outside the EEA for the purposes of any double taxation arrangements, may elect to enter into an "exit charge payment plan", pursuant to which the company may defer payment of some or all of the corporation tax arising as a result of its migration.

The relevant provisions of EU law

33. Section 2(1) of the European Communities Act 1972 (the "ECA") states as follows:

" (1) All such rights, powers, liabilities, obligations and restrictions from time to time created or arising by or under the Treaties, and all such remedies and procedures from time to time provided for by or under the Treaties, as in accordance with the Treaties are without further enactment to be given legal effect or used in the United Kingdom shall be recognised and available in law, and be enforced, allowed and followed accordingly; and the expression "enforceable EU right" and similar expressions shall be read as referring to one to which this subsection applies."

34. Article 49 of the TFEU (formerly Article 43 of the Treaty establishing the European Community (the "TEC")) provides for the freedom of establishment, and states as follows:

" Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital."

35. Article 54 of the TFEU (formerly Article 48 of the TEC) makes it clear that companies which have their registered office, central administration or principal place

of business in the EU can avail themselves of the freedom of establishment for which Article 49 provides, in the same way as a natural person, and states as follows:

“ Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.

"Companies or firms" means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non- profit-making.”

36. Articles 63 to 65 of the TFEU (formerly Articles 56 to 58 of the TEC) provide for the freedom to move capital and state (in their relevant parts) as follows:

“Article 63

1. Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.

2. Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited.

Article 64

1. The provisions of Article 63 shall be without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Union law adopted in respect of the movement of capital to or from third countries involving direct investment — including in real estate — establishment, the provision of financial services or the admission of securities to capital markets. ...

Article 65

1. The provisions of Article 63 shall be without prejudice to the right of Member States:

a. to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested; ....

2…

3. The measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63.”

37. Council Directive 88/361/EEC, which required Member States to abolish restrictions on movements of capital, contained, at Annex 1 to the Directive, a “nomenclature” (the “Nomenclature”) classifying various capital movements in order to “facilitate the application of [the] Directive”. Although Article 67 of the TEC, pursuant to which that Directive was enacted, was repealed by the Treaty of Amsterdam, the Nomenclature “retains the same indicative value, for the purposes of defining the term ‘movement of capital’ as it did before [the entry into force of Article 63 of the TFEU], subject

to the qualification, contained in the introduction to the nomenclature, that the list set out therein is not exhaustive” (see *FII 1* at paragraph [179]).

38. That being the case, and, in view of the analysis set out in paragraphs 253 to 268 below, I have set out the Nomenclature in full below. It states as follows:

“In this Nomenclature, capital movements are classified according to the economic nature of the assets and liabilities they concern, denominated either in national currency or in foreign exchange.

The capital movements listed in this Nomenclature are taken to cover:

— all the operations necessary for the purposes of capital movements: conclusion and performance of the transaction and related transfers. The transaction is generally between residents of different Member States although some capital movements are carried out by a single person for his own account (e.g. transfers of assets belonging to emigrants),

— operations carried out by any natural or legal person (1), including operations in respect of the assets or liabilities of Member States or of other public administrations and agencies, subject to the provisions of Article 68 (3) of the Treaty,

— access for the economic operator to all the financial techniques available on the market approached for the purpose of carrying out the operation in question. For example, the concept of acquisition of securities and other financial instruments covers not only spot transactions but also all the dealing techniques available: forward transactions, transactions carrying an option or warrant, swaps against other assets, etc. Similarly, the concept of operations in current and deposit accounts with financial institutions, includes not only the opening and placing of funds on accounts but also forward foreign exchange transactions, irrespective of whether these are intended to cover an exchange risk or to take an open foreign exchange position,

— operations to liquidate or assign assets built up, repatriation of the proceeds of liquidation thereof (1) or immediate use of such proceeds within the limits of Community obligations,

— operations to repay credits or loans.

This Nomenclature is not an exhaustive list for the notion of capital movements — whence a heading XIII — F. ‘Other capital movements — Miscellaneous’. It should not therefore be interpreted as restricting the scope of the principle of full liberalization of capital movements as referred to in Article 1 of the Directive.

I — DIRECT INVESTMENTS (1)

1. Establishment and extension of branches or new undertakings belonging solely to the person providing the capital, and the acquisition in full of existing undertakings.

2. Participation in new or existing undertaking with a view to establishing or maintaining lasting economic links.

3. Long-term loans with a view to establishing or maintaining lasting economic links.

4. Reinvestment of profits with a view to maintaining lasting economic links.

A — Direct investments on national territory by non-residents (1)

B — Direct investments abroad by residents (1)

II — INVESTMENTS IN REAL ESTATE (not included under I) (1)

A — Investments in real estate on national territory by non-residents

B — Investments in real estate abroad by residents

III — OPERATIONS IN SECURITIES NORMALLY DEALT IN ON THE CAPITAL MARKET (not included under I, IV and V)

(a) *Shares and other securities of a participating nature* (1).

(b) *Bonds* (1).

A — Transactions in securities on the capital market

1. Acquisition by non-residents of domestic securities dealt in on a stock exchange (2).

2. Acquisition by residents of foreign securities dealt in on a stock exchange.

3. Acquisition by non-residents of domestic securities not dealt in on a stock exchange (2).

4. Aquisition by residents of foreign securities not dealt in on a stock exchange.

B — Admission of securities to the capital market (2)

(i) *Introduction on a stock exchange* (2).

(ii) *Issue and placing on a capital market* (*).

1. Admission of domestic securities to a foreign capital market.
2. Administration of foreign securities to the domestic capital market.

IV — OPERATIONS IN UNITS OF COLLECTIVE INVESTMENT UNDERTAKINGS (2)

(a) Units of undertakings for collective investment in securities normally dealt in on the capital market (shares, other equities and bonds).

(b) Units of undertakings for collective investment in securities or instruments normally dealt in on the money market.

(c) Units of undertakings for collective investment in other assets.

A — Transactions in units of collective investment undertakings

1. Acquisition by non-residents of units of national undertakings dealt in on a stock exchange.

2. Acquisition by residents of units of foreign undertakings dealt in on a stock exchange.

3. Acquisition by non-residents of units of national undertakings not dealt in on a stock exchange.

4. Acquisition by residents of units of foreign undertakings not dealt in on a stock exchange.

B — Administration of units of collective investment undertakings to the capital market

(i) *Introduction on a stock exchange.*

(ii) *Issue and placing on a capital market.*

1. Admission of units of national collective investment undertakings to a foreign capital market.
2. Admission of units of foreign collective investment undertakings to the domestic capital market.

V — OPERATIONS IN SECURITIES AND OTHER INSTRUMENTS NORMALLY DEALT IN ON THE MONEY MARKET ([2])

A — Transactions in securities and other instruments on the money market

1. Acquisition by non-residents of domestic money market securities and instruments.

2. Acquisition by residents of foreign money market securities and instruments.

B — Admission of securities and other instruments to the money market

(i) *Introduction on a recognized money market ([*]).*

(ii) *Issue and placing on a recognized money market.*

1. Admission of domestic securities and instruments to a foreign money market.
2. Admission of foreign securities and instruments to the domestic money market.

VI — OPERATIONS IN CURRENT AND DEPOSIT ACCOUNTS WITH FINANCIAL INSTITUTIONS (3)

A — Operations carried out by non-residents with domestic financial institutions

B — Operations carried out by residents with foreign financial institutions

VII — CREDITS RELATED TO COMMERCIAL TRANSACTIONS OR TO THE PROVISION OF SERVICES IN WHICH A RESIDENT IS PARTICIPATING (3)

1. Short-term (less than one year).

2. Medium-term (from one to five years).

3. Long-term (five years or more).

A — Credits granted by non-residents to residents

B — Credits granted by residents to non-residents

VIII — FINANCIAL LOANS AND CREDITS (not included under I, VII and XI) (3)

1. Short-term (less than one year).

2. Medium-term (from one to five years).

3. Long-term (five years or more).

A — Loans and credits granted by non-residents to residents

B — Loans and credits granted by residents to non-residents

IX — SURETIES, OTHER GUARANTEES AND RIGHTS OF PLEDGE

A — Granted by non-residents to residents

B — Granted by residents to non-residents

X — TRANSFERS IN PERFORMANCE OF INSURANCE CONTRACTS

A — Premiums and payments in respect of life assurance

1. Contracts concluded between domestic life assurance companies and non-residents.

2. Contracts concluded between foreign life assurance companies and residents.

B — Premiums and payments in respect of credit insurance

1. Contracts concluded between domestic credit insurance companies and non-residents.

2. Contracts concluded between foreign credit insurance companies and residents.

C — Other transfers of capital in respect of insurance contracts

XI — PERSONAL CAPITAL MOVEMENTS

A — Loans

B —Gifts and endowments

C — Dowries

D — Inheritances and legacies

E — Settlement of debts by immigrants in their previous country of residence

F — Transfers of assets constituted by residents, in the event of emigration, at the time of their installation or during their period of stay abroad

G — Transfers, during their period of stay, of immigrants' savings to their previous country of residence

XII — PHYSICAL IMPORT AND EXPORT OF FINANCIAL ASSETS

A — Securities

B — Means of payment of every kind

XIII — OTHER CAPITAL MOVEMENTS

A — Death duties

B — Damages (where these can be considered as capital)

C — Refunds in the case of cancellation of contracts and refunds of uncalled-for payments (where these can be considered as capital)

D — Authors' royalties: patents, designs, trade marks and inventions (assignments and transfers arising out of such assignments)

E — Transfers of the monies required for the provision of services (not included under VI)

F — Miscellaneous

EXPLANATORY NOTES

For the purposes of this Nomenclature and the Directive only, the following expressions have the meanings assigned to them respectively:

Direct investments

Investments of all kinds by natural persons or commercial, industrial or financial undertakings, and which serve to establish or to maintain lasting and direct links between the person providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity. This concept must therefore be understood in its widest sense.

The undertakings mentioned under I-1 of the Nomenclature include legally independent undertakings (wholly-owned subsidiaries) and branches.

As regards those undertakings mentioned under I-2 of the Nomenclature which have the status of companies limited by shares, there is participation in the nature of direct investment where the block of shares held by a natural person of another undertaking or any other holder enables the shareholder, either pursuant to the provisions of national laws relating to companies limited by shares or otherwise, to participate effectively in the management of the company or in its control.

Long-term loans of a participating nature, mentioned under I-3 of the Nomenclature, means loans for a period of more than five years which are made for the purpose of establishing or maintaining lasting economic links. The main examples which may be cited are loans granted by a company to its subsidiaries or to companies in which it has a share and loans linked with a profit-sharing arrangement. Loans granted by financial institutions with a view to establishing or maintaining lasting economic links are also included under this heading.

Investments in real estate

Purchases of buildings and land and the construction of buildings by private persons for gain or personal use. This category also includes rights of usufruct, easements and building rights.

Introduction on a stock exchange or on a recognized money market

Access — in accordance with a specified procedure — for securities and other negotiable instruments to dealings, whether controlled officially or unofficially, on an officially recognized stock exchange or in an officially recognized segment of the money market.

Securities dealt in on a stock exchange (quoted or unquoted)

Securities the dealings in which are controlled by regulations, the prices for which are regularly published, either by official stock exchanges (quoted securities) or by other bodies attached to a stock exchange — e.g. committees of banks (unquoted securities).

Issue of securities and other negotiable instruments

Sale by way of an offer to the public.

Placing of securities and other negotiable instruments

The direct sale of securities by the issuer of by the consortium which the issuer has instructed to sell them, with no offer being made to the public.

Domestic or foreign securities and other instruments

Securities according to the country in which the issuer has his principal place of business. Acquisition by residents of domestic securities and other instruments issued on a foreign market ranks as the acquisition of foreign securities.

Shares and other securities of a participating nature

Including rights to subscribe to new issues of shares.

Bonds

Negotiable securities with a maturity of two years or more from issue for which the interest rate and the terms for the repayment of the principal and the payment of interest are determined at the time of issue.

Collective investment undertakings

Un[d]ertakings:

— the object of which is the collective investment in transferable securities or other assets of the capital they raise and which operate on the principle of risk-spreading, and

—the units of which are, at the request of holders, under the legal, contractual or statutory conditions governing them, repurchased or redeemed, directly or indirectly, out of those undertakings' assets. Action taken by a collective investment undertaking to ensure that the stock exchange value of its units does not significantly vary from their net asset value shall be regarded as equivalent to such repurchase or redemption.

Such undertakings may be constituted according to law either under the law of contract (as common funds managed by management companies) or trust law (as unit trusts) or under statute (as investment companies).

For the purposes of the Directive, ‘common funds’ shall also include unit trusts.

Securities and other instruments normally dealt in on the money market

Treasury bills and other negotiable bills, certificates of deposit, bankers' acceptances, commercial paper and other like instruments.

Credits related to commercial transactions or to the provision of services

Contractual trade credits (advances or payments by instalment in respect of work in progress or on order and extended payment terms, whether or not involving subscription to a commercial bill) and their financing by credits provided by credit institutions. This category also includes factoring operations.

Financial loans and credits

Financing of every kind granted by financial institutions, including financing related to commercial transactions or to the provision of services in which no resident is participating.

This category also includes mortgage loans, consumer credit and financial leasing, as well as back-up facilities and other note-issuance facilities.

Residents or non-residents

Natural and legal persons according to the definitions laid down in the exchange control regulations in force in each Member State.

Proceeds of liquidation (of investments, securities, etc.)

Proceeds of sale including any capital appreciation, amount of repayments, proceeds of execution of judgements, etc.

Natural or legal persons

As defined by the national rules.

Financial institutions

Banks, savings banks and institutions specializing in the provision of short-term, medium-term and long-term credit, and insurance companies, building societies, investment companies and other institutions of like character.

Credit institutions

Banks, savings banks and institutions specializing in the provision of short-term, medium-term and long-term credit.

([1]) See Explanatory Notes below.

([2]) See Explanatory Notes below.

([3]) See Explanatory Notes below."

39. For the purposes of the discussion which follows:

(a) a company which is within the charge to corporation tax because it is resident in the UK or carries on a trade in the UK through a permanent establishment is described as being "within the UK tax net" and, correspondingly, a company which is within the charge to tax on all or part of its net income, profits or gains in another Member State is described as being "within the tax net" of that Member State; and

(b) since, by virtue of the EEA Agreement, the EU freedoms extend to all states which are within the EEA, references to the "EU" and to a "Member State" should respectively be treated as including the parts of the EEA which are not within the EU and to states within the EEA which are not Member States.

Discussion

General overview

40. It is, perhaps, surprising that, given the number of decisions of the Court of Justice of the European Union (or its predecessor, the European Court of Justice) (together, the "CJEU") in relation to circumstances that are similar to those which are in issue in the Appeals, there is no CJEU decision which considers either the Group Transfer Rules themselves or the equivalent of those rules in any other Member State.

41. Before examining in detail the questions which have arisen in the Appeals in relation to the EU Law Issue, I think that it would be helpful to summarise the general principles of EU law which are relevant in this case and the submissions which each party has made in relation to how those principles apply to the facts involved in the Appeals.

42. In that regard, the following general principles of EU law are not in dispute between the parties:

(a) the freedoms set out in Articles 49 and 63 TFEU are directly effective in the UK and each of those freedoms is capable of being relied upon by a taxpayer in a case where the UK's domestic legislation restricts the relevant freedom – see Section 2 of the ECA;

(b) in that context, if the UK's domestic legislation which restricts a freedom gives rise to a tax liability for a person (A) other than the person whose freedom has been restricted (B), then A is entitled to rely on the fact that B's freedom has been restricted in order to avoid the adverse tax consequence which flows from that restriction – see *Philips* at paragraph [39] and *Felixstowe* at paragraphs [22] and [23];

(c) domestic legislation which prohibits, impedes or renders less attractive the exercise of a freedom must be regarded as a restriction on that freedom – see *NGI* at paragraph [36];

(d) for that purpose, domestic legislation should be regarded as prohibiting, impeding or rendering less attractive the exercise of a freedom as long as it is capable of doing so – it is not necessary to show that the domestic legislation in question has actually had the effect of prohibiting, impeding or rendering less attractive the exercise of the relevant freedom – see *Thin Cap* at paragraph [62];

(e) domestic legislation of a Member State restricts the freedom of establishment of a resident of another Member State if, inter alia, it subjects the subsidiaries of that person to a less favourable tax treatment than subsidiaries of a resident of the first-mentioned Member State – see *Oy AA* at paragraphs [30] to [43];

(f) where a Member State restricts an EU freedom, that restriction may be justified if the situation in which the restriction arises is not objectively comparable to the situation which would have pertained if no other Member State had been involved – see *Germany* at paragraph [60], *LabTec* at paragraph [38] and *Class IV ACT* at paragraphs [57] to [62];

(g) where a Member State restricts an EU freedom, that restriction may be justified by overriding reasons in the public interest. These include the objective of ensuring the balanced allocation of taxing powers between the Member States – see *NGI* at paragraphs [45], [46] and [94], *LabTec* at paragraphs [43] and [47] and *Panayi* at paragraphs [53] and [56];

(h) where a Member State seeks to rely on the objective of the balanced allocation of taxing powers in order to justify a restriction, the domestic legislation in issue should be appropriate to ensuring the attainment of the objective in question and should not go beyond what is necessary in order to attain that objective. In other words, the restriction should be proportionate – see *NGI* at paragraph [50]; and

(i) if the domestic legislation in issue either give rises to a restriction on the relevant freedom which is unjustified, or a restriction which, whilst being justified, goes beyond what is proportionate, then the relevant national court must either construe the domestic legislation in a manner which is consistent with the freedom (the doctrine of "conforming interpretation") or, if a conforming interpretation is not possible, disapply the relevant provisions to the relevant extent – see *Fleming* at paragraph [25].

43. As I have already noted, none of the principles set out in paragraph 42 above is a matter of dispute between the parties. However, the parties do disagree in relation to how those principles should be applied in connection with the application of the Group Transfer Rules in relation to each of the 2011 Disposal and the 2014 Disposal. I will in due course elaborate in greater detail on the precise arguments which have been made by each party but a broad summary of each party's position is set out in paragraphs 45 to 50 below.

44. In this decision, I will adopt the same basis of proceeding as did each party in making its submissions, which is to say that I will address first the analysis in relation to the 2014 Disposal and I will then consider the additional issues which arise in relation to the 2011 Disposal. This seems appropriate given that the involvement of a Swiss resident company (JTISA) in the 2011 Disposal gives rise to additional complexity as compared to the 2014 Disposal.

45. In relation to the 2014 Disposal, the Appellant submits that:

(a) the fact that the Disposal was precluded from falling within the Group Transfer Rules and therefore gave rise to a requirement for the Appellant to make an immediate payment of the whole of the corporation tax liability of the Appellant in respect of the disposal of the shares in Galleon by the Appellant to its parent company, JTIH, and would not have given rise to such a requirement for the Appellant if JTIH had been a UK resident parent company, means that the Group Transfer Rules create a restriction on JTIH's freedom of establishment – that is to say, JTIH's freedom to establish the Appellant in the UK;

(b) a charge to corporation tax in respect of the gain which had accrued within the Appellant in respect of the shares in Galleon up to the date of the disposal cannot be justified on the grounds that the situation involving JTIH, as a Dutch resident company outside the UK tax net, in relation to that transfer was not objectively comparable to the situation which would have pertained if JTIH had been within the UK tax net;

(c) however, that charge to corporation tax can be justified by overriding reasons in the public interest – namely, the objective of ensuring the balanced allocation of taxing powers between the Member States;

(d) nevertheless, requiring the whole of that corporation tax liability to be paid immediately went beyond what was necessary in order to attain that objective. The UK legislation should have allowed for the Appellant to have an option to defer the obligation to pay the tax;

(e) as for the terms and extent of that deferral, given that, in their application to intra-group disposals of assets where the assets remain within the UK tax net, the Group Transfer Rules provide for deferral until the relevant assets are the subject of a disposal outside the group or cease to remain within the UK tax net, the Group Transfer Rules should be given a conforming interpretation so as to provide for an intra-group disponor of an asset in circumstances where the freedom would be restricted by an immediate charge to tax (in this case, the Appellant) to have an option to defer paying the corporation tax until the asset in question (in this case, the shares in Galleon) are the subject of a disposal outside the group or sub-group of which the non-UK resident but EU resident parent company (in this case, JTIH) is the parent company; and

(f) in the alternative, since there is more than one way of achieving a proportionate restriction on the freedom, the question of which restriction to apply is a matter which must necessarily be left to Parliament and is not within the competence of the UK courts, with the result that the only appropriate remedy in this case is the disapplication of part of the UK legislation.

46. In relation to the 2011 Disposal, the Appellant submits that:

(a) even though the transferee in relation to the 2011 Disposal, JTISA, was resident outside the EU, the fact that the Disposal was precluded from falling within the Group Transfer Rules and therefore gave rise to a requirement for the Appellant to make an immediate payment of the whole of the corporation tax liability of the Appellant in respect of the disposal of the Brands and related assets to a sister company resident outside the UK, and would not have given rise to such a requirement for the Appellant if that sister company had been resident in the UK, means that the UK legislation creates a restriction on JTIH's freedom of establishment – that is to say, JTIH's freedom to establish the Appellant in the UK;

(b) it follows that the analysis set out above in relation to the 2014 Disposal is equally true of the 2011 Disposal. In terms of justification and proportionality, the fact that Switzerland is outside the EU and was not party to Council Directive 2010/24/EU concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures (the "Multilateral Convention") at the time of the 2011 Disposal does not change the analysis because (i) first, there is a double tax treaty between the UK and Switzerland, Article 25 of which has been in effect since 1 January 2011 and provides for exchanges of information between the two jurisdictions; (ii) secondly, JTIH, the parent company of JTISA, is resident in the Netherlands and was therefore within the scope of the Multilateral Convention at the time of the 2011 Disposal; and (iii) thirdly, the disponor of the intangibles, the Appellant, remains within the UK (so that the deferred corporation tax liability would still be capable of being enforced against it) and has undertaken to provide the Respondents with an annual statement confirming that the intangibles either remain within the sub-group headed by JTIH or have left that sub-group;

(c) in the alternative, the fact that the Disposal was precluded from falling within the Group Transfer Rules and therefore gave rise to a requirement for the Appellant to make an immediate payment of the whole of the corporation tax liability of the Appellant in respect of the disposal of the Brands and related assets to a sister company resident outside the UK and would not have given rise to such a requirement for the Appellant if that sister company had been resident in the UK means that the UK legislation creates a restriction on the freedom of the Appellant and/or JTIH to move capital; and

(d) in that regard, Article 63 TFEU is clearly, on its terms, capable of applying to movements of capital to jurisdictions outside the EU. In addition, even if JTIH were to be precluded from relying on the freedom to move capital in this instance – either (i) because CJEU case law suggests that, where circumstances potentially constitute a restriction on both the freedom of establishment and the freedom to move capital, then, if those circumstances involve a relationship of parent and subsidiary, only the freedom of establishment should be considered or (ii) because the "standstill" provisions in Article 64 might be regarded as precluding reliance by JTIH on its freedom to move capital in the context of a direct investment in JTISA– the same does not hold true for the Appellant, as its relationship with JTISA is that of one subsidiary of a common parent company to another.

47. Finally, the Appellant submits in relation to each Disposal that, if I am unable to conclude (i) whether or not the circumstances of the Disposal in question engages or restricts a particular freedom; (ii) whether or not any restriction on a freedom is justified by the fact that the circumstances of a member of the JT Group which is outside the UK tax net are not objectively comparable to the circumstances of a member of the JT Group which is within the UK tax net; or (iii) whether or not the requirement to make an immediate payment of the whole of the corporation tax liability to which the UK legislation currently gives rise constitutes a proportionate manner of securing the balanced allocation of taxing powers whilst preserving the relevant freedom, then I should refer the relevant question to the CJEU.

48. In their response to the Appellant's submissions in relation to the 2014 Disposal, the Respondents contend that:

(a) although the requirement to make an immediate payment of the whole of the corporation tax liability in respect of the disposal of the shares in Galleon by the Appellant to its Dutch resident parent company (JTIH) is a restriction on JTIH's freedom of establishment – that is to say, JTIH's freedom to establish the Appellant in the UK – that restriction is justified because the situation involving JTIH, as a non-UK resident company outside the UK tax net, and the situation which would have pertained if JTIH had been a UK resident company are not objectively comparable. In particular, as Section 171, when it applies to a disposal to a UK resident company, provides for the transferee to acquire the asset at an amount equal to the base cost of the disponor, a transferee which is outside the UK tax net is not in an objectively comparable situation to that of a transferee which is within the UK tax net;

(b) even if the restriction which the Group Transfer Rules create were not to be regarded as being justified on the basis of the lack of objective comparability, that restriction is both justified and proportionate because (i) a charge to corporation tax on the gain which has accrued on the shares in Galleon in the hands of the Appellant is necessary to secure the balanced allocation of taxing powers; and (ii) as the gain in question has been realised by the Appellant, by virtue of the Appellant's having disposed of the shares in Galleon for full consideration in cash, requiring an immediate payment of the whole of the corporation tax liability is proportionate. In that regard, the Respondents maintain that the various decisions of the CJEU to the effect that the right of the taxpayer to be given an option to defer the payment of the taxes arising when assets leave the tax net of a Member State relate to unrealised gains as opposed to realised gains, and are therefore distinguishable from the circumstances which are in issue in the Appeals;

(c) if requiring the immediate payment of the whole of the corporation tax liability is not proportionate, then, as it has been held by the CJEU to be proportionate in the case of unrealised gains and UK legislation should not be amended beyond what is necessary in order to give effect to the relevant freedom, a proportionate restriction would be to give the intra-group disponor of an asset in circumstances where the freedom would be restricted by an immediate charge to tax (in this case, the Appellant) an option to pay the tax in question in instalments in the same manner as if the disponor had itself ceased to be within the UK tax net while continuing to hold the asset which was the subject of the intra-group disposal;

(d) to give effect to that proportionate restriction, a conforming interpretation should be given to the payment provisions in the TMA so as to provide for the disponor of an asset in circumstances where the freedom would be restricted by an immediate charge to tax to have an option to pay the corporation tax liability in instalments on the same terms as if the disponor had ceased to be within the UK tax net and become subject to the UK exit charge in respect of that asset;

(e) it is not appropriate to apply the conforming interpretation of the UK legislation in the manner proposed by the Appellant because that (i) would be inconsistent with the existing CJEU case law in which provision for an option to pay exit taxes in instalments has been held to be proportionate; (ii) would go considerably further than is necessary to render the UK legislation compatible with the freedom of establishment; and (iii) would be contrary to the grain (or thrust) of the UK's domestic legislation as a whole – for example, there is no other provision in the UK's domestic legislation for a tax liability (as opposed to a gain) to be fixed and then deferred indefinitely and the grain (or thrust) of the Group Transfer Rules is that tax should be payable immediately on any gain arising on an intra-group disposal made to a transferee which is outside the UK tax net; and

(f) if a conforming interpretation is not possible, then the same outcome can be obtained by way of a "temporal disapplication" of the provision in Section 171 which limits the application of the Group Transfer Rules to intra-group disposals to transferees within the UK tax net.

49. In their response to the Appellant's submissions in relation to the 2011 Disposal, the Respondents contend that:

(a) none of the EU freedoms is engaged;

(b) as regards the freedom of establishment, JTIH does not have a freedom of establishment in relation to JTISA because JTISA is resident outside the EU and the corporation tax liability to which the 2011 Disposal gave rise would have arisen even if JTIH had been a UK resident company so that the Group Transfer Rules do not create a restriction on JTIH's freedom to establish the Appellant in the UK;

(c) as regards the freedom to move capital, CJEU case law shows that, in a group situation, the only freedom which needs to be considered is the freedom of establishment and the freedom to move capital is irrelevant. In any event, even if it were permissible to consider in this case whether or not the Group Transfer Rules create a restriction on the freedom to move capital, (i) the only movements of capital made by JTIH were its direct investments in JTISA (and therefore the standstill in Article 64 of the TFEU for restrictions existing under national law on 31 December 1993 applied) and (ii) the disposal of intangibles for full consideration by one subsidiary in a group to another does not itself amount to a movement of capital (and therefore the Disposal did not amount to a movement of capital by the Appellant to JTISA). In addition, so far as both bases for arguing that the 2011 Disposal gave rise to movements of capital, the UK is permitted by the terms of Article 65 to restrict the freedom to do so because JTISA was not in an objectively comparable situation to the situation of a transferee which was within the UK tax net;

(d) even if one of the freedoms was engaged, the restriction created by the Group Transfer Rules is justified by the fact that the situation involving JTISA, as a company outside the UK tax net, was not objectively comparable to the situation which would have pertained if JTISA had been within the UK tax net (as regards the application of Section 171) for the same reason as in relation to the 2014 Disposal and (as regards the application of Section 775) because the provision operates by specifying that the transferee steps into the shoes of the disponor and a transferee which is outside the UK tax net cannot do that; and

(e) even if the restriction to which the UK legislation gives rise were not to be regarded as being justified on the basis of the lack of objective comparability, the same arguments as apply in relation to justification and proportionality in the context of the 2014 Disposal apply in the context of the 2011 Disposal.

50. Finally, in relation to each Disposal, the Respondents submit that it is not appropriate for me to refer any question to the CJEU because the EU principles which are relevant in this case are *acte clair* and issues of conforming interpretation and disapplication are matters for the national court and not the CJEU.

Questions to be addressed in relation to each Disposal

51. It may be seen from the summary of the applicable EU law principles and the submissions of the parties set out above that the following questions need to be addressed in this decision in relation to each Disposal:

(a) first, which freedoms need to be considered in relation to the application of the Group Transfer Rules to the relevant Disposal? Is it the freedom of establishment set out in Article 49 of the TFEU or the freedom to move capital in Article 63 of the TFEU or both?

(b) secondly, if one or both of the freedoms needs or need to be considered, do the Group Transfer Rules create a restriction on the relevant freedom or freedoms?

(c) thirdly, if the Group Transfer Rules create a restriction on the relevant freedom or freedoms, can that restriction be justified on the basis that the circumstances of the transferee in the particular case are not objectively comparable to those which would have pertained if the transferee had been within the UK tax net?

(d) fourthly, if the Group Transfer Rules create a restriction on the relevant freedom or freedoms and the restriction cannot be justified on the basis of the lack of objective comparability, is the relevant restriction justified by overriding reasons in the public interest – namely, the balanced allocation of taxing powers between Member States?

(e) fifthly, if the relevant restriction on the freedom is justified, is the restriction proportionate – that is to say, does it go beyond what is necessary to achieve the objective of preserving the balanced allocation of taxing powers? and

(f) sixthly, if the relevant restriction on the freedom is not proportionate, how should the UK courts respond to the disproportionate restriction on the freedom which is created by the legislation? In other words, is it possible for the UK courts to adopt a conforming interpretation of any part of the UK legislation in order to achieve compliance with EU law or should some part of the UK legislation be disapplied, whether in whole or in part, in order to achieve that compliance?

Summary of conclusions

52. In view of the length of this decision, a summary of my conclusions in relation to the above questions in relation to each Appeal is as follows:

(a) in relation to the 2014 Appeal:

- the fact that the Disposal gave rise to an immediate liability to tax which would not have arisen if JTIH had been within the UK tax net means that the Group Transfer Rules create a restriction on JTIH’s freedom of establishment;

- that restriction is not justified on the basis that JTIH is not in an objectively comparable situation to that in which it would have been if it had been within the UK tax net;

- however, the restriction is justified by reference to overriding reasons in the public interest – namely, the objective of securing the balanced allocation of taxing powers between Member States;

- nevertheless, in requiring the tax in question to be paid immediately, the restriction goes further than is proportionate;

- the restriction would be proportionate if it were to provide for the tax in question to be paid in instalments;

- however, as there are various possible instalment payment bases which would be proportionate in this context, it is not within the competence of the UK courts to remedy the existing disproportionate restriction by selecting one of those options and applying the doctrine of conforming interpretation to treat the selected option as incorporated in the legislation;
- therefore, it is necessary to disapply the existing exclusion from the Group Transfer Rules for intra-group disposals to transferees which are outside the UK tax net in circumstances where that exclusion constitutes a restriction on the freedom of establishment, with the result that Section 171 should apply in those circumstances even though the transferee is not within the UK tax net; and
- in consequence, the EU Law Issue is determined in favour of the Appellant and the 2014 Appeal is upheld; and

(b) in relation to the 2011 Appeal:

- it is not necessary to consider whether the fact that the Disposal gave rise to an immediate liability to tax which would not have arisen if JTISA had been within the UK tax net means that the Group Transfer Rules create a restriction on JTIH's or the Appellant's freedom to move capital;
- however, it is necessary to consider whether that fact means that the Group Transfer Rules create a restriction on JTIH's freedom to establish the Appellant in the UK;
- the fact that the Disposal gave rise to an immediate liability to tax which would not have arisen if JTISA had been within the UK tax net does not mean that the Group Transfer Rules create a restriction on JTIH's freedom of establishment in the UK because the same liability would have arisen even if JTIH had been within the UK tax net; and
- as a result, the EU Law Issue is determined in favour of the Respondents and therefore the Valuation Issue in the 2011 Appeal needs now to be addressed.

53. I now turn to consider the questions set out in paragraph 51 above in the context of the 2014 Appeal.

<u>The 2014 Disposal</u>

Which freedoms?

54. It is common ground that the only freedom which needs to be considered in relation to the 2014 Disposal is the freedom of establishment and that the freedom to move capital is not in issue.

55. This is notwithstanding the fact that the acquisition of Galleon by JTIH with a view to its holding Galleon for the long term was clearly a direct investment by JTIH falling within paragraph "I – DIRECT INVESTMENTS" of the Nomenclature.

56. I agree that, in relation to the 2014 Disposal, it is unnecessary to consider the freedom to move capital because, leaving aside the question of whether a movement of capital by JTIH in the form of its making a direct investment in Galleon would fall outside the terms of Article 63 of the TFEU by virtue of the standstill in Article 64 of the TFEU, CJEU case law makes it clear that:

> (a) a company established in one Member State with a holding in the capital of a company in another Member State giving it definite influence over the second-mentioned company's decisions and allowing it to determine the second-mentioned company's activities is exercising its right of establishment; and
>
> (b) legislation which is targeted only at relations within a group of companies primarily affects that right of establishment and any restrictive effects on the free movement of capital "must be seen as an unavoidable consequence of any restriction on freedom of establishment and do not justify an independent examination of that legislation in the light of [Article 63]" (see *Thin Cap* at paragraphs [33] and [34], *Cadbury Schweppes* at paragraphs [31] to [33] and *FII 2* at paragraphs [89] to [92]).

57. Indeed, it is apparent from paragraph [73] in *Cadbury Schweppes* that, in such cases, even if, after examining whether the legislation in question is compatible with the freedom of establishment, the conclusion reached is that it is, one does not go on to consider whether the legislation in question might still constitute a restriction on the free movement of capital.

58. Since it was raised at the hearing and is highly relevant to the analysis in relation to the 2011 Disposal, I should at this juncture say that, in my view, the principle described in paragraphs 56 and 57 above is not gainsaid by the decision in *Glaxo* to the effect that the freedom to move capital can take priority over the freedom of establishment in circumstances where the national legislation in question is such that it might apply to circumstances which do not involve shareholdings conferring on their holder definite influence over another company's affairs and therefore are not confined to circumstances involving groups. This is because, in each case, in order to determine which of two possible freedoms is to take priority, the purpose of the relevant national legislation needs to be identified. Where that purpose is not concerned solely with transactions within a group, as was the case in *Glaxo*, then the freedom to move capital can take priority – see *Glaxo* at paragraphs [36], [37], [50] and [51] and *DMC* at paragraph [38].

59. In fact, both *Holböck* at paragraph [25], *FII 1* at paragraphs [36] to [38], [80] and [142] and *Portugal 1* at paragraph [44] show that, where the national legislation which is in issue applies to companies irrespective of the size of their holdings, and therefore irrespective of whether or not they exercise definite influence over the other company in question, it can be considered from the perspective of both freedoms and

without the need to prioritise one over the other. (For completeness, I would note that this is not entirely consistent with those cases specified in paragraph 58 above, where the view expressed was that, where the national legislation which is in issue applies to companies irrespective of the size of their shareholdings, only the freedom to move capital, and not both that freedom and the freedom of establishment, needs to be considered.)

60. Notwithstanding the inconsistency mentioned in paragraph 59 above, the CJEU case law plainly demonstrates that, where, as is the case in relation to the 2014 Disposal (and, indeed, the 2011 Disposal), the national legislation in question (ie the Group Transfer Rules) is limited in its application to transactions within a group of companies - and is therefore concerned only with companies which are under common control - then the only freedom which needs to be considered in relation to the national legislation is the freedom of establishment. This is the case even if the freedom of establishment is not engaged in relation to the transaction because it involves a company which is resident in a jurisdiction outside the EU – see *FII 2* at paragraph [98].

61. Moreover, the CJEU case law makes it equally plain that this is true regardless of whether, as is the case in relation to the 2014 Disposal, the transaction is between a subsidiary and its parent company or, as is the case in relation to the 2011 Disposal, the transaction is between two subsidiaries of a common parent. In *Thin Cap*, the legislation which was in issue – the rules relating to the non-deductibility of interest payments made by a UK resident company to a non-UK resident affiliate and the transfer pricing rules (prior to their amendment to include transactions taking place wholly within the UK tax net) – was considered both from the perspective of payments made by a UK resident company to its parent company and from the perspective of payments made by a UK resident company to another subsidiary of the same parent company – see Question (2) in paragraph [22].

62. It could not be clearer that the CJEU took both scenarios into account in reaching its conclusion that the freedom to move capital did not need to be considered in that case. For example, in the course of its reasoning in paragraphs [27] to [34], the CJEU expressly refers to "situations where the lending company has a definite influence on the borrowing company <u>or is itself controlled by a company which has such an influence</u>" [my emphasis] (see paragraph [28]), it describes the post-1998 UK legislation which was in issue in the case by reference both to the relationship of a parent and a subsidiary and to the relationship of two sister subsidiaries (see paragraph [30]) and it describes the legislation in issue in that case as being "targeted only at relations within a group of companies" (see paragraph [33]). It then goes on to say expressly in paragraph [101] that, in relation to Question (2) in that case, which was limited by its terms to loans made between two sister companies, "legislation such as the legislation at issue in the main proceedings, which is targeted only at relations within a group of companies, primarily affects freedom of establishment. Even if it were to be accepted that such legislation might have restrictive effects on the freedom to provide services and the free movement of capital, such effects must be seen as an unavoidable consequence of any restriction on freedom of establishment and do not justify an independent examination of that legislation in the light of Articles 49 EC and 56 EC".

63. I therefore consider that there is no basis for the argument that a distinction should be drawn in this context between, on the one hand, transactions between a parent and its subsidiary and, on the other hand, transactions between sister subsidiaries. Both categories of transaction are intra-group transactions and national legislation which is aimed at such transactions can be considered only from the perspective of the freedom of establishment.

64. Finally in this context, I do not agree with the submission made by Mr Baker at the hearing that *Kronos* at paragraphs [38] et seq. is to be regarded as authority for the proposition that, where a shareholder exercises definite influence over the decisions of a company in a jurisdiction which is outside the EU, the fact that the freedom of establishment in Article 49 of the TFEU cannot apply in that instance means that the shareholder can then rely on the freedom to move capital in Article 63 of the TFEU in connection with that company. It is plain both from the terms of paragraph [39] in *Kronos* and from the terms of paragraphs [98] et seq. in *FII 2* that, whilst this may be the case in relation to national legislation which does not apply exclusively to situations in which the shareholder exercises definite influence over the decisions of the company, it is not the case in relation to national legislation which can apply only to shareholdings which enable the holder to exercise definite influence over the company (which is the case in relation to the Group Transfer Rules). In the latter case, neither Article 49 of the TFEU nor Article 63 of the TFEU may be relied upon.

65. For the same reason, I do not consider that the decision in *EV* is authority for the proposition that the freedom to move capital in Article 63 of the TFEU can be considered in the context of the Group Transfer Rules. It is apparent from paragraphs [32] to [41] in the judgment in that case that the national legislation which was in issue there did not solely concern shareholdings conferring a definite influence over the decisions of the company which was distributing the dividends and that was the reason why Article 63 of the TFEU could be considered in relation to the national legislation in question.

66. In conclusion on this point, whilst there is some inconsistency in the CJEU case law in relation to national legislation which can apply to circumstances that do not involve shareholdings conferring on their holder definite influence over another company's affairs – in that *Glaxo* and *DMC* suggest that only the freedom to move capital should be considered in those cases, whereas *Holböck, FII 1* and *Portugal 1* suggest that both freedoms may be considered – the CJEU case law makes it plain that only the freedom of establishment, and not the freedom to move capital, can be considered in the case of national legislation, such as the Group Transfer Rules, which is confined to groups (see *Cadbury Schweppes, FII 2* and *Thin Cap*).

67. The discussion in paragraphs 56 to 66 above is of greater relevance in relation to the 2011 Disposal than in relation to the 2014 Disposal. So far as the 2014 Disposal is concerned, it suffices to note at this stage that, as I have already observed in paragraph 54 above, it is common ground that the only freedom which needs to be considered in the context of the 2014 Disposal is the freedom of establishment under Article 49 of the TFEU. The Respondents accept that, in establishing the Appellant in the UK, JTIH exercised that freedom of establishment.

Is there a restriction?

68. The Respondents also accept that the Group Transfer Rules create a restriction on that freedom of establishment because the consequence of the disposal of the shares in Galleon by the Appellant to JTIH was to crystallise an immediate liability to pay tax whereas, if JTIH had been within the UK tax net at the time of the 2014 Disposal, the consequence of the disposal of the shares in Galleon by the Appellant to JTIH would have been that no immediate liability to pay tax would have arisen. Instead, JTIH would simply have assumed the Appellant's base cost in the shares.

Can the restriction be justified by the lack of objective comparability?

69. However, the Respondents submit that, although the Group Transfer Rules create a restriction on JTIH's freedom of establishment, that restriction is justified because JTIH is not in an objectively comparable position to the position in which it would have been if it had been within the UK tax net at the time of the 2014 Disposal. In their view, the purpose and effect of the Group Transfer Rules is to enable any gain which has accrued on the relevant asset at the point of the intra-group disposal to crystallise not at the point of the disposal but only when the transferee disposes of the relevant asset. Thus, a transferee which is not within the UK tax net is not in an objectively comparable position to the position of a transferee which is, in that, in the former case, any future disposal of the relevant asset by the transferee will be outside the scope of UK tax.

70. In support of their submission, the Respondents cite the decision of the CJEU in *Class IV ACT*. That case concerned the UK's former regime for the taxation of dividends. Under that regime, a UK resident shareholder receiving a dividend from a UK resident company was entitled to a tax credit (which gave rise to a repayment of tax if the shareholder in question either was not liable to tax in the UK or had a tax liability in the UK which was less than the amount of the credit) in respect of the advance corporation tax paid by the dividend-paying company in connection with the dividend. However, a non-UK resident shareholder did not have the right to a tax credit unless it had such a right under the terms of an applicable double tax convention between its jurisdiction of tax residence and the UK. In concluding that the restriction to which the rules in question gave rise was justified, the CJEU held that non-UK resident shareholders receiving dividends from a UK resident company were not in an objectively comparable position to the position of UK resident shareholders receiving such dividends. It said as follows:

"[58] Where the company making the distribution and the shareholder to whom it is paid are not resident in the same Member State, the Member State in which the company making the distribution is resident, that is to say the Member State in which the profits are derived, is not in the same position, as regards the prevention or mitigation of a series of charges to tax and of economic double taxation, as the Member State in which the shareholder receiving the distribution is resident.

[59] It must be held in that regard, first, that to require the Member State in which the company making the distribution is resident to ensure that profits distributed to a non-resident shareholder are not liable to a series of charges to tax or to economic double taxation, either

by exempting those profits from tax at the level of the company making the distribution or by granting the shareholder a tax advantage equal to the tax paid on those profits by the company making the distribution, would mean in point of fact that that State would be obliged to abandon its right to tax a profit generated through an economic activity undertaken on its territory.

[60] Secondly, as regards a procedure for preventing or mitigating economic double taxation by the grant of a tax advantage to the ultimate shareholder, it must be pointed out that it is usually the Member State in which the latter is resident that is best placed to determine the shareholder's ability to pay tax (see, to that effect, *Schumacker*, paragraphs 32 and 33, and *D.*, paragraph 27). Likewise, in the case of shareholdings to which Directive 90/435 applies, Article 4(1) of that directive requires the Member State of the parent company which receives profits distributed by a subsidiary which is resident in another Member State, and not the latter State, to avoid a series of charges to tax, either by refraining from taxing such profits or by taxing such profits while authorising that parent company to deduct from the amount of tax due that fraction of the corporation tax paid by the subsidiary which relates to those profits and, if appropriate, the amount of the withholding tax levied by the Member State in which the subsidiary is resident."

71. The Respondents submit that, in relation to an intra-group disposal, a transferee which is outside the UK tax net is no different from a non-UK resident shareholder under the old UK dividend rules in that, if the UK were to be obliged to allow that transferee to assume the gain which has accrued on the relevant asset at the point of the disposal, then that would entail the UK's giving up its right to tax the accrued gain. As such, the relevant transferee is not in an objectively comparable position to the position of a transferee which is within the UK tax net.

72. If the position of the Appellant in this case had been that the gain which has accrued on the relevant asset at the point of the intra-group disposal should simply be assumed by the transferee and disappear into the ether, then there might be some merit in this position although, even then, based on the various decisions which are described in paragraphs 74 to 81 below, I believe that the CJEU would not hold that the position of the transferee was not objectively comparable to the position of a transferee which was within the UK tax net but would instead justify the restriction by reference to the need for the balanced allocation of taxing powers between Member States. (Indeed, the way in which the CJEU case law has developed over the period since *Class IV ACT* was decided suggests that, if that case were to be heard today, the CJEU might well conclude that the situation of a non-UK resident shareholder was objectively comparable to the situation of a UK resident shareholder but that the restriction was instead justified by reference to the need for the balanced allocation of taxing powers between Member States.)

73. Be that as it may, as the Appellant reiterated at numerous points in its submissions, it is not suggesting that the accrued gain should fall out of account from the UK tax perspective altogether and therefore that the UK should be unable to tax that gain. It is merely suggesting that the tax in respect of the gain should be deferred in the same way as it would have been if the transferee had been within the UK tax net. Admittedly, if the Appellant is right in its contention, then what will be deferred is the tax on the gain in question, as opposed to the gain in question itself, but, even if

that distinction may be relevant to the questions which I address further below, it is certainly not relevant in relation to the reasoning set out in *Class IV ACT*, where the point at issue was that the UK would be required to give up its right to tax profits which were properly taxable in the UK if it were required to give a tax credit to non-UK residents who did not have the benefit of a double tax convention. On that basis, I do not see the parallel which the Respondents are suggesting between the facts which were in issue in *Class IV ACT* and the facts of the 2014 Disposal.

74. Quite apart from the point made in paragraphs 72 and 73 above, Mr Baker provided me at the end of the hearing with a very long list of CJEU cases in which the fact that assets were leaving the tax net of the Member State imposing the charge – whether because of a transfer of assets between Member States or because of a migration – was held not to prevent the position in relation to the holding of the assets following that departure from being objectively comparable to the position which would have pertained if the assets had remained within the tax net of the Member State in question, with the result that the relevant restriction could not be justified on that basis. A few examples of those cases are *NGI* – see paragraph [38] – *Portugal 2* – see paragraph [29] – *Panayi* – see paragraph [49] - and *A Oy* – see paragraph [29].

75. In the latter case, the CJEU held that Finnish legislation imposing an immediate charge to tax on the disposal of the assets of a permanent establishment located outside Finland to a company resident in the same jurisdiction as the permanent establishment could not be justified on the basis of the lack of objective comparability, even though the assets left the Finnish tax net as a result of the disposal.

76. The same approach has been applied by the CJEU where the assets in question have stayed within the jurisdiction imposing the tax liability following the disposal but the Member State imposing the tax has been unable to justify the restriction giving rise to the tax on the basis that, because the disponor was no longer within the tax net of the Member State in question following the disposal, the situation was not objectively comparable to the situation which would have pertained if the disponor had remained within that tax net – see *DMC* at paragraphs [42] and [43].

77. The decision in *Germany* is of similar ilk in that, although it did not involve legislation relating to a transfer of assets or assets leaving the jurisdiction, it considered legislation relating to the ability to roll over, into newly-acquired assets, a gain previously made. Such a rollover was permitted only if the new assets were acquired by a permanent establishment in Germany and not if the new assets were acquired by a permanent establishment elsewhere. The CJEU held that that difference in tax treatment was not justified by an objective difference between the situation of the permanent establishment outside Germany which acquired the assets and the situation of a German permanent establishment – see *Germany* at paragraphs [56] to [60].

78. In similar vein, there are "fiscal unity" cases which establish the same point – namely, that the fact that the resident of another Member State is not within the tax net of the Member State which is seeking to distinguish between that Member State's

own residents and the residents of other Member States does not mean that the situation involving a resident of that other Member State is not objectively comparable to the situation involving a resident of the Member State in question.

79. In *X Holding BV,* the ECJ considered whether the Dutch rules which precluded non-Dutch resident companies from forming part of the Dutch fiscal unity could be justified on the basis that situations involving group companies resident outside the Dutch tax net were not objectively comparable to situations involving group companies resident within the Dutch tax net. The CJEU ultimately held that the restriction in question was justified by the need for the balanced allocation of taxing powers between Member States but, before doing so, it concluded that the situation in that case – where a Dutch resident company wished to form a fiscal unity with its Belgian resident subsidiary - was objectively comparable to the situation which would have pertained if that Belgian resident company had been Dutch resident. It rejected the arguments of the Dutch, German and Portuguese Governments to the effect that the fact that the Belgian resident company was not within the Dutch tax net meant that the two situations were not objectively comparable – see *X Holding BV* at paragraphs [21] to [24]. Crucially, the CJEU noted that, whilst a taxpayer's residence "may constitute a factor that might justify national rules involving different treatment for resident and non-resident taxpayers…that is not always the case. To accept that the Member State of establishment may in all cases apply different treatment solely because the registered office of a company is situated in another Member State would deprive Article [49 of the TFEU] of its substance". It went on to say:

"[24] However, the situation of a resident parent company wishing to form a single tax entity with a resident subsidiary and the situation of a resident parent company wishing to form a single tax entity with a non-resident subsidiary are objectively comparable with regard to the objective of a tax scheme such as that at issue in the main proceedings in so far as each seeks to benefit from the advantages of that scheme, which, in particular, allows the profits and losses of the companies constituting the single tax entity to be consolidated at the level of the parent company and the transactions carried out within the group to remain neutral for tax purposes."

80. Similarly, in *Oy AA*, the Finnish domestic tax rules provided for the making of "financial payments" within groups of companies. In a wholly-domestic group, such payments were deductible for the payer and taxable in the hands of the recipient. As such, the system was akin to the UK's group relief regime, allowing for tax capacity within a group to be shifted between companies in the group. The relevant rules provided that a "financial payment" which was made by a Finnish resident company to a parent company which was outside the Finnish tax net was not deductible, whereas a "financial payment" which was made by a Finnish resident company to a parent company within the Finnish tax net was so deductible. The CJEU rejected the argument of a number of EU Governments, including the UK, to the effect that the situation involving the parent company outside the Finnish tax net was not objectively comparable to the situation which would have pertained if the parent company had been within the Finnish tax net – see paragraphs [33] to [40]. It held that Finland could, if it wished, make deductibility of the "financial payments" conditional on the treatment to be applied to the payments by the Member State in which the recipient

was resident but it could not provide for a difference in tax treatment for the payer solely because the recipient was not within the Finnish tax net.

81. There are a number of other cases involving similar decisions by the CJEU. In my view, these cases make it clear that the mere fact that a Member State is unable to tax a resident of another Member State does not mean that the relevant restriction can be justified on the grounds that there is a lack of objective comparability. On the contrary, they show that, in order to justify the relevant restriction in that case, the Member State in question needs to rely on the fact that the restriction is necessary in order to secure the balanced allocation of taxing powers between Member States.

82. My conclusion on this point is, therefore, that the restriction created by the Group Transfer Rules cannot be justified on the basis that the situation of a transferee which is outside the UK tax net is not objectively comparable to the situation which would have pertained if the transferee in question had been within the UK tax net. On the contrary, the CJEU decisions described above show that the fact that the transferee in this case, JTIH, is outside the UK tax net does not prevent its situation from being regarded as objectively comparable to the situation which would have pertained if it had been within the UK tax net.

Can the restriction be justified by the need for the balanced allocation of taxing powers?

83. It is common ground that the UK is entitled to tax the gain which accrued on the Galleon shares in the hands of the Appellant prior to the 2014 Disposal. This is not surprising, given the number of cases which have held that legislation allowing a Member State to impose tax on assets when the assets leave the taxing jurisdiction of the Member State is justified by the need for the balancing allocation of taxing powers.

84. A much more difficult question is whether the relevant Member State is entitled to require that tax to be paid immediately or must allow payment of all or part of that tax to be deferred and, if the latter is the case, the basis on which the tax should be paid – that is to say, whether the deferral should be on a fixed term basis – for example, an instalment payment basis along the lines of the regime set out in Schedule 3ZB to the TMA or some other instalment payment basis – or on the basis that the Appellant need not pay the tax until the Galleon shares leave the relevant group or sub-group.

85. However, before I can deal with that question, I need to summarise a number of recent decisions of the CJEU in relation to circumstances where assets or taxpayers have ceased to fall within the tax net of a Member State (which, for want of a better title, I will term "exit tax cases") as those decisions have a direct bearing on the question. Those cases, in the order in which they were decided, are *NGI*, *Portugal 2*, *Denmark*, *DMC*, *Germany*, *LabTec*, *Panayi* and *A Oy*.

The exit tax cases

NGI

86. In *NGI*, the national legislation in issue gave rise to the imposition of tax under Dutch law on the unrealised gains of a Dutch registered company when it transferred its place of effective management to the UK, with the result that its profits thereafter were precluded from being subject to tax in the Netherlands because of the terms of the double tax convention between the Netherlands and the UK. At the time of the transfer, the taxpayer had a large sterling receivable which had given rise to a significant exchange-related gain. The CJEU held that the imposition of tax in respect of that gain meant that the taxpayer was placed at a cash flow disadvantage in comparison to a similar company which retained its place of effective management in the Netherlands. It went on to note the following:

"39. The Spanish, French and Portuguese Governments further submit that a company such as the applicant in the main proceedings does not suffer any disadvantage in comparison with a company that transfers its place of management within a Member State. In view of the fact that the exchange rate gain in Netherlands guilders on a claim expressed in sterling disappeared when the place of effective management of National Grid Indus was transferred to the United Kingdom, that company was, in the view of those governments, taxed on a capital gain that had been realised. A transfer of the place of management within the Member State concerned, by contrast, would not have given rise to the realisation of any capital gains.

40. That argument must be rejected. The tax at issue in the main proceedings is not charged on realised capital gains. The exchange rate gain that was taxed in the context of those proceedings relates to an unrealised capital gain which did not produce any income for National Grid Indus. Such an unrealised capital gain would not have been taxed if National Grid Indus had transferred its place of effective management within Netherlands territory."

87. It explained that a Member State was entitled to tax a gain "even if the gain has not yet actually been realised" (see paragraph [49]) but drew a distinction between the process of establishing the amount of tax and the process of recovering the tax.

88. Conducting the former process at the time of the transfer of the place of effective management was proportionate for the purpose of safeguarding the exercise of the Netherlands' power to tax. In that regard, it was not necessary for the Netherlands to have to take into account any decrease in the value of the taxpayer's assets which might occur following the transfer because, following the transfer, any increases and decreases in the value of such assets were potentially within the scope of the UK's power to tax.

89. As regards the latter process, the CJEU held that the immediate recovery of the tax in question was disproportionate and that "it must be stated that recovery of the tax debt at the time of the actual realisation in the host Member State of the asset in respect of which a capital gain was established by the authorities of the Member State of origin on the occasion of the transfer of a company's place of effective management to the host Member State may avoid the cash-flow problems which could be produced by the immediate recovery of the tax due on unrealised capital gains"(see paragraph [68]). However, it recognised that the administrative burden to the taxpayer in question which deferral until realisation could give rise might be so severe that, in certain circumstances – for example, where many assets were involved - deferral could be a greater hindrance to the freedom of establishment than immediate recovery. It therefore held that

taxpayers should be offered a choice between immediate payment of the tax - "which creates a disadvantage for the company in terms of cash flow but frees it from subsequent administrative burdens" - and deferred payment, possibly together with interest - which, whilst it would require the potentially indefinite tracing of assets, "would be less harmful to freedom of establishment than the measure at issue in the main proceedings" (see paragraph [73]).

90. The CJEU rejected the submissions of various Governments to the effect that providing for tracing would give rise to an excessive burden on the Member State in question. It pointed out that, first, tracing was relevant only to the recovery of the tax which was due and not to the ascertainment of that tax, secondly, if the taxpayer did not regard tracing to be an excessive burden, then the burden to be borne by the Member State in question in checking on the declarations made by the taxpayer in connection with such tracing could not be an excessive burden either and, thirdly, the machinery for mutual assistance between Member States in relation to the provision of information (which is now the Multilateral Convention) would enable the Member State in question to ascertain whether or not a particular asset had been realised.

Portugal 2

91. In *Portugal 2*, the national legislation in issue gave rise to the imposition of tax under Portuguese law if a company established in Portugal moved its place of effective management to another jurisdiction (except in relation to assets which remained within a Portuguese permanent establishment of the company) or if a Portuguese permanent establishment either ceased to carry on its business in Portugal or transferred its assets outside Portugal. All of the tax was payable immediately. The CJEU began by noting that "[w]hen a company exercises its right to freedom of establishment and transfers activities from Portuguese territory to another Member State, that cannot, according to the Commission, result in the imposition of tax that would be levied earlier or would be of a greater amount than the tax that would be applicable to a company which transfers activities but remains in Portuguese territory. In the Commission's submission, the provisions at issue are consequently liable to give rise to obstacles to freedom of establishment and they infringe Article 49 TFEU" (see paragraph [22]).

92. After pointing out that this meant that the circumstances to which the legislation was applicable gave rise to tax on unrealised capital gains, as compared to circumstances where the assets remained within the Portuguese tax net and were taxed only when realised, it went on as follows:

"31 So far as concerns the existence of any justification for the restriction on freedom of establishment that has been found and the justification's proportionality, the Court held in *National Grid Indus*, paragraph 86, that Article 49 TFEU precludes legislation of a Member State which prescribes the immediate recovery of tax on unrealised capital gains relating to assets of a company transferring its place of effective management to another Member State at the very time of that transfer.

32 Furthermore, as is apparent from paragraph 73 of the judgment in *National Grid Indus*, national legislation offering a company transferring its place of effective management to another Member State the choice between, first, immediate payment of the amount of tax and,

secondly, deferred payment of the amount of tax, possibly together with interest in accordance with the applicable national legislation, would constitute a measure less harmful to freedom of establishment than the measures at issue in the main proceedings."

93. Thus, the CJEU in *Portugal 2* held that the provision for immediate payment of the tax in question was not proportionate and that a provision for allowing the tax to be deferred "would be less harmful to freedom of establishment than the measures at issue in the main proceedings".

Denmark

94. In *Denmark*, the national legislation in issue gave rise to the imposition of tax under Danish law on gains accrued on assets which were transferred to a permanent establishment outside Denmark whereas no such charge arose on an equivalent transfer to a permanent establishment within Denmark. It is apparent from the arguments made by the parties in that case that both of them were interpreting the decision in *NGI* as stipulating that the optional deferral required in order for the legislation to be proportionate was deferral until eventual realisation and not deferral by way of instalments– see for example, paragraphs [13] and [14] in the unofficial English translation. This understanding was reflected later on in the judgment, when the CJEU, after referring to *NGI*, said as follows at paragraphs [33] to [38] in the unofficial translation:

"33 However, the Kingdom of Denmark points out that the position taken by the Court in the National Grid Indus judgment, above, assumes that the assets being transferred will actually be realised. On the other hand, when this tax on unrealised capital gains is generated by assets that are not intended to be realised after their transfer, it would be proportionate to the objective being pursued, consistent with ensuring that taxation power distribution between Member States be preserved, in order to demand the recovery of tax when a company transfers its assets to another Member State.

34 Furthermore, the Kingdom of Denmark maintains that, in the absence of any harmonisation of tax regulations when transferring assets between Member States, there are no other less radical ways of achieving this objective satisfactorily.

35 As a preliminary point, please note that the scope of the principle expressed in the National Grid Indus judgment, above, is not limited to unrealised capital gains made in the territory of a Member State and realised after the transfer of the assets to another Member State (see National Grid Indus judgment, paragraphs 68 and 70).

36 Please also note that since the sum of unrealised capital gains tax on the assets is definitively determined when a company transfers those assets to another Member State, the fact that some of the said assets may not be assigned after their transfer to the host State does not in itself deprive the State of origin of the possibility of recovering that sum.

37 Indeed, since Member States have the right to tax capital gains generated when the assets in question were on their territory, they have the power to provide for a cause for this taxation other than the effective transfer, in order to guarantee the taxation of assets which are not destined for transfer, and less detrimental to the freedom of establishment than the levy at the time of transfer.

38 The fact that solutions chosen in other Member States may differ from the one the Kingdom of Denmark is likely to use does not affect the possibility of the Kingdom of Denmark receiving tax on unrealised capital gains on those assets after the transfer of an asset to another Member State, provided that the definitive amount of tax is determined at the time of said transfer."

DMC

95. In *DMC*, the national legislation in issue gave rise to the imposition of tax under German law on the transfer of interests in a German limited partnership by companies registered in Austria to a German resident company in exchange for shares in that company. No charge to tax would have arisen under German law if the disponors had remained within the German tax net following the transfer. In the latter case, the gain would have been subject to tax only as and when the shares in the transferee company were the subject of the disposal.

96. In describing the position, the CJEU refers on a number of occasions to the fact that the gains on the limited partnership interests in question remained "unrealised" notwithstanding the exchange of the limited partnership interests for shares in the German company – see, for example, each of paragraphs [20], [27], [39] and [40] – and to the fact that the "realisation" of those gains would occur only as and when the shares in the German company were sold – see, for example, each of paragraphs [39], [40] and [53]. In the view of the CJEU, the exchange of the limited partnership interests in return for the shares meant that the capital gains on the limited partnership interests "necessarily reside in the shares" (see paragraph 54]). It therefore concludes that the treatment of the taxpayer in the situation under consideration "places the [taxpayer] at a disadvantage in terms of cash flow by comparison with investors who remain liable to tax [in Germany]" (see paragraph [40]).

97. The CJEU held that the tax in question was justified by the objective of pursuing the balanced allocation of taxing powers but only in those circumstances where Germany was unable to tax the German company in respect of any part of the gains which had accrued on the limited partnership interests at the point of the exchange.

98. More significantly in the context of this decision, the CJEU, referring to the earlier decisions in *NGI* and *Portugal*, held that the relevant provision of German law, which allowed the taxpayer to pay the tax arising in respect of the exchange in five instalments, "constitutes a satisfactory and proportionate measure for the attainment of the objective of preserving the balanced allocation of the power to impose taxes between Member States" (see paragraphs [61] and [62]) provided that any security which was required of the taxpayer in relation to the instalment payments was imposed only after a prior assessment of the risk of non-recovery and not simply as an invariable requirement in all cases (see paragraphs [65] to [68]).

Germany

99. In *Germany*, the national legislation in issue provided for gains realised upon the disposal of certain capital assets to be rolled over into certain replacement assets

(and thereby deferred until the disposal of those assets) as long as the replacement assets were acquired by a permanent establishment in Germany. No such deferral was possible where the replacement assets were acquired by a permanent establishment located outside Germany.

100. The CJEU held that that difference in treatment was "liable to give rise to a cash-flow disadvantage for the taxable person wishing to reinvest [the] capital gains in order to acquire replacement assets intended for a permanent establishment located within the territory of a Member State other than the Federal Republic of Germany, in comparison with a taxable person who carries out a similar reinvestment in a permanent establishment located within German territory" (see paragraph [58]) and that that difference gave rise to a restriction on the freedom of establishment.

101. Citing both *NGI* and *DMC*, the CJEU concluded that the restriction in question was justified because of the need to preserve the balanced allocation of taxing powers between Member States but that the restriction in question was not proportionate – the legislation in question should have given the relevant taxpayer an option to defer the payment of the tax. Significantly, the CJEU continued:

"71. In the present case, the fact that either an unrealised capital gain or a realised capital gain is at issue is irrelevant in this regard. What is of importance is that, as regards one or other of those capital gains, similar transactions, carried out in the purely domestic context of a Member State, unlike a cross-border transaction, did not result in the immediate taxation of those capital gains."

LabTec

102. In *LabTec*, the national legislation in issue gave rise to the imposition of tax under German law on the unrealised gains of a limited partnership established in Germany which had transferred its assets to a permanent establishment in the Netherlands in circumstances in which, by virtue of a double tax convention between Germany and the Netherlands, the assets left the German tax net. In that case, the position under German law at the time of the transfer was that the German tax authorities, by concession, allowed the tax liability to be paid in ten instalments. (Subsequent to the transfer, German law was changed so as to provide for the tax arising in respect of such transfers to be paid in five instalments). The taxpayer challenged the instalment basis of taxation, submitting that the tax in question should be deferred until the relevant assets were realised.

103. In reaching its decision, the CJEU again referred to the fact that, whereas a transfer of the assets to a permanent establishment of the limited partnership located in Germany would not have crystallised a charge to tax on the accrued gains on the the assets until the assets were actually realised, those gains became taxable immediately upon the transfer of the assets to the Dutch permanent establishment and that "that difference in treatment is likely to result in a disadvantage in terms of liquidity" and therefore deter the establishment of the Dutch permanent establishment (see paragraph [37]). However, it noted that *NGI* had made it clear that the imposition of tax on such gains as a result of the transfer was justified by the balanced allocation of taxing powers and that "Member States entitled to tax capital gains generated when the

assets in question were on their territory have the power, for the purposes of such taxation, to make provision for a chargeable event other than the actual realisation of those gains, in order to ensure that those assets are taxed (judgment in DMC, C-164/12, EU:C:2014:20, paragraph 53 and the case-law cited)" (see paragraph [45]) .

104. The CJEU went on:

"49 As regards the recovery of such a tax, the Court has held that it was appropriate to give the taxable person the choice between, on the one hand, immediate payment of that tax, and, on the other hand, deferred payment of that tax, together with, if appropriate, interest in accordance with the applicable national legislation (judgment in Commission v Germany, C-591/13, EU:C:2015:230, paragraph 67 and the case-law cited).

50 In that context, the Court further held that account should also be taken of the risk of non-recovery of the tax, which increases with the passage of time, which may be taken into account by the Member State in question, in its national legislation applicable to deferred payment of tax liabilities (see, to that effect, National Grid Indus, C-371/10, EU:C:2011:785, paragraph 74).

51 In the present case, the question therefore arises whether a staggered recovery of the amount of tax at issue by 10 annual instalments may be a proportionate measure to attain the objective of preserving the allocation of taxation powers between the Member States."

105. The CJEU concluded that, since recovery of the tax in issue in five instalments had been held to be proportionate in *DMC*, the same must be true of recovery in 10 instalments in the case in question.

Panayi

106. In *Panayi*, the national legislation in issue gave rise to the imposition of tax under UK law on the unrealised gains of a number of trusts when, as a result of changes in the trustees of the trusts, the trusts were treated as having migrated to Cyprus. About a year after the trust was treated as having migrated, and shortly before the date on which the trustees became liable to the exit tax under the national legislation, the trustees sold the shares which had been held by the trusts at the point of the migration and reinvested the proceeds of sale in other assets. If the changes in trustees had not occurred, and the trusts had accordingly been treated as remaining resident in the UK at the time of the disposal of the shares, then the tax in respect of the disposal of the shares would have become due a year later than the exit tax in fact became due.

107. The main point at issue in the case was whether any of the EU freedoms could apply in the context of a migration of trusts, given the status of trusts under the law of England and Wales and the manner in which the trusts changed their residence. But the CJEU also was asked to consider whether, assuming that any of the freedoms did apply, the fact that the trustees were obliged to pay the whole of the tax immediately and had no option under UK law to defer the tax was a proportionate restriction on the relevant freedom.

108. The CJEU held that the trusts were able to rely on the EU freedoms and that the change of residence of the trusts engaged the freedom of establishment. Consequently, the case law relating to changes in residence by a company was applicable. It followed that the exit charge was a restriction on the freedom of establishment and that that restriction was justified by the objective of preserving the balanced allocation of taxing powers between Member States but that, in failing to provide for an option to defer the payment of tax, the national legislation was not proportionate.

A Oy

109. In *A Oy*, the national legislation in issue gave rise to the imposition of tax under Finnish law on the transfer of a permanent establishment located in another Member State to a company resident in that other Member State. In common with the other recent exit cases cited above, the CJEU held that the legislation in question constituted a restriction on the freedom of establishment which was justified by the objective of attaining a balanced allocation of taxing powers between Member States but was not proportionate in that it failed to provide for an option to defer the payment of the tax.

Main points arising from the exit tax cases

110. In my view, the following relevant points emerge from the decisions in the exit tax cases.

111. In relation to the question of realisation:

(a) all of the cases related to unrealised gains in the broadest sense of the term. By that I mean that, in a number of the cases, such as *NGI*, *Portugal 2*, *Denmark*, *LabTec* and *Panayi*, there had been no disposal of the assets in question – there had merely been a change of residence of the entity holding the assets or a movement of assets within the same entity – whereas, in other cases, the gains were technically realised but had generated no cash. For example, in both *DMC* and *A Oy*, there had been disposals in return for shares, whilst in *Germany*, there had been a disposal for cash but that cash had been reinvested in replacement assets;

(b) it is clear from the comments of Advocate General Kokott at paragraphs [39] to [41] of her opinion in *A Oy* - to the effect that, whilst incorporation is technically a realisation, it is "not a genuine realisation of the value of the permanent establishment by way of sale but merely a restructuring measure" - that, even in those cases where there had technically been a realisation, the relevant circumstances were being seen as not involving a realisation;

(c) none of the decisions states expressly that the result of the case would have been different if the case had involved realised gains. There are various references in the course of the decisions to the fact that the gains in question were unrealised and that the taxpayer in question had suffered a cash flow disadvantage as a result of the imposition of the tax liability – see, for example, *NGI* at paragraphs [37], [39] and [40], *Portugal 2* at paragraphs [27] and [28], *Denmark* at paragraphs [24], [29] and [32] and *LabTec* at paragraphs [36] and [37]. One might infer from those references that the decision might have been different if the case had involved realised gains. However, those references might equally lead to the inference that the critical factor was not so much that the relevant gains were unrealised but rather the fact that the imposition of tax in those circumstances placed the company at a cash flow disadvantage relative to the similar circumstances with which those circumstances were being compared – that is to say, circumstances in which no cross-border element existed;

(d) *Germany* related to circumstances in which assets had been realised, albeit that the proceeds of realisation had been reinvested in replacement assets. In paragraph [71] of the decision, the CJEU might have said that, because it was dealing with circumstances in which the proceeds of sale of the initial assets had been reinvested in the replacement assets, the circumstances should be equated to the circumstances pertaining in the cases relating to tax on unrealised gains. Had it done so, then *Germany* would have been similar to *DMC*, in that, in both cases, the CJEU would have been treating, as "unrealised", the profits arising on a realisation which did not ultimately give rise to cash proceeds. However, the CJEU instead chose to say expressly that whether or not the circumstances under consideration related to realised or unrealised profits was irrelevant. All that mattered was that the national legislation in question was not treating similar transactions in the same way purely because one of them involved a cross-border element;

(e) in *Panayi*, although the gains in respect of the shares were unrealised at the point of migration, the shares were the subject of a disposal before the date on which the exit tax became due. The CJEU expressly rejected the proposition that that might affect its conclusion that the existing legislation was not justified. It said:

> "That finding cannot be called into question by the fact that, in the circumstances of the main proceedings, the gains were made after the establishment of the amount of the tax, but before that tax became payable, given that the disproportionality of the legislation at issue in the main proceedings is due to the fact that that legislation makes no provision for the taxpayer being able to defer the time when the tax payable is paid" (see paragraph [60]).

Thus, the fact that the trustees had the ability to pay the exit tax when that tax became due (as a result of the post-exit disposal) was not relevant to the question of whether the charge to tax was disproportionate. As noted in paragraph [56] of the opinion of Advocate General Kokott in *Panayi*, the existing regime was nevertheless still disproportionate because the trustees were obliged to pay the tax one year earlier than they would have been if no change in residence had occurred and were therefore being treated disadvantageously in comparison with trusts which remained resident in the UK and then made the disposal; and

(f) in *A Oy*, the CJEU held that the mere fact that the national legislation in question, in conformity to Article 10(2) of Council Directive 90/434/EEC (the "Mergers Directive") provided for a tax credit to be given to the taxpayer against the Finnish tax for the tax which, but for the Mergers Directive, would have been payable in the jurisdiction of the permanent establishment did not affect its conclusion that the national legislation in question was disproportionate "given that the disproportionality of [the national legislation in question] does not derive from the amount of tax due but from the fact that it makes no provision for the taxpayer to defer the time at which it is collected" (see paragraph [38]). This is the equivalent of the finding in *Panayi* to the effect that the fact that the taxpayer had realised the assets in question by the time that the exit tax became due did not affect the conclusion that requiring the immediate payment of tax because of the exit was disproportionate.

112. In relation to the basis of deferral:

(a) the only exit tax case which refers expressly to deferral until realisation of the assets in question is *NGI* at paragraphs [68] et seq.;

(b) in *Portugal 2*, the CJEU does not at any point say expressly that, when it is referring to deferral, it is referring to deferral until realisation (as opposed to deferral by allowing for the payment of tax by instalments). Whilst it might be inferred from the references to *NGI* in paragraphs [31] and [32] of the decision in *Portugal 2* that that is what the CJEU intended, the references in paragraphs [24] of Advocate General Mengozzi's opinion in that case to the deferral of tax until realisation of the assets, the arguments made by the Governments of various Member States (which are recorded in paragraph [33] of that opinion) to the effect that the decision in *NGI* should be confined to financial assets and should not extend to assets which are not intended to be realised and the suggestion by the Advocate General in paragraph [68] of his opinion to the effect that a proportionate justification for the restriction might entail instalment payments instead of deferral until realisation suggest that the references to deferral in the CJEU decision in *Portugal 2* might well be to a basis of deferral other than deferral until realisation;

(c) in *Denmark*, the CJEU in paragraphs [33] to [38] expressly states for the first time that the deferral principle laid down in *NGI* does not in all cases require deferral until the realisation of the assets in question and that an alternative basis of deferral may also be acceptable;

(d) *DMC* was the first exit tax case where the national legislation in question already provided for a deferred payment of tax. The deferred payment of the tax for which the national legislation provided was an instalment payment basis, a basis not envisaged by the decision of the CJEU in *NGI* but clearly discussed during the course of the proceedings in

Portugal 2 and then flagged by the CJEU in *Denmark* as a possible proportionate restriction on the freedom;

(e) in *Germany*, the CJEU did not make any comment on the fact that, whereas it had stipulated in *NGI* that, in order to be proportionate, the legislation in question needed to provide for an option to defer until realisation, it had stipulated in *DMC* that legislation providing an option to defer by making payments in instalments was proportionate. Instead, it simply referred to both of those cases together as stipulating that an option for deferral was necessary in order for the legislation to be proportionate (see paragraph [67]);

(f) similarly to *DMC*, *LabTec* was a case where the existing practice of the German tax authorities provided for the tax to be deferred and stipulated that the deferral was on an instalment payment basis. However, that instalment basis was different from the one pertaining in *DMC* as it allowed for the instalments to be paid over ten years and not simply five. The CJEU, following paragraphs [72] and [73] of the opinion of Advocate General Jääskinen in that case, noted that, since a five-year instalment payment basis had been held to be proportionate in *DMC*, it followed that a ten-year instalment payment basis must also be proportionate. It is clear from the observations in paragraphs [67] to [69] of the opinion of Advocate General Jääskinen in *LabTec* that it is now well-established that a Member State is not required to provide for deferral on a realisation basis and that an instalment payment basis of deferral is a proportionate alternative;

(g) in common with its decision in *Germany*, in *Panayi*, the CJEU again drew no distinction between deferral until realisation and deferral by way of a payment in instalments (see paragraph [57]); and

(h) in *A Oy*, in describing the need for the national legislation to provide an option for deferral, the CJEU again did not distinguish between deferral until realisation and deferral by way of the payment of instalments (see paragraph [37]). It is true that, in paragraphs [35] and [36] of its judgment, the CJEU referred to the administrative burden necessarily associated with tracing the transferred assets when it refers to deferral, but there are two reasons why this does not necessarily mean that the CJEU is contemplating that deferral until realisation is the only deferral option. The first is that, in the paragraphs in question, the CJEU is merely purporting to summarise the previous case law – *NGI* in paragraph [35] and *Germany* in paragraph [36] – and the second is that, even in the case of deferral by way of the payment of instalments, there will generally be provision for acceleration of the instalments in the case of a realisation – as is the case in Schedule 3ZB to the TMA – and therefore tracing remains a relevant consideration in that case too. It is clear from paragraphs [38], [42] and [44] of the opinion of Advocate General Kokott in *A Oy* that she considered that deferral by way of the payment of instalments over five years would be proportionate.

Is the restriction proportionate?

113. I now return to the question posed in paragraph 84 above, which is whether Section 171 in its existing form, which has the effect of requiring the Appellant to pay all of the tax arising in respect of the 2014 Disposal on the same date or dates as the Appellant was required to pay the corporation tax arising on the rest of its taxable profits in respect of the accounting period in which the 2014 Disposal occurred, is proportionate.

114. The Respondents submit that it is, because:

> (a) this is a case involving realised gains and the existing CJEU case law which stipulates that proportionality requires a Member State to offer an option to defer payment of the tax relates solely to unrealised gains; and
>
> (b) in similar vein, since the Appellant realised cash from the disposal, it had the ability to pay all of the tax arising from the disposal immediately.

115. As regards the point set out in paragraph 114(a) above, I agree that each of the exit tax cases related to "unrealised" gains in the broadest sense of the term. A number of them – such as *NGI*, *Portugal*, *Denmark*, *LabTec* and *Panayi* - concerned gains which were "unrealised" in the purest sense, in that they involved no more than a change in residence of the same entity or a movement of assets within the same entity. However, as noted in paragraphs 111(a) and 111(b) above, others of them involved "unrealised" gains in a more nuanced sense.

116. Nevertheless, although the exit tax cases that have been decided to date can therefore all be seen as involving unrealised gains in the broad sense described above, the CJEU has never expressly said that the principles which it has laid down in the exit tax cases should be limited to circumstances involving unrealised gains. On the contrary, the CJEU could not have been clearer in saying precisely the opposite of that in paragraph [71] of its decision in *Germany* – see paragraphs 101 and 111(d) above. It is apparent from that statement that the relevant issue is not whether the gains in question have been realised or remain unrealised but rather whether, in the case under consideration, the fact that another Member State is involved in the matter under consideration has given rise to a tax liability which would not have arisen in wholly domestic circumstances that are otherwise equivalent. Similar sentiments were expressed by the CJEU at paragraph [60] in *Panayi* and Advocate General Kokott at paragraph [56] of her opinion in *Panayi* in relation to the acceleration of the tax which had occurred in that case by reason of the prior migration of the trusts and by the CJEU at paragraph [38] in *A Oy* in relation to the tax credit under the Mergers Directive (see paragraphs 111(e) and 111(f) above).

117. On that basis, I consider that the principles laid down in the exit tax cases have direct application to the 2014 Disposal notwithstanding the fact that the Appellant received cash in return for the shares in Galleon. This is because, by virtue of the fact that the relevant Disposal was made to JTIH, the Appellant became liable to pay tax

which it would not have become liable to pay if JTIH had been within the UK tax net at the time of the 2014 Disposal.

118. In any event, I believe that the Respondents are wrong in saying that the gain which arose as a result of the 2014 Disposal should be regarded as a realised gain simply because the Appellant received cash consideration for the Galleon shares from JTIH. It is worth noting that the JT Group as a whole – including, in this particular context, the sub-group headed by JTIH – is a single economic unit. Thus, from the commercial perspective, transfers within that unit cannot be seen as realisations in any meaningful sense. (The fact that the question of what amounts to a realisation should be considered from the commercial perspective, as opposed to a rigid legalistic perspective, is demonstrated by cases such as *DMC*, *A Oy* and *Germany*, each of which involved a disposal of the original asset either in return for consideration in kind or in return for cash which was then reinvested in a replacement asset.)

119. The conclusion that the 2014 Disposal did not give rise to a realisation is particularly relevant when one considers that the freedom of establishment which has been infringed by Section 171 is the freedom of establishment of JTIH and not the freedom of establishment of the Appellant. In what meaningful sense can it be said that JTIH "realised" the accrued gain on the Galleon shares when those shares were transferred to it by the Appellant? I would suggest that it did not. So far as JTIH was concerned, that accrued gain remained just as unrealised after the 2014 Disposal as it did before that Disposal.

120. In addition, the fact that a group of companies should be regarded as a single integrated economic unit is recognised by the Respondents themselves when they say the following at paragraph 45305 of their Capital Gains Tax Manual:

"The no gain/no loss rule in TCGA92/S171(1) ensures that assets can generally be moved around a group of companies without any immediate capital gains consequences[.]). This recognises that business activities carried on within the overall economic ownership of a corporate group, within the charge to corporation tax, should, in broad terms, be tax neutral. This is achieved by fixing both the consideration received for the asset by the transferor and the consideration given for the asset by the transferee. The transferor has neither chargeable gain nor allowable loss. The transferee effectively takes over the transferor's capital gains cost, augmented by indexation allowance as appropriate….Therefore a chargeable gain or allowable loss will accrue only when an asset is disposed of outside the group (or the part of the group that is chargeable to corporation tax on chargeable gains) and that gain or loss will reflect the economic gain or loss throughout the group's period of ownership…"

and has been recognised by HM Treasury when it said the following in its consultation document of February 2010 in relation to simplifying the chargeable gains tax rules:

"1.8 As far as possible, the capital gains rules for groups of companies are intended to recognise that a group of companies operates as a single economic entity. This principle underpins the 'no-gain-no-loss' asset transfer rule [f/n: Section 171, Taxation of Chargeable Gains Act 1992], which allows companies within the same corporate group to transfer assets between one another on a tax-neutral basis."

121. As regards the point set out in paragraph 114(b) above, it is clear from paragraph [60] of the CJEU decision in, and the facts of, *Panayi* that whether or not the relevant taxpayer has sufficient cash to discharge the whole of the tax liability immediately is irrelevant. All that matters is whether the relevant taxpayer is being treated differently from the way in which it would have been treated if it and the assets had remained within the tax net of the Member State in question. If it is, then the principles laid down in the exit tax cases are applicable, regardless of whether or not it has the cash to discharge the whole of the tax liability immediately.

122. In conclusion on this question, I consider that the fact that the Group Transfer Rules currently have the effect of crystallising an immediate liability to pay tax on the whole of the accrued gain when the Appellant transferred the shares in Galleon to JTIH is not proportionate, for the reasons set out in the various exit tax cases described in paragraphs 86 to 112 above.

123. For completeness, because it was raised in argument by the Respondents at the hearing, I should at this juncture make it clear that the fact that the Appellant in this case was entitled to make an application under Section 55 of the TMA for the postponement of the tax arising in respect of the 2014 Disposal pending the determination of the 2014 Appeal and that such application has been successful is in my view of no relevance whatsoever in this context.

124. In the first place, any such application might not have been successful – it is for the Respondents to decide on the extent to which any such application should be granted (subject to a right of the relevant appellant to appeal to the First tier Tribunal) – and therefore it did not give rise to an untrammelled right of deferral for the Appellant. In that respect, it was similar to paragraph 6(4) of the Gesetz über die Besteuerung bei Auslandsbeziehungen (Law on foreign transaction tax), of 8 September 1972 which was relevant in *Wächtler*. That provision limited deferral to circumstances in which "immediate recovery would have consequences which would be difficult for the taxpayer to bear" and it was consequently described by the CJEU in the (slightly different) context pertaining in *Wächtler* as not being proportionate (see *Wächtler* at paragraph [68]).

125. In addition, the right to apply for a postponement of the tax under Section 55 of the TMA arises only in circumstances where an appeal has been made against an assessment made in accordance with the UK legislation in question. In order for an option to defer tax to be compatible with EU law, it would need to have been made available to the Appellant regardless of, and logically prior to, the existence of any appeal against an assessment made in accordance with the UK legislation.

How should the national court respond in the case of a restriction on an EU freedom which is disproportionate?

126. As noted by Henderson J in *Prudential* at paragraph [106], once it is established that existing UK legislation infringes EU law, the obligation of the national court is to apply the UK legislation in such a way as to remove that infringement. This follows from Section 2(4) of the ECA, which provides that "any enactment passed or to be

passed…shall be construed and have effect subject to" the UK's obligations under the TFEU which have been incorporated into the UK legislation by Section 2(1) of the ECA.

127. It is common ground that there are two possible ways of achieving this outcome. One is the application of the principle of conforming interpretation – pursuant to which the UK legislation is construed in such a way as to render the UK legislation EU law-compliant - and the other is to disapply a particular provision of the UK legislation either in whole or in part so as to ensure that the UK legislation is EU law-compliant. The former takes precedence over the latter in that disapplication occurs only in circumstances where a conforming interpretation is not possible.

128. Before addressing which of these alternative approaches I believe should apply in this case, I need to make some general observations about the doctrine of conforming interpretation and how it has been applied in other cases.

The doctrine of conforming interpretation

129. At paragraph [8] in *Marleasing*, the CJEU explained (in the context of an EU directive) that the national court needs to construe national legislation so far as possible in accordance with EU law. The leading domestic authority on the interpretation of the UK legislation in the light of EU law is the House of Lords decision in *Litster*. It is apparent from that decision (and several others which have followed it) that the principles of construction which operate in this context extend much wider than the principles of construction which operate in the purely domestic context – see *IDT* at paragraph [82]. It is also clear that it is for the national court and not the CJEU to perform this role – see *IDT* at paragraphs [79] and [81].

130. In *IDT*, at paragraph [85], Arden LJ (with whom the other members of the Court of Appeal agreed) held that the exercise of conforming interpretation in the context of EU law is the same as the exercise of conforming interpretation in the context of human rights, as Section 3 of the Human Rights Act 1998 (the "HRA") requires that UK legislation is to be construed "so far as possible" in a manner which is compatible with the European Convention on Human Rights (the "ECHR"), and is therefore on all fours with the approach described in *Marleasing*.

131. Thus, it is helpful to start this section of this decision by setting out what Lord Nicholls in the House of Lords in *Ghaidan* said about the approach to be taken in determining the limits of the doctrine of conforming interpretation. Lord Nicholls said the following:

"[30] From this it follows that the interpretative obligation decreed by s 3 is of an unusual and far-reaching character. Section 3 may require a court to depart from the unambiguous meaning the legislation would otherwise bear. In the ordinary course the interpretation of legislation involves seeking the intention reasonably to be attributed to Parliament in using the language in question. Section 3 may require the court to depart from this legislative intention, that is, depart from the intention of the Parliament which enacted the legislation. The question of difficulty is how far, and in what circumstances, s 3 requires a court to depart from the intention of the enacting Parliament. The answer to this question depends upon the intention reasonably to be attributed to Parliament in enacting s 3.

[31] On this the first point to be considered is how far, when enacting s 3, Parliament intended that the actual language of a statute, as distinct from the concept expressed in that language, should be determinative. Since s 3 relates to the "interpretation" of legislation, it is natural to focus attention initially on the language used in the legislative provision being considered. But once it is accepted that s 3 may require legislation to bear a meaning which departs from the unambiguous meaning the legislation would otherwise bear, it becomes impossible to suppose Parliament intended that the operation of s 3 should depend critically upon the particular form of words adopted by the parliamentary draftsman in the statutory provision under consideration. That would make the application of s 3 something of a semantic lottery. If the draftsman chose to express the concept being enacted in one form of words, s 3 would be available to achieve Convention-compliance. If he chose a different form of words, s 3 would be impotent.

[32] From this the conclusion which seems inescapable is that the mere fact the language under consideration is inconsistent with a Convention-compliant meaning does not of itself make a Convention-compliant interpretation under s 3 impossible. Section 3 enables language to be interpreted restrictively or expansively. But s 3 goes further than this. It is also apt to require a court to read in words which change the meaning of the enacted legislation, so as to make it Convention-compliant. In other words, the intention of Parliament in enacting s 3 was that, to an extent bounded only by what is "possible", a court can modify the meaning, and hence the effect, of primary and secondary legislation.

[33] Parliament, however, cannot have intended that in the discharge of this extended interpretative function the courts should adopt a meaning inconsistent with a fundamental feature of legislation. That would be to cross the constitutional boundary s 3 seeks to demarcate and preserve. Parliament has retained the right to enact legislation in terms which are not Convention-compliant. The meaning imported by application of s 3 must be compatible with the underlying thrust of the legislation being construed. Words implied must, in the phrase of my noble and learned friend Lord Rodger of Earlsferry, "go with the grain of the legislation". Nor can Parliament have intended that s 3 should require courts to make decisions for which they are not equipped. There may be several ways of making a provision Convention-compliant, and the choice may involve issues calling for legislative deliberation."

132. As for the other Law Lords in *Ghaidan*, Lord Steyn held that the application of Section 3 of the HRA did not depend on the linguistic features of the legislation and that Section 3 was the prime remedy where legislation was not compatible with the ECHR but declined to formulate precise rules as to when Section 3 of the HRA could be used and Lord Rodger held that, in deciding how to interpret the legislation, the courts should not produce a meaning which departed substantially from a fundamental feature or cardinal principle of the legislation and that courts should be less ready to interpret legislation in a manner to be compatible with ECHR rights where there would be important practical repercussions arising out of that which the courts are not equipped to evaluate.

133. Arden LJ in *IDT* noted the following in relation to the application of the decision in *Ghaidan* in the context of compliance with EU law:

"[88] The decision in the Ghaidan case is a powerful statement of the court's preparedness to interpret legislation so that it is compatible with human rights. The speeches, all of which repay careful study, contain extremely valuable guidelines. The House of Lords has recognized the force of the mandatory obligation in s 3. However, s 3 permits only interpretation, not the rewriting of legislation which goes beyond mere interpretation. I would add that in s 3 the words "in a way which is compatible with the Convention rights" make it clear that the courts have a choice as to precisely how to interpret the legislation to achieve the objective in s 3, namely that, where possible, the legislation should be compatible with human rights.

[89] The critical point made by the House of Lords in the *Ghaidan* case can be found in the passage from the speech of Lord Nicholls which I have set out above. Lord Nicholls accepts that the effect of interpretation in accordance with s 3 of the 1998 Act may be to change the meaning of the legislation but, as he explains, the meaning adopted by the court must not conflict with a fundamental feature of the legislation. He adopts the words of Lord Rodger that the interpretation chosen by the court must "go with the grain of the legislation". Lord Nicholls, Lord Steyn and Lord Rodger all accepted that there would be occasions when the courts could not adopt an interpretation that would make the legislation compatible with Convention rights because that would involve making policy choices which the court was not equipped to make (see [33] to [35] per Lord Nicholls, [49] per Lord Steyn and [115] per Lord Rodger). It is also clear from the *Ghaidan* case that the interpretation of legislation under s 3 or the *Marleasing* principle may involve a substantial departure from the language used though it will not involve a departure from the fundamental or cardinal features of the legislation. It is possible to read the legislation up (expansively) or down (restrictively) or to read words into the legislation. The question of whether s 3 can be applied does not depend on whether it is possible to solve the problem by a simple linguistic device.

[90] Lord Nicholls also makes it clear that there is no need to find that the statutory language should be ambiguous before interpreting the legislation so as to be compatible with Convention rights. He does not deal expressly with the possibility of Parliament making express provision in contravention of Convention rights. Mr Lasok refers to such a possibility in the context of legislation designed to implement Community legislation in his argument before us (para 60, above). So he submits that Parliament might use language which made it clear that it did not intend VAT to be imposed in a situation in which it was chargeable under the Sixth Directive. The situation which he postulates is not one in which Parliament has specifically stated that it is legislating in a manner which departs from the Sixth Directive. In the situation postulated, as it seems to me, the court's interpretative duty, whether arising under Community law or arising under s 3, is not excluded. In determining whether the solution is one of interpretation or impermissible law-making, the relevant test remains whether the interpretation that would be required to make the statute in question Convention-compliant or in this case, EU law-compliant, would involve a departure from a fundamental feature of the legislation. As I see it, the latter cannot be the case where the effect of the interpretation would be to bring the statute into conformity with the objectives of the Sixth Directive in the absence of clear statutory language to the effect that Parliament intended that there should not be such conformity."

134. In *Vodafone 2*, the Court of Appeal was addressing the compatibility of the motive test in the UK's controlled foreign companies ("CFC") legislation with the EU freedom of establishment. A preliminary issue which arose in that case was whether the national court was limited in its application of a conforming interpretation just to the provision of the UK's CFC legislation in which the motive test itself was set out

or whether other parts of the UK's CFC legislation were also open to a conforming interpretation. Sir Andrew Morritt C emphatically rejected the former position, noting that "the obligation of the national court is to examine the whole of the national law to consider how far it may be applied so as to conform to enforceable Community rights" (see paragraph [34]). He also noted that the fact that the application of a conforming interpretation necessarily had a retrospective effect was no objection to the process (see paragraph [56]).

135. Whilst retrospectivity is an inevitable consequence of the doctrine of conforming interpretation, there is an important constitutional issue to be borne in mind before a UK court exercises that doctrine. This is that it is not the function of judges to legislate. Where it is clear from existing CJEU and UK law how a provision of UK law which imposes a disproportionate restriction on an EU freedom needs to be interpreted in order to remove that restriction or to render that restriction proportionate and therefore EU law-compliant, then the UK courts may do that. But if that is not the case, then the UK courts can give effect to Section 2(4) of the ECA only by disapplying such parts of the UK legislation as will have the effect of removing the restriction or rendering the restriction EU law-compliant and leave to Parliament the role of passing any legislation which may be needed to remedy the position consequent to that decision.

136. This was a point made by Lord Nicholls in relation to the HRA in *Ghaidan* at paragraph [33], when he noted that "[t]here may be several ways of making a provision Convention-compliant, and the choice may involve issues calling for legislative deliberation". It was also reflected in the judgment of Lord Scott in *Fleming* although *Fleming* was technically not a case involving conforming interpretation as such. I will say more below about the judgments in *Fleming*.

137. In *Prudential*, Henderson J had to consider how the national court should respond to the decision in *FII 2* to the effect that certain provisions of the UK legislation relating to the taxation of foreign source dividends did not comply with EU law. The approach which Henderson J adopted in paragraphs [85] et seq. of his decision involved two stages. The first involved identifying the defects in the existing UK legislation and the second involved considering what was required in order to eliminate those defects. In determining the amendment to the existing UK legislation which was to be made at the second stage in the process, Henderson J's approach was to identify the most minor amendment to the UK legislation which would make the UK legislation EU law-compliant – see paragraph [148].

138. In that part of his decision, Henderson J was dealing with the election regime in Section 438(6) of the Income and Corporation Taxes Act 1988 (the "ICTA") and had the choice of providing for the relevant taxpayers to be able to elect to make foreign source portfolio dividends exempt (so that the election in respect of such dividends matched the election which was available in relation to UK source portfolio dividends) or of providing for the relevant taxpayers to be able to elect to make the foreign source portfolio dividends taxable but carrying a tax credit sufficient to secure compliance with Article 63 of the TFEU. Henderson J selected the latter of those two

options on the basis that "the grant of an exemption might go further than would be necessary to remedy the breach of EU law".

139. A similar view was expressed by the Court of Appeal in *Routier* at paragraph [93]. Arden LJ noted that "[w]here a statute does not fulfil the requirements of EU law, the courts may interpret it so far as possible so that it complies with EU law (and no further: *R (Hurst) v London Northern District Coroner* [2007] 2 AC 189, [52])".

140. From the above cases, I believe that the following principles and limitations are relevant in the application of the doctrine of conforming interpretation:

(a) the obligation of the UK courts to construe UK legislation consistently with EU law is broad and far-reaching;

(b) it is not constrained by conventional rules of construction (see Lord Oliver in *Pickstone* at page 126B);

(c) it does not require ambiguity in the legislative language (see Lord Nicholls in *Ghaidan* at paragraph [32]);

(d) it is not an exercise in semantics or linguistics (see Lord Nicholls, Lord Steyn and Lord Rodger in *Ghaidan* at paragraphs [31], [35], [48], [49] and [110] to [115]);

(e) it permits departure from the strict and literal application of the words which the legislature has elected to use (see Lord Oliver in *Litster* at page 577A and Lord Nicholls in *Ghaidan* at paragraph [31]);

(f) it permits the implication of words necessary to comply with EU obligations (see Lord Oliver in *Litster* at page 577A);

(g) the precise form of the words to be implied does not matter (see Lord Rodger in *Ghaidan* at paragraph [122] and Arden LJ in *IDT* at paragraph [114]);

(h) any provision within the UK legislation can be the subject of the conforming interpretation and not just the provision which gives rise to the infringement of EU law (see Sir Andrew Morritt C in *Vodafone 2* at paragraph [34]);

(i) it is inevitable that the application of a conforming construction will have a retrospective effect. That "is no more an objection in the field of conforming interpretation than it is in the case of domestic statutory construction" (see Sir Andrew Morritt C in *Vodafone 2* at paragraph [56]);

(j) on the other hand, the construction given by the UK courts must go with the grain of the legislation and not conflict with a fundamental feature of the legislation (see Lord Nicholls and Lord Rodger in *Ghaidan* at paragraphs [33] and [111] et seq.);

(k) in addition, the UK courts may interpret the legislation so far as possible so that the legislation is EU law-compliant but no further (see Arden LJ in *Routier* at paragraph [93]); and

(l) finally, the exercise of the interpretive obligation must not offend against the principle of legal certainty and cannot require the national court to make a decision for which it is not equipped or give rise to important practical repercussions which the court is not equipped to evaluate (see Lords Nicholls and Lord Rodger in *Ghaidan* at paragraphs [33] and [111] et seq.).

The submissions of the parties in relation to conforming interpretation

141. In relation to the question of whether or not the doctrine of conforming interpretation can be applied in this case and, if it can, the appropriate amendment to be made to the UK legislation, the Respondents submit that the exit tax cases summarised in paragraphs 86 to 112 above demonstrate that, if the existing restriction on the freedom of establishment which arises as a result of the operation of the Group Transfer Rules is disproportionate, then it is appropriate to apply the doctrine of conforming interpretation to the provisions of Section 59FA of, and Schedule 3ZB to, the TMA to allow the intra-group disponor of an asset to a transferee outside the UK tax net in circumstances where an EU freedom would be restricted by an immediate charge to tax an option to pay the tax which arises as a result of the intra-group disposal in instalments, in the same way as those provisions currently apply to exit taxes.

142. In response, the Appellant contends that it is clear from the decision in *NGI* that the CJEU has held in the past that allowing for an option of deferral until realisation is a proportionate restriction on the relevant EU freedom in the context of an exit tax. Whilst it is true that the CJEU has also held - in *DMC* and *LabTec* - that allowing for an option of deferral in instalments is also a proportionate restriction on the relevant EU freedom, both of those cases were ones where the existing national legislation already provided for an option to defer payment of the tax on an instalment basis and the CJEU merely accepted that that existing approach was a proportionate restriction on the relevant EU freedom. In contrast, this case relates to national legislation which does not already contain a proportionate restriction on the relevant EU freedom. The national court is therefore not obliged to assume that the form of restriction which was held to be proportionate in *DMC* and *LabTec* should necessarily be followed in this case.

143. In addition, says the Appellant, Section 171 allows the transferee in the case of an intra-group disposal of assets which remain within the UK tax net to benefit from deferral until the asset leaves the group or sub-group. It follows that, insofar as it is open to the national court to choose between rival restrictions to the UK legislation, there are at least two deferral options which have been held to be proportionate and the option of deferral until the asset leaves the group or sub-group is closer to the position pertaining where the transferee in an intra-group disposal remains within the UK tax net than the option of deferral by paying in instalments.

144. The Respondents' reply to that argument is twofold.

145. First, the Respondents submit that the exit tax cases establish that it is unnecessary to put an intra-group transferee which is outside the UK tax net but

located in a Member State in an identical position to an intra-group transferee which is within the UK tax net. In all of those cases, it was held to be proportionate to establish the tax liability at the time when the assets ceased to be within the tax net of the Member State concerned (even though no such tax liability would have arisen at that time if the assets had remained within the tax net of the Member State concerned). In addition, the CJEU has already held in *DMC* and *LabTec* that it is proportionate for that tax liability to be paid in instalments and that there is no need for it to be deferred until realisation. Thus, say the Respondents, parity of reasoning suggests that there is no reason why, in the case of an intra-group disposal to a transferee outside the UK tax net but within a Member State, the tax liability in question should not be calculated immediately and then paid in instalments. The fact that a transferee within the UK tax net would have been able to defer its liability until the relevant asset left the group or sub-group is neither here nor there.

146. Secondly, the Respondents point out that the CJEU and UK case law shows that, where there is more than one restriction on a freedom which is proportionate, the restriction which needs to be adopted by way of conforming interpretation is the one which involves the least violence to the national legislation. If that were not the case, then the provisions for deferred instalment payments which were endorsed by the CJEU in *DMC* and *LabTec* would not have been endorsed (because they did not provide for deferral until realisation) and the CJEU would not have made the statements which it did in paragraphs [33] to [38] in *Denmark.*

147. In addition, it is apparent from the statement made by Arden LJ in *Routier* at paragraph [93] and the decision made by Henderson J in *Prudential* at paragraph [148] that, where UK legislation infringes an EU freedom and there is more than one possible way of amending the UK legislation in order to render the restriction on the relevant EU freedom proportionate, it is within the competence of the UK courts to choose one of those measures and, in exercising that choice, the UK courts are obliged to select the measure which preserves the national legislation to as great an extent as possible whilst ensuring that the national legislation complies with EU law.

148. The Appellant submits that, on the contrary, it is the EU freedom, and not the national legislation, to which the least violence should be done in applying a conforming interpretation. In other words, where an EU freedom is restricted by the existing national legislation, the appropriate proportionate response to that is to amend the existing national provisions in such a way as to ensure that the existing national provisions, as so amended, do the least harm to the applicable EU freedom.

149. In this regard, both parties claim that the references in *NGI* at paragraph [65] and *Portugal 2* at paragraph [32] to deferral's being "less restrictive" than the measure that was under consideration in the relevant decision support its case. The Appellant alleges that, in the context of only two options, "less" means "least" whilst the Respondents say that "less" means no more and no less than "less".

150. The Respondents add that further support for their proposed conforming interpretation can be found in Council Directive (EU) 2016/1164 (the "Tax Avoidance Directive"), which was passed on 12 July 2016 and deals, at Article 5,

with exit taxes. It is clear from the terms of that Directive that the Member States have agreed that the option to defer the payment of exit taxes over five instalments (together with interest on the deferred amounts) is proportionate in the case of exit taxes. Although it is apparent from Recital (10) to the Directive that Article 5 of the Directive does not cover disposals of assets within a group and is confined to exit taxes, the Respondents claim that it would be perverse if the proportionate restriction in the case of intra-group disposals of assets were to be more generous to the disponor than the restriction upon which the Member States have agreed in relation to exits. The Respondents say that, even if one accepts that an intra-group disposal does not involve a realisation and is therefore to be equated to the exit scenarios, there is no reason why the former should be treated more favourably than the latter.

151. They add that applying a conforming interpretation to the TMA in the manner described in paragraph 141 above would not go against the grain of the UK legislation or be contrary to a cardinal feature of the UK legislation. On the contrary, the thrust of the UK legislation (and the Group Transfer Rules) is that, in relation to an intra-group disposal to a transferee which is outside the UK tax net, an immediate tax liability should arise. In contrast, the conforming interpretation which is being suggested by the Appellant does go against the thrust of the existing UK legislation in that there is no provision in the UK legislation which provides for a tax liability to be calculated and then deferred until a later realisation. There are provisions which allow for an accrued gain to be rolled over or held over, but not for a tax liability to be treated in that way.

152. The Appellant submits that the conforming interpretation which it has suggested is both straightforward – it entails providing within Section 171 itself that, where the section is precluded from applying to an intra-group disposal solely because the transferee is not within the UK tax net, then the disponor should have the option to defer paying the tax until the asset in question leaves the relevant group or sub-group – and also in line with the thrust (and cardinal feature) of the legislation - which is to enable any tax arising on an intra-group disposal to be capable of deferral until the asset leaves the group or sub-group in question. The Appellant adds that the conforming interpretation of the TMA provisions suggested by the Respondents is convoluted and would involve considerable amendment to the relevant provisions of the TMA in order to operate effectively.

153. Finally, the Appellant says that, if there is more than one conforming interpretation which might be applied in any particular case, then the constitutional principle to which Lord Nicholls referred in *Ghaidan* shows that it is not within the competence of the UK courts to choose between those measures because, by doing that, the UK courts would themselves be legislating. In this case, says the Appellant, even if the Respondents are right in saying that allowing for an instalment payment basis of deferral is the correct approach to be adopted, there is no clarity over the precise basis on which that instalment payment basis of deferral is to operate. For example, whilst the Respondents have submitted that the existing legislation in Schedule 3ZB to the TMA should simply be extended to include the taxes arising from intra-group disposals to transferees outside the UK tax net but within another Member State, who was to say whether that approach or a five year or ten year

instalment basis approach or some other instalment basis approach (such as the one outlined in Article 5 of the Tax Avoidance Directive) should be adopted?

154. The Respondents reply that this case is not one in which a UK court is being asked to legislate. In this case, there is an existing provision for an immediate tax liability to be calculated and the only issue is whether EU law requires the UK legislation to have provided for the taxpayer to have an option to defer paying the tax until the asset leaves the group or sub-group or should be treated in exactly the same way as an exit tax. As such, this is not a case where applying a conforming interpretation is beyond the competence of the national court.

Conclusion in relation to conforming interpretation

Which party's conforming interpretation?

155. If the only issue which arose in relation to this question were to be which of the parties' respective proposed conforming interpretations is to be preferred, then I would have no hesitation in saying that, in my view, the preferred conforming interpretation is the one which has been proposed by the Respondents.

156. I would start by making the point that, even if the Appellant were to be right in saying that the tax liability in this case should be deferred until the shares leave the group or sub-group, the group or sub-group would still not be in the same position as a group or sub-group which benefits from the Group Transfer Rules in their present form in the case of a disposal to a transferee which is within the UK tax net. This is because, as noted elsewhere in this decision, where Section 171 applies, the transferee assumes the base cost of the disponor and the tax liability itself does not arise until the later date when the asset leaves the transferee's group or sub-group. In contrast, even if the tax liability arising on an intra-group disposal to a transferee which is outside the UK tax net were to be deferred until the asset left the group or sub-group, the tax liability would still have crystallised at the point when the asset was the subject of the relevant intra-group disposal. Thus, it would be the obligation to pay the tax and not the crystallisation of the tax liability which would be deferred. This distinction is a meaningful one in at least three respects.

157. First, as has been mentioned in a number of the exit tax cases, the fact that the tax liability has crystallised means that it would be unaffected by any subsequent diminution in the value of the asset which might occur following that event. In this respect, see, for example, the reasoning of the CJEU in *NGI* at paragraphs [56] et seq.. This is very different from the manner in which the Group Transfer Rules operate in relation to the intra-group disposal of an asset to a transferee which is within the UK tax net. In the latter case, any subsequent diminution in the value of the asset does affect the quantum of the tax liability. To take an obvious example, if an asset with a base cost of 100 were to be transferred intra-group at a time when it had a value of 500 and then fall in value back to 100 by the time that it left the group or sub-group, there would be no tax to pay in circumstances where the transferee was within the UK tax net but tax on 400 to pay in circumstances where the transferee was not. As the CJEU has noted, this difference is an inevitable consequence of the balanced

allocation of taxing powers between Member States. It would not be appropriate in this example for the UK to be exposed to any diminution in the value of the asset once the asset has left the UK.

158. Secondly, the fact that no charge to tax arises in the case of an intra-group disposal where the asset remains within the UK tax net, whereas one arises in a case where the asset leaves the UK tax net means that, where the rate of corporation tax changes between the date of the intra-group disposal and the date when the asset in question leaves the group or sub-group in question, then, even if there were to be no change in the value of the asset following the intra-group disposal, the amount of tax payable in the two scenarios would differ.

159. Thirdly, the fact that an actual liability to tax crystallises at an earlier stage in the case of an intra-group disposal to a transferee which is outside the UK tax net than in the case of an intra-group disposal to a transferee which is within the UK tax net means that the two groups are in a very different position in terms of liabilities and enforcement on insolvency.

160. The above points reveal that there is no particular reason to suggest that, just because, in the case of an asset which remains within the UK tax net, the Group Transfer Rules operate by allowing the crystallisation of a group's or sub-group's tax liability in respect of the asset to be deferred until the asset leaves the group or sub-group, the proportionate response to the restriction on the freedom of establishment which the Group Transfer Rules create is to allow the tax liability which has crystallised under the Group Transfer Rules in the case of an asset which leaves the UK tax net to be deferred until the asset leaves the group or sub-group. The two outcomes would still be very different in many ways. I therefore believe that the ostensible similarity between the outcome for which the Appellant is contending in relation to this question and the manner in which Section 171 operates in the context of an intra-group disposal to a transferee which is within the UK tax net is more apparent than real.

161. Turning then to the issue of whether the appropriate conforming interpretation to be given to the UK legislation is:

> (a) to extend to the disponor of an asset to a transferee which is outside the UK tax net but within another Member State the existing regime applicable to exit taxes under Section 59FA of, and Schedule 3ZB to, the TMA; or
>
> (b) to read Section 171 as enabling such a disponor to have the option to defer the tax arising by reason of the failure of the transferee to satisfy the condition in Section 171(1A)(b) of the TCGA until the asset in question leaves the group or sub-group in question,

I agree with the Respondents that their proposed conforming construction goes with the grain of the existing UK legislation whereas the Appellant's does not.

162. In the first place, as Mr Baldry pointed out in his submissions, there is no precedent within the UK legislation for deferring a crystallised tax liability, as opposed to deferring a gain which will or may ultimately give rise to a tax liability. (Even in the case of a holdover under Section 116 of the TCGA, where a change in the value of the new asset following the conversion of the old asset into the new asset cannot prevent a liability to tax on any gain which has accrued prior to the conversion from arising, it is the gain on the old asset which is held over and not tax on that gain.)

163. Secondly, for similar reasons to those noted in paragraphs 156 to 160 above, I think it is wrong to describe the grain of the Group Transfer Rules (or the UK legislation as a whole) as being that disposals within a group should not give rise to an immediate liability to tax. On the contrary, whilst that is undoubtedly the case in relation to the intra-group disposal of assets which remain within the UK tax net following the disposal, it is not the case in relation to the intra-group disposal of assets which leave the UK tax net in consequence of the disposal. In respect of intra-group disposals falling within the latter category, the grain of the legislation is that a tax liability based on the market value of the asset in question should crystallise at the point of the intra-group disposal. Indeed, the Appellant has implicitly accepted that to be the case by recognising that it cannot dispute the right of the UK to impose a tax liability at that point. The Appellant's argument turns on when that tax liability needs to be paid and not on whether that tax liability properly arises.

164. Thirdly, there is an obvious parallel between assets which leave the UK tax net on the migration of their holder and assets which leave the UK tax net because of an intra-group disposal to a transferee which is outside the UK tax net. In both cases, the balanced allocation of taxing powers means that the UK needs to be able to impose tax by reference to the market value of the assets in question at the point when the assets leave the UK tax net. In the case of migrations, this is achieved by the option for deferred payment set out in Section 59FA of, and Schedule 3ZB to, the TMA. Thus, extending the regime applicable to exit taxes in those provisions to intra-group disposals would be very much consistent with the grain of the legislation.

165. As for the relevant CJEU case law, I believe that the way in which it has developed since the decision in *NGI* shows that the correct conforming interpretation which is to be applied in this case is to provide for an option to defer in the form of instalment payments (of the kind set out in Schedule 3ZB to the TMA) and not to provide for an option to defer until the asset in question leaves the relevant group or sub-group. It is true that the CJEU in *NGI* held that an option to defer the payment of exit taxes until realisation would be a proportionate restriction on that freedom. But, in saying that, the CJEU did not expressly rule out other measures which would also be proportionate and its decisions since then have consistently suggested that an option to allow for payment in instalments is not only a proportionate measure in the context of exit taxes but in fact the preferred proportionate measure in those cases. (As an aside, it is worth noting at this point that no CJEU case so far has suggested a deferral along the lines which the Appellant is now proposing – that is to say, deferral until the asset in question leaves the group or sub-group. Even in *NGI*, the suggestion

by the CJEU was that the tax in question might be deferred until the realisation of the asset.)

166. Support for the proposition that the CJEU case law has developed in the direction mentioned in paragraph 165 above starts with the observations made by Advocate General Mengozzi in his opinion in *Portugal 2,* follows on into the statements made by the CJEU in its decision in *Denmark* and then reaches fruition in the decisions of the CJEU in *DMC* and *LabTec.*

167. It is apparent from Advocate General Mengozzi's opinion in *Portugal 2* that, whilst the Commission in that case was continuing to advocate that the option to defer should be an option to defer until realisation, as described in *NGI*, the Member States were arguing that the decision in *NGI* should be confined to its facts, which were that the company in that case held only a financial asset – see paragraphs [24] and [33] of the Advocate General's opinion. It is also apparent that, in paragraph [68] of the Advocate General's opinion, the Advocate General suggested that an option to pay by way of instalment would be a proportionate restriction on the freedom. In the light of these remarks, it is noteworthy that, in its decision in *Portugal 2*, the CJEU simply referred to the need for Portugal to provide for deferred payment of the exit tax, without making any explicit comment on the basis of that deferral (see, for example, paragraph [32] of its decision).

168. The CJEU decision in *Denmark*, which followed *Portugal 2,* stated expressly for the first time that a Member State was entitled to give effect to the principle laid down in *NGI* in a manner other than providing for deferral until realisation – see paragraphs [33] to [38] of that decision. Moreover, following that decision, there is no exit tax case which has suggested that the deferral that needs to be offered by the national legislation is deferral until realisation. Deferral is simply mentioned in generic terms.

169. There were then the decisions in *DMC* and *LabTec* in which deferral of exit taxes by way an option to pay by instalments was expressly endorsed by the CJEU as constituting a proportionate restriction on the freedom.

170. The Tax Avoidance Directive is also indicative that, so far as exit taxes are concerned, deferral by way of an option to pay by instalments is a proportionate restriction on the EU freedoms because Article 5 of that Directive provides for exit taxes to be paid by way of five instalments, together with interest. The link between the instalment basis set out in the Tax Avoidance Directive and the CJEU's direction of travel in relation to exit taxes is highlighted in paragraph [2] of the opinion of Advocate General Kokott in *Panayi*.

171. I can see no reason why the intra-group disponor of an asset to a transferee which is outside the UK tax net but located within a Member State should be in a more favourable position as regards the tax liability which crystallises on that disposal than a company which simply leaves the UK tax net whilst holding the relevant asset. In the course of his submissions, Mr Baker candidly accepted that, if the UK legislation already provided for a taxpayer who became liable to the tax arising in

respect of an intra-group disposal to a transferee which is outside the UK tax net but located within a Member State to have an option to pay such tax in instalments, in accordance with the provisions set out in Schedule 3ZB to the TMA, then any challenge to that legislation on the grounds that it involved a disproportionate restriction on the freedom of establishment would fail, given the decisions in *DMC* and *LabTec*. Mr Baker did not seek to argue that such an option, whilst clearly being proportionate in the case of exit taxes, would be regarded as not being proportionate in the case of intra-group disposals, and I think he was right to do so.

172. For completeness, I should record that, in my view, the CJEU decision in *Wächtler* does not detract from my conclusion that the correct conforming interpretation in this case would be to amend the legislation to provide for deferral by way of instalment payments as opposed to deferral by way of realisation. In *Wächtler*, the CJEU was addressing the rights of a German national to exercise freedom of movement under the Agreement between the European Community and its Member States, of the one part, and the Swiss Confederation, of the other, signed in Luxembourg on 21 June 1999 (the "AFMP"). The CJEU held that, by parity of reasoning with its decisions in the exit tax cases, an immediate charge to tax in Germany at the point of migration by a German national to Switzerland was disproportionate. It then went on to consider whether its answer might be affected by the provision of German law mentioned in paragraph 124 above, which allowed for deferral in a case where "immediate recovery would have consequences which would be difficult for the taxpayer to bear". In that regard, it said as follows:

"68 That conclusion is not called into question by the fact that, in a situation where the immediate collection of the tax payable would have consequences that would be difficult for the taxpayer to bear, that tax regime provides for the possibility of payment of that tax in instalments. Leaving aside the fact that the instalment-payment measure is possible only in that specific situation, it is incapable of eliminating, in such a situation, the cash-flow disadvantage inherent in the obligation on the taxpayer to pay, at the time of the transfer of his domicile to Switzerland, a proportion of the tax payable on the unrealised capital gains with respect to the shares concerned. Moreover, that measure remains more onerous, for the taxpayer, than a measure that permits the deferral, until the disposal of those shares, of payment of the tax payable."

173. In that part of its decision, the CJEU was merely commenting on the reasons why the existing German legislation remained disproportionate despite the existence of a provision for deferral in certain circumstances. Just as it had done in *Panayi* at paragraph [60], where it concluded that the fact that the taxpayer had the cash to meet the immediate charge to tax did not cure the disproportionality of the legislation imposing the immediate charge to tax (as to which, see paragraph 121 above), it held that the mere fact that there were circumstances in which deferral might be allowed did not cure the disproportionality of the immediate liability to which the existing legislation generally gave rose. (In this respect, see also the decision in *A Oy* at paragraph [38] as mentioned in paragraph 111(f) above.) It was not suggesting that, in order for the existing legislation to be made proportionate, the legislation would need to be amended in order to provide for deferral until realisation. Indeed, if the CJEU had been suggesting that, then it would have been contradicting the vast body of exit

tax case law to which I have referred above, including, in particular, *DMC* and *LabTec*.

174. Once it is accepted that an option for deferral by way of instalment payments would be a proportionate restriction had it already been part of the UK legislation, as the Appellant does, then the Appellant's case in relation to which of the two conforming interpretations is to be preferred inevitably depends on its establishing that, in relation to this question, either:

> (a) the case law of the CJEU demonstrates that a distinction must be drawn between circumstances where the existing national legislation already contains a restriction which is proportionate and circumstances where the restriction in the existing national legislation is disproportionate; or
>
> (b) the case law of the CJEU and/or UK case law demonstrates that, where more than one measure is available to render non-EU law-compliant national legislation compliant, the national court is obliged (or, at least, entitled) to choose the measure which least restricts the applicable EU freedom (ie the measure which does the most damage to the national legislation).

I have not been provided with any case law which supports either of the above propositions.

175. In relation to the first proposition, it is true that *DMC* and *LabTec* are both examples of cases where the national legislation already contained a proportionate restriction and that there is no CJEU case where, having determined that the existing national legislation infringed a relevant EU freedom, the CJEU then went on to set out detailed instalment payment provisions which would not infringe that freedom. However, this is a function of the fact that the role of the CJEU is to consider whether existing national legislation is EU law-compliant. It is not for the CJEU to set out in detail how the existing national legislation should be amended in order to ensure that it becomes EU law-compliant. In the words of the Upper Tribunal in *BT Pension Scheme*, "[i]t is not for the ECJ in that situation to rewrite the member state's legislation for it so as to ensure that the refusal was confined to circumstances in which it could be justified" (see paragraph [245]). So I can see no reason why, if the existing national legislation in the form set out in each of *DMC* and *LabTec* was proportionate, it would not also be proportionate to amend the legislation so that it takes that form.

176. In relation to the second proposition, it is directly contrary to the position which was outlined by Henderson J in *Prudential* at paragraph [148] and Arden LJ in *Routier* at paragraph [93], which is to say that, if the existing legislation gives rise to a disproportionate restriction on an EU freedom, then that legislation needs to be amended in such a way as to ensure that it ceases to do so, but no further.

177. The approach which Henderson J adopted in paragraphs [85] et seq. of his decision involved two stages. The first involved identifying the defects in the existing UK legislation and the second involved considering what was required in order to

eliminate those defects. There is no suggestion in his approach that, in determining the amendment to the existing UK legislation which was to be made at the second stage in the process, the UK legislation should be amended in such a way as to impinge upon the relevant EU freedom to the least extent possible. On the contrary, his approach was to start from the opposite direction and consider what was the most minor amendment to the UK legislation which would make the UK legislation EU law-compliant.

178. This approach is in my view supported by the decisions of the CJEU in *DMC* and *LabTec*. In both of those cases, national legislation which provided for deferral by way of instalment payments was endorsed, notwithstanding the fact that it involved a greater restriction on the relevant EU freedom than deferral until realisation. If the relevant principle had been that any restriction on the EU freedom should be as minimal as possible, then the national legislation in question would not have been upheld.

179. The Appellant may say that the approach of the CJEU which was displayed in *DMC* and *LabTec* is applicable only in a case where the existing national legislation is already EU law-compliant and that, in a case where the existing national legislation is not EU law-compliant, a different approach should be adopted. But it has not provided me with any decisions which support that proposition. Moreover, it seems to me that it would be perverse if the CJEU were to reject the proposition that an existing proportionate restriction in the national legislation should be replaced by another proportionate restriction which entailed a lesser restriction on the relevant EU freedom (as it did in *DMC* and *LabTec*) and then adopt the principle that, in a case where the existing national legislation does not include a proportionate restriction on the relevant EU freedom, the existing national legislation should be amended to the greatest extent possible in order least to restrict the relevant freedom. Thus, I consider that the CJEU's approach in upholding the national legislation in *DMC* and *LabTec* is consistent with the approach taken by Arden LJ in *Routier* and Henderson J in *Prudential*.

180. Mr Baker said that the following passage in *NGI* supported his view that national legislation which did not already contain a proportionate restriction on an EU freedom should be amended so that it least restricted the relevant EU freedom:

"65. According to National Grid Indus and the Commission, the immediate recovery of the tax at the time of the transfer of a company's place of effective management to another Member State is disproportionate. The recovery of tax at the time when the capital gains are actually realised would be a less restrictive measure than that provided for by the legislation at issue in the main proceedings, and would not endanger the allocation of powers of taxation between the Member States."

181. He added that similar language was used in *Portugal 2* at paragraph [32] in the reference to a measure's being "less harmful to the freedom of establishment than the measures at issue in the main proceedings".

182. Mr Baker submitted that, in that context, "a less restrictive measure" should be construed as saying "the least restrictive measure". He explained that, because, in that

case, there was a choice between only two options – the existing measure and the alternative that the CJEU was about to suggest - the CJEU had used the word "less" instead of "least" (which requires there to be three options) and that this showed that, where an existing restriction is not proportionate, the appropriate amendment to the national legislation should be the one that least infringes the relevant EU freedom.

183. I do not agree. I believe that the CJEU in this passage was simply pointing out that deferring the recovery of tax until realisation would be less restrictive on the freedom than the existing (disproportionate) restriction of requiring immediate payment of the tax. It was doing no more and no less than that.

184. For the reasons set out above, I consider that, insofar as it is within the competence of the UK courts to choose between the conforming interpretation which has been proposed by the Appellant and the conforming interpretation which has been proposed by the Respondents, the conforming interpretation which has been proposed by the Respondents is very much to be preferred.

185. Finally in this context, I do not agree with Mr Baker's submission to the effect that the Respondents' proposed conforming interpretation would necessarily involve too many changes to the existing language in the TMA to fall within the doctrine of conforming interpretation.

186. In this case, the UK legislation already includes a detailed set of provisions which provide for an option to pay exit taxes on a deferred basis. Since the parallel between those exit taxes and the taxes crystallising on an intra-group disposal to a transferee outside the UK tax net but within a Member State is obvious, I believe that a conforming interpretation of the existing TMA provisions in a way which extends their application to encompass the latter circumstances would be relatively straightforward.

187. The machinery to which those provisions give rise allows a company which ceases to be within the UK tax net to enter into an exit charge payment plan, whereupon it may defer payment of the charge to corporation tax which arises in consequence of that cessation. An exit charge payment plan can provide for a "standard instalment method" in accordance with paragraph 13 of Schedule 3ZB to the TMA or a "realisation method" in accordance with paragraphs 14 to 17 of Schedule 3ZB to the TMA, or a combination of the two methods, must provide for interest to be charged on the deferred payments in accordance with paragraph 9 of Schedule 3ZB to the TMA and must meet certain other requirements which are laid down in the schedule. One of those is that, where an Officer of the Respondents considers that agreeing to accept payment in accordance with the plan "would present a serious risk as to collection of the tax in the absence of provision regarding security in respect of that tax", the exit charge payment plan may contain provisions in relation to the provision of that security (see paragraphs 8(2) and 8(3) of Schedule 3ZB to the TMA).

188. Where an exit charge payment plan is entered into by a company, "the plan does not prevent the tax becoming due and payable under section 59D or 59E, but…the Commissioners for Her Majesty's Revenue and Customs …may not seek payment of the tax

otherwise than in accordance with the plan…[and] may make repayments in respect of any amount of the tax paid, or any amount paid on account of tax, before the plan is entered into" (see paragraph 9(2) of Schedule 3ZB to the TMA).

189. Where an exit charge payment plan provides for the payment of the tax in respect of an asset by way of the standard instalment method, the tax in respect of the deemed disposal of that asset on migration is required to be paid in six equal instalments, the first of which becomes due on the first day after the period of nine months beginning immediately after the end of the accounting period in which the migration occurred and the remainder of which become due on each of the first five anniversaries of that day, but the outstanding instalments are accelerated if the company becomes insolvent, enters into administration or appoints a liquidator (or suffers an event which is equivalent to one of those events under the law of an EEA state outside the UK) or if the company ceases to be resident in the EEA (each, a "relevant event").

190. Where an exit charge payment plan provides for the payment of the tax in respect of an asset by way of the realisation method, then the date on which the tax becomes due in respect of the deemed disposal of that asset on migration depends on the nature of the asset in question.

191. Where the asset in question is trading stock or is an asset (other than an intangible fixed asset) which is subject to tax under the TCGA, the tax in question is required to be paid on the first to occur of:

(a) the disposal of the asset to which the tax relates;

(b) the tenth anniversary of the end of the accounting period in which the migration occurred; and

(c) the company's becoming subject to a relevant event,

and becomes due on (in the case of the events described in paragraph 191(a) or 191(b) above) the date of the event in question and (in the case of a relevant event) the first day after the period of nine months beginning immediately after the end of the accounting period in which the migration occurred or, if that date has already passed, the next anniversary of that date.

192. In contrast, where the asset is a loan relationship, derivative contract or intangible fixed asset, then the tax in question is required to be paid in ten instalments or, if the remaining term or useful life of the loan relationship, derivative contract or intangible fixed asset in question is less than ten years immediately following the end of the accounting period in which the migration occurred, instalments which are equal to the number of years in question. In either case, the first instalment becomes due on the first day after the period of nine months beginning immediately after the end of the accounting period in which the migration occurred and the remainder become due on each subsequent anniversary of that day but the outstanding instalments are accelerated if:

(a) the company becomes subject to a relevant event; or

(b) the company ceases to be party to the relevant loan relationship or derivative contract or disposes of the relevant intangible fixed asset (a "trigger event"),

and becomes due on (in the case of a relevant event) the date of the relevant event in question and (in the case of a trigger event) the day on which the next instalment would otherwise have been due.

193. There are paragraphs in Schedule 3ZB to the TMA which provide for partial acceleration of the outstanding instalments in the case of part disposals or realisations.

194. I have set out the provisions of the schedule in some detail in order to show that, in my view, it would not involve significant violence to the schedule if it were to be extended to cover intra-group disposals. The schedule already operates on an asset by asset basis, which makes it amenable to extension in that way and I would expect that, by:

(a) extending paragraph 1 of the schedule to include intra-group disposals to transferees located outside the UK tax net but within the EEA;

(b) in that context, applying the relevant event and trigger event definitions to events befalling the transferee instead of events befalling the migrating company; and

(c) also in that context, construing references in the schedule to (i) the cessation of residence as references to the making of any such disposal, (ii) the migration accounting period as references to the accounting period in which the disposal occurs; (iii) the exit charge provisions to references to the gains arising as a result of the non-application of the Group Transfer Rules to such disposals; and (iv) the date on which the company ceased to be resident in the UK or the EEA state in which it has become resident as references to the date of such disposal or the EEA state of the transferee,

it should be possible for Parts 1 and 3 of the schedule to apply to such disposals, *mutatis mutandis*.

195. I would regard the changes described above as falling easily within the ambit of the doctrine of conforming interpretation, as outlined in paragraphs 129 to 140 above, noting the muscular approach to construction which the doctrine involves.

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196. I should start this part of the decision by observing that, in my view, this question is by some measure the most difficult question which arises in connection with the Appeals.

197. It is tempting to conclude that, on the basis that:

(a) the CJEU case law and the Tax Avoidance Directive suggest that it is proportionate for a Member State to provide for the payment of exit taxes by way of instalment;

(b) there is an obvious parallel between exit taxes and taxes arising in respect of an intra-group disposal to a transferee which is outside the UK tax net;

(c) the UK has existing legislation in place which sets out a regime for the payment of exit taxes by way of instalments; and

(d) it would be relatively straightforward to adopt a conforming interpretation of that legislation and thereby extend it to cover taxes arising under the Group Transfer Rules in circumstances where those rules are restricting any person's freedom of establishment,

I should adopt that course of action in this case.

198. However, the reasoning set out in paragraph 197 above is deceptive in that it does not address the crucial question of whether it is within the competence of the UK courts to select one particular instalment payment basis over any others.

199. At the hearing, as an alternative to his own conforming interpretation of Section 171, Mr Baker submitted that it was not open to me in this case to choose the Respondents' proposed conforming interpretation of the UK legislation when there were so many other EU law-compliant options available in the context of deferred payment by way of instalments. Mr Baker made the valid point that, even if I accepted that deferred payment by way of instalments (and not deferred payment by reference to the asset's leaving the group or sub-group) was the correct outcome in this case, who was to say whether that instalment payment basis should take the form proposed by the Respondents – that is to say, tracking the existing rules in Schedule 3ZB to the TMA – or the form of a more straightforward five-year or ten-year instalment payment plan along the lines approved by the CJEU in *DMC* and *LabTec* or conceivably some other basis such as the one reflected in Article 5 of the Tax Avoidance Directive? The differences between the rules governing exit taxes in Article 5 of the Tax Avoidance Directive and the UK domestic provisions governing exit taxes in Schedule 3ZB to the TMA tend to highlight this issue. In Mr Baker's view, it is beyond the competence of the UK courts to choose between various proportionate options because that would involve legislating and is therefore something which can be done only by Parliament.

200. In support of his submission, Mr Baker referred me to the following statement by Lord Nicholls in *Ghaidan*:

> "Nor can Parliament have intended that s 3 should require courts to make decisions for which they are not equipped. There may be several ways of making a provision Convention-compliant, and the choice may involve issues calling for legislative deliberation."

201. Mr Baker also points to the decision of the House of Lords in *Fleming* as supporting his argument. *Fleming* was technically not a case involving the doctrine of conforming interpretation – see the statement to that effect by Lord Walker at

paragraphs [25] and [49] in *Fleming*. Instead, the matter at issue in *Fleming* was how the national court should apply the doctrine of disapplication in the case of a regulation which introduced a three-year time limit on claims to deduct input tax and which infringed EU law by failing to provide for a transitional period. The majority in the House of Lords held that the relevant provision should be disapplied until either Parliament or the Respondents (by way of a properly-communicated announcement) established a reasonable transitional period within which claims to deduct input tax which exceeded the new time limit could still be made.

202. However, in the course of his judgment, Lord Scott said as follows:

"[20] My Lords, I would, for my part, reject the premise on which these two alternatives are based. The UK instituted a VAT scheme for the repayment by the Commissioners of input tax that enabled claims for repayment to be made without limit of time. That was a surprising, and perhaps unintended, feature of the scheme but was a lawful feature. There is no suggestion that the scheme failed properly to implement the Sixth Directive. The scheme was then amended by the introduction of a three year time limit that was to apply not only prospectively but also retrospectively with no transitional period during which those, like Mr Fleming and Condé Nast, who had been sitting on their claims, would be able to take into account the change in the law and bring their claims before they became time barred. Whether a reasonable transitional period for claims to be brought that on 1 May 1997 were already at least three years old should have six months, 12 months or some other period from 1 May 1997 is open to argument but is not in point. The important fact is that there was no transitional period. The VAT regime is not judge-made and is not made by the Commissioners. It is a statutory scheme consisting of primary legislation made by Parliament and secondary legislation made by others under powers conferred by Parliament. The Commissioners have management powers conferred by Parliament but these powers do not extend to enabling the Commissioners to amend the statutory scheme. The Business Briefs published by the Commissioners can properly be regarded as published pursuant to the Commissioners' management powers but are not a means enabling the Commissioners to amend the VAT régime made by primary and secondary legislation. The two Business Briefs, to which reference has been made in this Opinion, contained provisions purporting to extend the period within which certain s 80 claims which had accrued to the taxpayers before the amendment to s 80(4) came into effect could be brought. These provisions have been described as "concessions". They are, my Lords, nothing of the sort. If European law does not recognise the validity of a UK statutory limitation period in relation to a certain class of VAT claim it is not a "concession" for those charged with the management of the scheme to purport to amend the scheme by allowing some of those whose claims would be barred by the invalid provision to have some additional period to bring their claims. In *EC Commission v United Kingdom* [2005] STC 582, [2005] SWTI 366, another VAT case, the ECJ said in its judgment at para 25, that:

". . . it is settled case law that the incompatibility of national legislation with Community provisions can be finally remedied only by means of national provisions of a binding nature which have the same legal force as those which must be amended. Mere administrative practices cannot be regarded as constituting the proper fulfilment of obligations under Community law."

The UK's obligation is to put in place a legal scheme for the bringing of claims for repayment of input tax. Regulation 29 constitutes the legal scheme. If, as is the case, para (1A) cannot, consistently with Community law, be applied against a certain class of taxpayers, into which class both Mr Fleming and Condé Nast fall, the defect cannot, in my opinion, be cured by "mere administrative practices". The Business Briefs fall, in my opinion, under that heading.

[21] It is argued, alternatively, that the court can and should fix the duration of an extra period, a transitional period, that must be allowed to Claimants whose pre 1 May 1997 claims would otherwise be barred by para (1A). It is, to me, a surprising proposition that the court can, by judicial legislation, add a transitional period in order to cure the invalidity of a statutory provision that would not otherwise comply with European law and be enforceable against certain Claimants. There are, to my mind, several objections to the proposition. First, it is not the function of judges to legislate. Second, the principle that people must be expected to know the law and conduct their affairs in accordance with the law can hardly apply to a judicial amendment to primary or secondary legislation that, until it is made known in the judge's pronounced judgment, is held in pectore. The objection to retrospective legislation would apply here too. Third, the important principle of certainty can hardly be satisfied. The terms of the judicial amendment might change as the case travelled up the appellate chain. And the ability of this House to depart from previous decisions would need to be kept in mind.

[22] The notion that a court can add a transitional provision to reg 29(1A), and thereby avoid the need to disapply the paragraph in relation to reg 29 claims based on some pre 1 May 1997 input tax payments, appears to derive from language used by the ECJ in paras 40 to 43, but particularly para 41, of the judgment in the *Grundig* case [2002] ECR I-6325. These paragraphs are set out in para 44 of Lord Walker's Opinion. In para 41 the ECJ said that the fact that a national court had held a transitional period fixed by its national legislature to be insufficient did not necessarily mean that the new limitation period could not be applied retrospectively at all, and continued:

"The principle of effectiveness merely requires that such retroactive application should not go beyond what is necessary in order to ensure observance of that principle. It must, therefore, be permissible to apply the new period for initiating proceedings to actions brought after expiry of an adequate transitional period, assessed at six months in a case such as the present, even where those actions concern the recovery of sums paid before the entry into force of the legislation laying down the new period."

My Lords, the ECJ in this passage was dealing with the principle of effectiveness. But that is not the only principle in play. The principle of certainty, too, must be taken into account. Taxpayers are entitled to know from the statutory scheme what input tax repayment claims they can bring under reg 29. In the absence of any statutory transitional provision, how are they to know whether pre 1 May 1997 claims that are more than three years old can be brought or, as to claims based on input tax paid between 1 May 1994 and 1 May 1997, within what period they can be brought? It is no answer to the requirement of certainty to be told that the claims can be brought within "an adequate transitional period". There is also the constitutional point, which may or may not apply to judges sitting in Italian courts. It is the function of judges sitting in UK courts to construe primary and secondary legislation. It is the function of judges sitting in UK courts to disapply UK legislation that is inconsistent with Community law. It is not the function of judges sitting in UK courts to amend UK legislation that is inconsistent with Community law. Moreover, the passage I have already cited from the ECJ judgment in *EC Commission v United Kingdom* seems to me pertinent here too: ". . . incompatibility of national legislation with Community provisions can be finally remedied only by means of national provisions of a binding nature which have the same legal force as those which must be amended.""Mere administrative practices" cannot do this. Nor can judges."

203. In response to Mr Baker's argument, Mr Baldry referred me to the decision in *Prudential*, where Henderson J was provided by the parties with two possible conforming interpretations, both of which would have made the existing UK legislation proportionate and considered himself able to select one of those options on the basis that it did less damage to the existing legislation and was sufficient to render the existing legislation EU law-compliant (see paragraph [148] in *Prudential*).

204. Mr Baldry also referred me to the decision in *Vodafone 2*, where the Court of Appeal held that deficiencies (from the perspective of EU law-compliance) in the drafting of the motive exclusion set out in Section 748(3) of the ICTA could be cured by inserting into Section 748(1) of the ICTA an additional exception from the UK CFC regime for companies established and carrying on genuine economic activities in an EEA state. Counsel for the taxpayer in that case had objected to that proposed conforming interpretation for various reasons, one of which was that it "would involve legal or economic policy decisions and would fail to satisfy the test of legal certainty". In the view of counsel for the taxpayer in that case, the conforming interpretation in question "involved a decision on legal, economic and policy grounds which should be left to Parliament" (see paragraph [55]). In response, Sir Andrew Morritt C said as follows:

"[58] Third, the conforming interpretation advanced by counsel for HMRC reflects and excepts from the operation of the CFC Legislation precisely that element of it which the ECJ held to constitute the hindrance to freedom of establishment. That is, by definition, sufficiently certain for a conforming interpretation whether or not the exclusion from the exception of wholly artificial transactions is included. There can be no objection to such an exclusion for the like reason. It follows precisely the formulation of the justification for the hindrance which the ECJ found to be acceptable.

[59] It is the case that there are likely to be other ways of achieving conformity, for example s 751A inserted into the CFC Legislation by the Finance Act 2007, and the choice of one rather than another may well involve policy decisions. But if that consideration alone could render a conforming interpretation illegitimate it would considerably restrict the occasions in which a conforming interpretation could be adopted and lead to an increase in disapplications. The choice of a conforming interpretation which faithfully follows a conclusion of the ECJ, as in this case, does not in my view trespass on the forbidden ground of legislation."

205. After reflecting on these rival submissions, I have decided that, although this question is somewhat finely-balanced, Mr Baker's argument is to be preferred to Mr Baldry's in the context of this case.

206. I should start by saying that I am not sure that the decision in *Fleming* itself is a particularly apt example of the principle on which Mr Baker is relying. This is because:

(a) as mentioned above, *Fleming* was not a case relating to the ambit of the doctrine of conforming interpretation. Instead, it related to disapplication – the action which a UK court is required to take if it is unable to render the existing UK legislation EU law-compliant by applying a conforming interpretation. This is a significant difference because a UK court has a choice as to whether or not to apply a conforming interpretation, albeit a choice which needs to be exercised within the boundaries laid down by the previous case law, as summarised in paragraphs 129 to 140 above. In contrast, a UK court which is unable to render the existing UK legislation EU law-compliant by the application of conforming interpretation is then bound by Section 2(4) of the ECA to disapply some part of the existing UK legislation. It is this difference to which Lord Walker was referring at paragraph [62] of the decision, when he noted that "[t]he disapplication of offending legislation is the duty of the national court, even if it involves action which would otherwise be alien to the strong judicial instinct not to intrude on the province of the legislature". So the issue in *Fleming* was not how to interpret the existing UK legislation in a manner which made it EU law-compliant but rather the extent to which the relevant part of the existing UK legislation should be disapplied;

(b) moreover, in *Fleming*, only one of the Law Lords - Lord Scott in the paragraphs set out in paragraph 202 above – held that it was beyond the competence of the court (and, for that matter, the Respondents) to specify the transitional provision which should be treated as applying to the new regulation; and

(c) in addition, three of the Law Lords – Lord Neuberger, Lord Hope and Lord Carswell – considered that an appropriate transitional rule could be introduced in the future by the Respondents (instead of Parliament) as long as the Respondents publicised their view appropriately.

207. In relation to the point set out in paragraph 206(a) above, since the UK courts have a duty to disapply legislation which is not EU law-compliant, there is inevitably a slight tension between the general constitutional prohibition on judges acting as legislators and the obligation of the national courts to disapply the provisions of existing national legislation which infringe EU law. I will return to this in the section of this decision in which I deal with disapplication but it suffices to note at this point that the approach of the Law Lords i*n Fleming* needs to be considered on the basis that *Fleming* was a disapplication case and not a conforming interpretation case.

208. In relation to the point set out in paragraph 206(b) above, none of the Law Lords apart from Lord Scott considered that there was a constitutional barrier to their determining an appropriate transitional period. Lord Walker held that it was open to the UK courts to determine the scope of the transitional period and proceeded to select one of the options in that regard which had been presented to the court (see paragraph [69]), Lord Neuberger attempted to determine the scope of the transitional period himself before ultimately concluding that legislation (or a properly-communicated decision by the Respondents) was necessary in order to determine that period (see paragraphs [98] to [108]), Lord Hope said that, in an appropriate case, the UK courts might be able to determine the relevant transitional period but that, on the facts of that case, it was impossible for the UK courts to do so and the matter should be left to Parliament or the Respondents (see paragraphs [10] and [12]) and Lord Carswell said that he agreed with both Lord Hope and Lord Neuberger (see paragraph [77]).

209. Thus, four of the Law Lords were of the view that it would not exceed the competence of the UK courts to specify what it regarded to be the appropriate transitional period. In addition, Lord Walker expressly rejected the view that this was properly a matter for Parliament, holding, at paragraph [62], that the determination of an appropriate transitional period "is not merely within your Lordships' power but is your Lordships' plain duty under EU law."

210. The point set out in paragraph 206(c) above is of less relevance to this case but the fact that three of the Law Lords in *Fleming* were prepared to conceive of circumstances in which the determination of the appropriate transitional period might be made by the Respondents (as an administrative matter) instead of by Parliament again reveals that the monopoly of Parliament in relation to the selection of an appropriate measure for ensuring EU law-compliance by the UK legislation was being questioned.

211. The above summary reveals that, with the exception of the judgment of Lord Scott, the House of Lords decision in *Fleming* is not in fact authority for the proposition that, where a UK court is provided with various options for applying a conforming interpretation of UK legislation, the UK court is not entitled to select one of those options on the grounds that it would be unconstitutional to do so.

212. Notwithstanding that observation in relation to *Fleming*, I consider that it is clear both as a constitutional matter and based on the observations of Lord Nicholls in *Ghaidan* and Lord Scott in *Fleming* that, if there are a number of different ways of applying a conforming interpretation of the existing UK legislation, each of which is proportionate and equally valid as a matter of EU and UK law, I am precluded from applying a conforming interpretation of the existing UK legislation which involves selecting one of those options over the other or others. That selection can be made only by Parliament and my role must necessarily be confined to disapplying some part of the existing UK legislation which will have the effect of rendering the UK legislation EU law-compliant.

213. I do not consider that the decision in *Fleming* precludes me from reaching that conclusion. In the first place, as noted above, *Fleming* related to the quite separate issue of disapplication and not the issue of conforming interpretation. That alone is sufficient to mean that it has no binding effect in the context of determining the scope of the doctrine of conforming interpretation. Moreover, in any event, the actual decision in *Fleming* – one which was reached by four of the Law Lords – was no more than that the regulation in question should be disapplied *sine die* (because of the absence of any provision for a transitional period) and that no transitional period could be determined by the court.

214. Having said that, I should make it clear that, in my view, the conclusion set out above does not mean that the UK courts are precluded from making any form of choice in the context of applying the doctrine of conforming interpretation.

215. For example, UK case law shows that, if a UK court has two fixed and clear possible conforming interpretations, both of which give rise to a proportionate

restriction on the relevant freedom but one of which does less violence to the existing UK legislation than the other, it is open to the court to choose the latter option. Indeed, the UK court is obliged to choose the latter option, given the principle described in *Routier* at paragraph [93] to the effect that the conforming interpretation of the legislation must do no more than ensure that the existing UK legislation is EU law-compliant. So, the option for the court in that case is more apparent than real. Those were the facts in *Prudential*.

216. Similarly, UK case law shows that, if there are two or more possible ways of applying a conforming interpretation to the UK legislation, both of which have the same substantive effect in terms of removing a particular hindrance to an EU freedom identified by the CJEU but which take different legal forms (ie necessitate different changes to the existing legislation), a UK court is entitled to choose between those methods of effecting the change. Critically, in that event, the court in question is simply exercising a discretion as to the form which the relevant conforming interpretation will take – it is not making a policy decision as to the substantive effect on the existing UK legislation to which its conforming interpretation will give rise. Those were the facts in *Vodafone 2*.

217. However, the facts of the present case are some way removed from those in *Prudential* and *Vodafone 2* in that all that can be said for certain based on the previous decisions of the CJEU is that:

> (a) the existing restriction on the freedom of establishment is disproportionate by requiring tax to be paid immediately; and
>
> (b) an option to defer that tax by allowing for payments to be made by way of instalments would be proportionate and would do less damage to the existing UK legislation than providing for the deferral of that tax until the asset leaves the relevant group or sub-group.

218. Despite the fact that the only appropriate conforming interpretation would, for that reason, involve provision for the tax in question to be paid by way of instalments, it is wholly unclear whether that instalment payment basis should track the existing regime in Schedule 3ZB to the TMA or follow one of the instalment payment regimes which were held to be proportionate in *DMC* and *LabTec* or take some other form altogether, such as the form set out in Article 5 of the Tax Avoidance Directive. The decision as to which regime is to be applicable is a matter which must necessarily be decided by Parliament.

219. In that regard, I understand that the UK is proposing to amend its exit charge rules in order to comply with its obligations under the Tax Avoidance Directive. Whilst that would, of course, involve blending two of the possible instalment payment options to which I have referred above into one, it does somewhat highlight the fact that this is a matter which can be addressed only by Parliament.

220. In conclusion on this point, even if one accepts the principle that the most appropriate option for a conforming interpretation would be to amend the UK legislation to provide for an option to pay the tax by way of instalments, as I do, I am

not equipped to decide which of the vast array of possible instalment payment options should be selected. In particular, I do not believe that the existing domestic case law in relation to the doctrine of conforming interpretation entitles me to reach the automatic conclusion that the fact that there is existing legislation in the UK providing for a specific type of optional instalment payment regime in the case of company migrations and that there are clear similarities between the exit tax regime and the regime which I am now addressing means that I am entitled to select that particular instalment payment option over any other. Any decision as to the precise basis on which deferred payment by way of instalments should be offered is a matter for Parliament and not for the UK courts.

Disapplication

221. Since I consider myself unable to apply the doctrine of conforming interpretation in this case, the only remedy to the existing disproportionate restriction on the freedom of establishment created by the Group Transfer Rules in the context of the 2014 Disposal is to disapply part of the existing UK legislation.

222. This too is not straightforward because it is not obvious how disapplication should work in circumstances such as these where the infringement of EU law is caused not by the provisions of the UK legislation which give rise to tax on disposals of chargeable assets but instead by the exclusion from the Group Transfer Rules of an intra-group disposal to a transferee which is outside the UK tax net but located in a Member State.

223. The Appellant submits that, if a conforming interpretation is not possible, then one disapplication option ("disapplication option 1") would be to disapply the charge to tax in these circumstances altogether. That would be the outcome if, for example, the requirements in Section 171(1A)(b) of the TCGA were to be disapplied in all cases where the operation of that provision would give rise to a restriction on an EU freedom. If that were to be done, then, in such circumstances, Section 171 would apply in the same way as it currently does to an intra-group disposal to a transferee which is within the UK tax net. That result would, of course, ensure that the UK legislation was no longer infringing EU law but it would also mean that the UK could not tax the gain accruing on the relevant asset prior to the intra-group disposal. It would therefore go considerably further than is required by EU law and would be contrary to the objective of the balanced allocation of taxing powers which both parties agree allows the UK to tax such a gain. Even the Appellant is not contending that the gain arising in respect of the 2014 Disposal should simply escape UK tax altogether.

224. In recognition of that fact, the Appellant submits that another disapplication option ("disapplication option 2") would be to apply the legislation on the basis that the amount of tax arising on the disposal to a transferee which is outside the UK tax net but located in another Member State could be calculated when the transfer is made and then payment could be deferred until the relevant asset leaves the group or sub-group.

225. The Appellant goes on to say that simply disapplying Section 171 in the case of all intra-group transfers ("disapplication option 3") is not an available remedy because doing so would not cure the infringement of EU law.

226. The Respondents say that the only possible disapplication option in this case is their version of the Appellant's disapplication option 2 (which might be termed "disapplication option 2A" for the sake of convenience). The only difference between the Appellant's disapplication option 2 and the Respondents' disapplication option 2A is that the former involves a deferral until the asset in question leaves the group or sub-group whereas the latter involves deferral on an instalment payment basis.

227. My views on these submissions are as follows:

> (a) first, I have some difficulty in following how the Appellant's disapplication option 2 and the Respondents' disapplication option 2A can be said to involve a disapplication at all. It seems to me that the result to which each of those options would give rise, whilst attractive in that it would enable the UK to tax the gain which has accrued on the asset prior to the intra-group disposal, wouldn't involve disapplying any of the existing legislation so much as amending that legislation. As such, I consider that those options can be achieved only by way of a conforming interpretation – a remedy which I have already decided is not open to me.
>
> In this regard, I should make it clear that, although the Respondents described their disapplication option 2A in paragraph [61] of their skeleton argument as involving the "temporal disapplication" of the relevant legislation, this is not an apt description of either their disapplication option 2A or the Appellant's disapplication option 2. A "temporal disapplication" is the type of disapplication remedy which the House of Lords was considering in *Fleming*. In other words, it involved disapplying the offending regulation for a specified period of time in order to provide for transitional relief.
>
> In contrast, in this case, both of these disapplication options do not involve a temporary suspension of the offending legislation but rather an amendment to the existing legislation to allow it to provide for the tax liability which is crystallised by the offending legislation to be deferred. This cannot properly be described as a "temporal disapplication" or in fact a disapplication at all in any meaningful sense;
>
> (b) secondly, I do not follow the argument of the Appellant in relation to disapplication option 3. If Section 171 were to be disapplied altogether, so that all intra-group disposals gave rise to tax by reference to the market value of the asset transferred, without regard to whether or not the transferee was within the UK tax net, then I do not see how the UK legislation would be restricting anyone's freedom of establishment. In that case, in relation to every intra-group disposal, the disponor would be being treated in exactly the same way regardless of whether or not the transferee was within the UK tax net and therefore there would simply be no restriction on the freedom of establishment;

(c) the above means that I face the unpalatable choice between disapplication option 1 – which will have the effect that the UK will be unable to tax the accrued gain on an asset which leaves the UK tax net in circumstances where imposing an immediate liability to tax would constitute a restriction on an EU freedom and which will therefore be contrary to the principle of the balanced allocation of taxing powers between Member States and give rise to an outcome for which neither party in this case has contended – and disapplication option 3 – which will have the effect of disturbing the tax treatment which is currently accorded to intra-group disposals of assets which stay within the UK tax net following the disposal;

(d) I do not think that the exercise of this choice can be equated to the process of exercising a choice which I considered (in relation to applying a conforming interpretation of UK law) to be solely a matter for Parliament and beyond the competence of the UK courts.

In the first place, once a conforming interpretation of UK law has been discounted, I am obliged to disapply some part of the UK legislation in order to make it comply with EU law. That is an obligation imposed on me under Section 2(4) of the ECA. The fact that disapplication is a duty of the UK courts in these circumstances is made clear by Lord Walker in *Fleming* at paragraph [62] and Peter Gibson LJ in the Court of Appeal in *Autologic* at paragraphs [22] to [24]. In the words of Lord Walker in *Fleming* at paragraph [62], it is the UK court's "plain duty" in a case where UK law is not EU law-compliant to disapply the offending legislation. This must be the case even if disapplication would give rise to a result for which neither party is contending.

Since there is a duty to disapply, it necessarily follows that, where there is more than one way of achieving EU law-compliance, each of which is equally valid, the UK court is not precluded from exercising a choice as between those disapplication options in the fulfilment of its duty. Indeed, it is arguable that the four Law Lords in *Fleming* who considered that they were entitled to determine the precise scope of the transitional provision in that case went further than they needed to in order to comply with that duty. There was a clear imperative for the House of Lords in that case to disapply the new regulation because of the absence from that regulation of any transitional provision. The Law Lords could have achieved that outcome simply by saying that the regulation would be disapplied until a proper transitional provision was later adopted by Parliament and refusing to consider alternative transitional provisions themselves. The fact that four of the Law Lords did not do that demonstrates that, in their view, the UK courts have some latitude in the exercise of disapplication.

In any event, in this case, there are only two possible disapplication options and, in my view, one of them is the obvious choice over the other for the reasons which follow. Thus, even if it might be said that exercising a choice between disapplication options was beyond the competence of the UK courts in this context, I am in a similar position in relation to selecting one of the disapplication options over the other as was the court in applying a conforming interpretation in each of *Prudential* and *Routier*;

(e) by way of expanding on the latter statement, notwithstanding that it gives rise to an outcome which is more beneficial to the Appellant and detrimental to the Respondents than the outcome for which the Appellant has argued in this case, disapplication option 1 is, in my view, plainly the appropriate disapplication option to adopt in this context. I say that because it involves disapplying, in the appropriate circumstances, the restriction in Section 171(1A)(b) of the TCGA – which imposes the requirement that the transferee must be within the UK tax net - that constitutes the infringement of the relevant EU freedom in this case;

(f) putting this another way, the UK has disproportionately restricted the freedom of establishment of JTIH in this instance by imposing an immediate tax liability on the Appellant in respect of the disposal of the Galleon shares by the Appellant to JTIH. The UK cannot therefore be surprised if, as a result of the disapplication of that disproportionate restriction, the Appellant is better off in relation to that disposal than it has submitted it should be;

(g) moreover, applying disapplication option 1 also means that the disapplication affects only those disposals where assets leave the UK tax net and an immediate charge to tax would constitute a restriction on an EU freedom. Disapplication option 3 would have much more far-reaching consequences and is harder to justify in terms of curing the existing disproportionate restriction on the relevant EU freedom; and

(h) I am reinforced in this conclusion by the statement by Lord Walker in *Fleming* at paragraph [49] to the effect that the process of disapplication "involves the identification of the class or classes of taxpayers who are so circumstanced that the offending provisions must not be invoked against them, either in particular cases or at all". It seems to me that disapplication option 3 would involve disturbing the provisions of UK law which provide for intra-group disposals to transferees within the UK tax net to be made without crystallising either a gain or a loss. Such transferees are not the class of taxpayers which is circumstanced such that "the offending provisions must not be invoked against them". On the contrary, the class of taxpayers which is relevant in this regard is disponors making intra-group disposals of assets to transferees which are not within the UK tax net. On that basis, it seems to me that disapplication option 3 would involve the wrong form of disapplication. In contrast, disapplication option 1 would prevent intra-group disposals to transferees which are not within the UK tax net from giving rise to a gain or a loss and would involve not invoking the offending provision – ie the requirement in Section 171(1A) of the TCGA that the transferee needs to be within the UK tax net – in the appropriate circumstances.

228. I realise that my ultimate conclusion in relation to the 2014 Disposal is counter-intuitive given that it is clear that, as a matter of EU law, the UK is entitled to impose

tax on the gain which has accrued on the shares in Galleon prior to the intra-group disposal which led to the shares' leaving the UK tax net and the only disproportionality in the present restriction on the freedom of establishment to which the UK legislation gives rise is the timing of the tax liability. However, the reason for my conclusion lies in the finite scope of the doctrine of conforming interpretation, coupled with the imprecision which necessarily arises out of the disapplication which needs to be made in the present context. In that respect, it is similar to the conclusion ultimately drawn in *Fleming* to the effect that the offending regulation should be disapplied *sine die*, as opposed to being disapplied for a finite period which appeared to the House of Lords to be fair.

Conclusion in relation to the 2014 Disposal

229. For the reasons set out above, my conclusion is that, in relation to the 2014 Disposal, the EU Law Issue should be determined in favour of the Appellant and therefore the 2014 Appeal should be upheld.

230. I now deal with the additional questions which have arisen in the context of the 2011 Appeal.

<u>The 2011 Disposal</u>

Which freedoms?

231. There are two key differences between the 2014 Disposal and the 2011 Disposal. The first is that the transferee in the case of the 2014 Disposal was the disponor's EU resident parent company (JTIH), whereas the transferee in the case of the 2011 Disposal was the disponor's non-EU resident sister company (JTISA) and the second is that the subject matter of the transfer in the case of the 2014 Disposal was shares in another group company (Galleon), whereas the subject matter of the transfer in the case of the 2011 Disposal was intangibles.

232. Both of those differences, and particularly the first, are relevant when one examines whether the Group Transfer Rules can be said to create a restriction on an applicable EU freedom in the context of the 2011 Disposal.

Freedom to move capital

233. Turning first to the freedom to move capital, it is common ground that movements of capital between the EU and countries outside the EU (such as Switzerland) potentially fall within the ambit of Article 63 of the TFEU, subject to the limitations on that freedom set out in Articles 64 and 65 of the TFEU.

234. I believe that both parties also accept that, when JTIH established JTISA and subscribed for shares in JTISA and JTIH made inter-company loans to JTISA to finance the payment of the Consideration, those were movements of capital within the scope of heading "I – DIRECT INVESTMENTS" of the Nomenclature.

235. Mr Baker submits that the fact that the 2011 Disposal was precluded from falling within the Group Transfer Rules and therefore gave rise to a requirement for the Appellant to make an immediate payment of the whole of the corporation tax liability of the Appellant in respect of the disposal of the Brands and related assets to JTISA meant that the Group Transfer Rules created a restriction on the exercise by JTIH of its freedom to make the above movements of capital because they made it less attractive for JTIH to exercise its freedom.

236. He adds that, in addition to the movements of capital described above, the transfer of the Brands and related assets by the Appellant to JTISA was a movement of capital falling within "I – DIRECT INVESTMENTS", "XIII – OTHER CAPITAL MOVEMENTS – D" or "XIII – OTHER CAPITAL MOVEMENTS – F" of the Nomenclature or captured by the introductory paragraphs of the Nomenclature with their reference to "operations to…assign assets built up" and that the Group Transfer Rules restricted that freedom because they did not prevent the imposition of an immediate tax liability in respect of the Disposal, which made it less attractive for the Appellant to exercise its freedom to make that movement of capital.

237. In response to these submissions, Mr Baldry relies primarily on the fact that the restriction created by the Group Transfer Rules can be considered only in the context of the freedom of establishment and not in the context of the freedom to move capital.

238. He adds that:

(a) the disposal of the Brands and related assets by the Appellant to JTISA was not a movement of capital at all because a simple transfer of intangible assets for full consideration is not a capital movement;

(b) in any event, the Disposal did not fall within any of the headings in the Nomenclature apart from "XIII – OTHER CAPITAL MOVEMENTS – F Miscellaneous". It did not fall within "I – DIRECT INVESTMENTS" because the critical feature of that category is the intention to create lasting economic links between the person providing the capital and the entrepreneur to whom the capital has been made available and not to the links between the entrepreneur to whom the capital has been made available and the assets representing that capital – in that respect, see the CJEU decision in *Holböck*. It also did not fall within "XIII – OTHER CAPITAL MOVEMENTS – D" because that category is confined to intangible assets associated with the rights of authors;

(c) as regards any capital movement which comprises a direct investment in JTISA, Article 64 of the TFEU does not prevent the UK from applying the Group Transfer Rules in their present form, as the restriction created by those rules was a restriction that existed in UK law on 31 December 1993; and

(d) the UK is, in any event, entitled under Article 65 of the TFEU to apply provisions of its law which distinguish between taxpayers who are not in the same situation with regard to residence or the place where their capital is invested and the Group Transfer Rules are doing just that in this context because a Swiss resident company cannot be regarded as being in the same situation as a UK resident company.

239. I consider that the short answer to the question of whether or not the freedom to move capital can be considered in the context of the 2011 Disposal is "no" – for the reasons which I have already set out in some detail in paragraphs 54 to 66 above. In my view, taking into account the purpose of the Group Transfer Rules and the existing CJEU case law in relation to the EU freedoms which are to be considered in any given circumstances, the only EU freedom which can be considered in relation to the Group Transfer Rules is the freedom of establishment.

240. Mr Baker argues that, even if I am right in concluding that it is not permissible to consider whether the Group Transfer Rules create a restriction on the freedom of JTIH to move capital to JTISA (JTIH's wholly-owned subsidiary), that limitation is relevant only to movements of capital between a parent company and its subsidiary and not to movements of capital between sister subsidiaries and therefore it does not prevent the Group Transfer Rules from being considered to create a restriction on the freedom of the Appellant to move capital to JTISA. However, as I have already noted in paragraphs 61 to 63 above, this submission flies in the face of the decision in *Thin Cap*.

241. I have therefore concluded that I am not permitted to consider whether the application of the Group Transfer Rules in the context of the 2011 Disposal created a restriction on the freedom to move capital of either JTIH or the Appellant.

242. Whilst the above is sufficient to dispose of that particular issue in the context of the 2011 Appeal, I will, in deference to the fact that both parties made material submissions on the subject of the freedom to move capital, set out my views in relation to the various questions which arose in that context.

243. I would start by observing that I am not convinced that the fact that the Group Transfer Rules did not prevent the imposition of an immediate liability to tax in the hands of the Appellant when the Appellant disposed of the Brands and related assets to JTISA amounted to a restriction on the movements of capital comprising the establishment by JTIH of JTISA, the subscription of shares by JTIH in JTISA or the making of the loans by JTIH to JTISA. I say this because the Group Transfer Rules did not as such impose any restriction on any of those movements of capital itself – JTIH was able to make each such movement of capital without any impediment – or make it less attractive to make any such movement of capital itself. Instead, the tax liability to which the Group Transfer Rules gave rise arose only at the stage when the disposal of the Brands and related assets was made. So, whilst one might say that the Group Transfer Rules rendered it less attractive for JTIH to procure that the Appellant made the disposal of the Brands and related assets to JTISA, that is a quite separate and distinct matter from the movements of capital which JTIH made to JTISA prior to the making of that disposal. There was no necessary connection between the movements of capital in question between JTIH and JTISA and the subsequent disposal of the Brands and related assets and therefore the Group Transfer Rules should not be seen as making it less attractive for JTIH to have made its direct investments in JTISA.

244. Even if I am wrong in reaching that conclusion, each of the movements of capital in question was a direct investment and, as such, the provisions of Article 64 of the TFEU need to be addressed.

245. In that regard, it is common ground that Section 171 was in existence on 31 December 1993 and therefore that, to the extent that the assets the disposal of which was prevented from benefiting from the Group Transfer Rules in the context of the 2011 Disposal were assets falling within the chargeable gains regime (and not the intangibles regime), any restriction on JTIH's freedom to move capital to JTISA was protected by the standstill in Article 64 of the TFEU.

246. There is, however, a dispute between the parties in relation to whether or not Section 775 should also be regarded as a restriction which was in place on 31 December 1993, given that:

> (a) the intangibles regime was introduced after the relevant date and therefore Section 775 in its present form did not exist on the relevant date; and
>
> (b) although Section 171 and Section 775 give rise to similar outcomes – namely, a deferral of the tax arising on any accrued gain at the point of an intra-group disposal to a transferee within the UK tax net - the way in which Section 775 operates is slightly different from the way in which Section 171 operates. In the latter case, the existence of the disposal is respected but the disposal is treated as taking place on a no gain/no loss basis whereas, in the former case, the transferee steps into the shoes of the disponor and is treated as having held the asset all along, so that the disposal is not respected as such.

247. In this regard, Mr Baldry referred me to the following passage in *FII 1*:

"192 As the Court stated in *Konle*, any national measure adopted after a date laid down in that way is not, by that fact alone, automatically excluded from the derogation laid down in the Community measure in question. If the provision is, in substance, identical to the previous legislation or is limited to reducing or eliminating an obstacle to the exercise of Community rights and freedoms in the earlier legislation, it will be covered by the derogation. By contrast, legislation based on an approach which is different from that of the previous law and establishes new procedures cannot be regarded as legislation existing at the date set down by the Community measure in question (see *Konle*, paragraphs 52 and 53)."

248. In Mr Baldry's view, the decisions in *FII 1* and *Konle* show that Section 775 should be regarded for the purposes of Article 64 of the TFEU as a restriction which existed on 31 December 1993 because it is, in substance, identical to Section 171 (in that it provides for any gain on intangibles to be deferred in a case where the intangibles are the subject of an intra-group disposal but only where the transferee in question is within the UK tax net).

249. In response, Mr Baker relies on the fact that the two provisions operate in slightly different ways, as noted in paragraph 246(b) above. He also points out that, as Mr Baldry is relying, in the context of his arguments on objective comparability – as

to which see paragraph 319 below – that the way in which Section 775 operates (by providing for the transferee to stand in the shoes of the disponor, as opposed to deeming the disposal to take place on a no gain/no loss basis), is very different from the way in which Section 171 operates, Mr Baldry's position on whether or not Section 775 should be seen as a restriction which was in place on 31 December 1993 is inconsistent with his position in relation to whether or not a transferee outside the UK tax net was in an objectively comparable position to a transferee within the UK tax net.

250. I have decided that Mr Baldry's position on this point is to be preferred. When one looks at the decisions in *FII 1* and *Konle*, it is apparent that the key factor in this context is to look at the substance of the two provisions and to ask whether they are both following a common approach, as opposed to focusing on the nuances in the way in which each provision operates. When one does that, it is clear that the substance of Section 171 and Section 775 is one and the same – namely, to provide for any gain which has accrued at the point of the intra-group disposal to be assumed by the transferee (in a case where the transferee is within the UK tax net) and to crystallise immediately (in a case where the transferee is not). So I believe that Section 775 should be regarded as a restriction which was in place on 31 December 1993 by virtue of the existence, on that date, of Section 171.

251. For completeness, I should add that, in *Konle*, the question which the CJEU was addressing was whether Austria could rely on Article 70 of the Act of Accession (the "AoA") in order to justify a particular provision in its legislation. Article 70 of the AoA was worded slightly differently from Article 64 of the TFEU in that it stipulated that "[n]otwithstanding the obligations under the Treaties on which the European Union is founded, the Republic of Austria may maintain its existing legislation regarding secondary residences for five years from the date of accession." Thus, it referred to "existing legislation" as opposed to an "existing restriction". Whilst the CJEU in *FII 1* appears to have treated those two phrases as identical, it seems to me that the language in Article 64 of the TFEU is, if anything, arguably wider (because it is less specific) than the language in the AoA. This tends to reinforce my view that Section 775 should be regarded as a restriction which existed on 31 December 1993.

252. The above means that, even if I am wrong in concluding that both:

> (a) it is not permissible to consider whether the Group Transfer Rules create a restriction on the freedom to move capital set out in Article 63 of the TFEU; and
>
> (b) the Group Transfer Rules in any event do not amount to a restriction on the freedom of JTIH to move capital to JTISA,

the Group Transfer Rules would still amount to a permitted restriction on that freedom by virtue of the standstill in Article 64 of the TFEU.

253. Turning then to the parties' respective submissions in relation to whether or not the Group Transfer Rules created a restriction on the Appellant's freedom to move capital by transferring the Brands and related assets to JTISA, the TFEU does not

itself contain a definition of what constitutes a movement of capital. However, both parties accept that the Nomenclature, whilst not being exhaustive, is indicative of what constitutes a movement of capital and has frequently been referred to as such by the CJEU. For example, see the explanation in *FII 1* at paragraph [179] to which I have referred in paragraph 37 above. Indeed, the Nomenclature says very clearly in its introductory section that "This Nomenclature is not an exhaustive list for the notion of capital movements – whence a heading XIII – F. 'Other capital movement – Miscellaneous. It should not therefore be interpreted as restricting the scope of the principle of full liberalization of capital movements as referred to in Article 1 of the Directive". (As noted in paragraph 37 above, the reference to Article 1 of the Directive should now be construed as a reference to Article 63 of the TFEU.)

254. The most immediate problem to which this gives rise is that the Nomenclature can fairly be described as somewhat Delphic in nature. A significant difficulty is that the various categories of capital movement set out in the Nomenclature are, in each case, circumscribed by whether or not they amount to "capital movements", in an undefined sense, in the first place. That much can be seen in the fact that the Nomenclature is not so much setting out what amounts to a capital movement as putting the various matters which amount to capital movements into categories – see, for example, the opening words of the Nomenclature ("In this Nomenclature, capital movements are classified…") and the words already quoted from the introductory section in paragraph 253 above.

255. It follows that the real issue in this context is not whether the disposal of the Brands and related assets in the course of the 2011 Disposal fits into one or more of the sections from I to XIII which are set out in the Nomenclature – because, even if it does not fit into any of the headings which appear before "XIII – OTHER CAPITAL MOVEMENTS - F - Miscellaneous", it is bound to fall within that heading as long as it amounts to a capital movement - but rather whether that disposal can properly be described as a capital movement in the first place.

256. Much of the discussion at the hearing in relation to the freedom to move capital related to the former issue. Mr Baker submitted that the reference in the introduction to the Nomenclature to "operations to liquidate or assign assets built up" and the reference to "patents, designs, trade marks and inventions (assignments and transfers arising out of such assignments)" in "XIII – OTHER CAPITAL MOVEMENTS – D" were apt to cover the disposal of the Brands and related assets by the Appellant because, in relation to the first of these, the Brands and related assets had been built up in the hands of the Appellant before the 2011 Disposal and, in relation to the second of these, the Brands and related assets were intangibles falling into the category in question. He also argued that the Disposal could be regarded as falling within "I – DIRECT INVESTMENTS" since the Explanatory Notes to the Nomenclature describe this category as "Investments of all kinds by natural persons or commercial, industrial or financial undertakings, and which serve to establish or maintain lasting and direct links between the person providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity" and, in this case, the Brands and related assets were being made available to JTISA in order for JTISA to carry on an economic activity on a lasting basis.

257. In response, Mr Baldry said that there was no basis for regarding an assignment of assets such as intangibles for full consideration as amounting to a capital movement. In addition, he observed that the words "operations to liquidate or assign assets built up" which appeared in the introduction to the Nomenclature did not mean that an assignment of assets was thereby rendered a category of capital movement in its own right. The words were simply making it clear that the categories of capital movement set out in sections I to XIII which followed the introduction should be taken to include operations to liquidate or assign assets built up as a consequence of, or in the course of, one of the specified capital movements. For example, a dividend paid in respect of shares which had been subscribed in order to establish or maintain lasting and direct links between the subscriber and the issuer would, by virtue of these words, fall within "I – DIRECT INVESTMENT" in the same way as the original share subscription itself.

258. Mr Baldry also submitted that the words "Authors' royalties:" which appeared at the start of "XIII – OTHER CAPITAL MOVEMENTS - D" clearly showed – by the use of the colon following "royalties" – that the subsequent references to "patents, designs, trade marks and inventions (assignments and transfers arising out of such assignments)" meant that the various types of intangibles there specified were confined to those which related to authors' royalties and not more generally.

259. Finally, Mr Baldry relied on Article 65(1) of the TFEU – which stipulates that Article 63 of the TFEU is without prejudice to the right of Member States to apply the provisions of their own law that "distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested" – to submit that those provisions of UK law (such as the Group Transfer Rules) which distinguish between taxpayers who are within the UK tax net and taxpayers who are not take precedence over the freedom to move capital in Article 63 of the TFEU.

260. In response, Mr Baker pointed out the terms of Article 65(3) of the TFEU, to the effect that "[t]he measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63." Mr Baker said that the effect of Article 65(3) of the TFEU was to negate the impact of Article 65(1) of the TFEU to the extent that the latter article purported to allow restrictions on a movement of capital based purely on the fact that the capital was being moved to a different jurisdiction. He said that, reading the two provisions together, the net position was ultimately no different from that pertaining in the case of restrictions on the freedom of establishment – that is to say that, as long as a movement of capital involving a transferee outside the UK tax net was objectively comparable to a movement of capital involving a transferee within the UK tax net, Article 65 of the TFEU would not limit the application of Article 63 of the TFEU in that scenario.

261. I have found this a difficult question to answer.

262. If there had been no Nomenclature, I would not have been inclined to consider a disposal of intangible assets in return for consideration equal to the market value of

those assets to be a movement of capital. After all, in that circumstance, each party to the transaction maintains the same value before and after the transaction and there is no sense in which capital has been shifted from one party to the other. The position would be different if the intangible assets were to be transferred for no consideration or at an undervalue. In that case, there would be a demonstrable shift in value from the disponor to the transferee and the situation would be akin to the making of a distribution, which has been held in various CJEU cases to amount to a movement of capital.

263. Logically, the terms of the Nomenclature should not change my answer, because, as I have noted above, the Nomenclature is merely about categorising movements of capital. It does not, as such, contain a definition of what amounts to a movement of capital in the first place. Nevertheless, I consider that the categories set out in the Nomenclature must inevitably influence one's view on what amounts to a movement of capital in the first place, as the terms of the Nomenclature reveal the types of transactions which, in the view of the contracting parties to the Directive in which the Nomenclature was contained, should be regarded as being movements of capital. And, when one looks at the terms of the Nomenclature, it is plain that the mere fact that each party to a transaction gives and receives equal consideration in the course of a transaction is not intended automatically to preclude that transaction from amounting to a movement of capital. For example, a subscription for shares or a long-term loan which, in either case, is made with the intention of establishing or maintaining lasting economic links is clearly intended to qualify as a movement of capital, even though each party to the transaction is providing equal consideration. Similarly, "XIII – OTHER CAPITAL MOVEMENTS E – Transfers of the monies required for the provision of services (not included under VI)" is clearly contemplating that a payment for services can amount to a movement of capital even if the services provided are of equal value to the payment made. The same is true of many of the other transactions listed in the Nomenclature, such as certain acquisitions of securities, units and shares, the making of loans, acquisitions of real estate and payments made in the performance of insurance contracts.

264. Thus, even though I find it hard to see how many of the transactions which are described in the Nomenclature actually amount to a movement of capital in the sense which I would ordinarily understand, it is hard to maintain that the mere fact that full consideration has been provided in the course of a transaction prevents that transaction from amounting to a movement of capital.

265. Given that conclusion, the only bases for determining that the disposal of the Brands and related assets for full consideration does not amount to a movement of capital for the purposes of the Nomenclature would be to succeed in establishing that:

(a) the Nomenclature is confined to transactions of a financial nature and does not include transactions in intangibles; or

(b) the disposal of the Brands and related assets does not fit within any of the categories which are described in the Nomenclature.

266. In relation to the point made in paragraph 265(a) above, whilst I accept that many of the categories which are described in the Nomenclature are financial in nature, in that they relate to shares, loans, securities, units and credit transactions, there are also a number of categories which are not financial in nature. For example, I have already mentioned the reference to services in "XIII – OTHER CAPITAL MOVEMENTS E", but there are also references to real estate (in "II – INVESTMENTS IN REAL ESTATE"), to assets in general (in "IX – PERSONAL CAPITAL MOVEMENTS – F – Transfers of assets constituted by residents, in the event of emigration, at the time of their installation or during their period of stay abroad") and even to intangibles themselves (in XIII – OTHER CAPITAL MOVEMENTS – D – Authors' royalties: patents, designs, trade marks and inventions (assignments and transfers arising out of such assignments)"), to name just a few. (In relation to the latter category, whilst I accept Mr Baldry's submission that the disposal of the Brands and related assets in this case do not fall within that category because the use of the colon after "royalties" shows that the intangibles there listed are limited to those which arise in relation to the works of authors, I think that the very existence of that category in the Nomenclature shows that transfers of intangibles for full consideration are intended to be capable of constituting a movement of capital. It would be a surprising outcome if a transfer of an author's intellectual property rights for full consideration were to amount to a movement of capital falling within the Nomenclature but a transfer of a company's intellectual property rights for full consideration could not.)

267. In relation to the point made in paragraph 265(b) above, once it is accepted that a transfer of intellectual property rights for full consideration amounts to a movement of capital, then, in my view, it must inevitably fall to be treated as such for the purposes of the Nomenclature, either because of the specific statement in the introduction to the Nomenclature – to the effect that the Nomenclature is not an exhaustive list and "should not therefore be interpreted as restricting the scope of the principle of full liberalization of capital movements as referred to in Article 1 of the Directive" – or because of the category entitled "XIII – OTHER CAPITAL MOVEMENTS – F – Miscellaneous" amongst the categories in the Nomenclature.

268. It follows that, in relation to the movement of capital by the Appellant to JTISA represented by the 2011 Disposal, unless Articles 64 or 65 of the TFEU can be seen as permitting the UK to restrict the freedom to move that capital for which Article 63 of the TFEU provides, the only reason why the Appellant would be unable to rely on that freedom in the present case is my conclusion to the effect that the restriction contained in the Group Transfer Rules is susceptible to challenge only in relation to the freedom of establishment.

269. I do not think that either of Articles 64 or 65 of the TFEU is of assistance to the Respondents in this regard.

270. Article 64 of the TFEU does not apply to all movements of capital – the only movements of capital to which it refers are "direct investment – including in real estate – establishment, the provision of financial services or the admission of securities to capital markets". As part of his submissions in relation to the freedom to move capital, Mr Baker sought to persuade me that the disposal of the Brands and related assets by the

Appellant to JTISA amounted to a direct investment in JTISA by the Appellant. If that were to be correct, then, ironically, it would have the effect of enabling the UK to rely on Article 64 of the TFEU to justify the restriction on the freedom of the Appellant to move capital to JTISA set out in Article 63 of the TFEU. However, I agree with Mr Baldry that the disposal of the Brands and related assets by the Appellant to JTISA does not amount to a direct investment by the Appellant in JTISA – the mere fact that JTISA intends to hold the Brands and related assets for the long-term is not relevant in this regard as the "lasting and direct links" to which the Nomenclature refers as constituting a key feature of a direct investment are the lasting and direct links between the person providing the capital and the entrepreneur to whom the capital is made available.

271. Similarly, I do not consider that Article 65 of the TFEU assists the Respondents in this context. I agree with Mr Baker that the combined effect of Articles 65(1) and 65(3) of the TFEU is to put the UK in this regard in a similar position to that in which it is placed in relation to the freedom of establishment. In other words, a Member State cannot treat differently two objectively comparable circumstances merely because, in one case but not the other, the capital is being moved out of the Member State.

272. In conclusion, for the reasons set out above, I consider that:

(a) the Appellant is not entitled to rely on Article 63 of the TFEU in relation to the 2011 Disposal because the CJEU case law demonstrates that the Group Transfer Rules must be considered solely in relation to the freedom of establishment in Article 49 of the TFEU; but

(b) if that were not the case, then the Appellant would not have been able to challenge the imposition of the immediate liability to tax which arose as a result of the 2011 Disposal by relying on JTIH's freedom to move capital to JTISA but it would have been so able by relying on its own freedom to move capital to JTISA.

Freedom of establishment

273. It is common ground that JTIH has no freedom of establishment in relation to JTISA but that JTIH does have a freedom of establishment in relation to the Appellant. It is also common ground that, if, in relation to the 2011 Disposal, the Group Transfer Rules can be said to amount to a restriction on JTIH's freedom of establishment in relation to the Appellant, then it is necessary to go through the same process in relation to that restriction as I have applied in the case of the 2014 Disposal – in other words, to consider possible justification based on the lack of objective comparability or the need to ensure the balanced allocation of taxing powers, the proportionality of the restriction and, ultimately, the appropriate remedy if the restriction is considered either not to be justified or to be disproportionate.

274. However, the parties take issue with one another in relation to the question of whether the imposition on the Appellant of the immediate liability to tax which arose

as a result of the 2011 Disposal can be said to have amounted to a restriction on JTIH's freedom of establishment in relation to the Appellant.

Is there a restriction?

275. Mr Baker contends that it did. He bases this contention on the fact that the immediate tax liability which has been imposed on the Appellant as a consequence of the 2011 Disposal would not have arisen if the Brands and related assets had been transferred to a company within the UK tax net. The restriction therefore arises from the fact that the Appellant is being treated adversely in relation to the disposal to JTISA in comparison to the way in which it would have been treated if the disposal had been made to a transferee within the UK tax net. Mr Baker alleges that that adverse treatment was liable to render less attractive an investment in the Appellant by JTIH and therefore amounted to a restriction on JTIH's freedom to establish the Appellant in the UK.

276. Mr Baker's position is that the fact that the transferee in relation to the 2011 Disposal was not resident in the EU is irrelevant in this context. The only relevant feature was that the transferee was outside the UK tax net. If the transferee had been a French resident subsidiary, then the immediate tax liability to which the Disposal gave rise would have amounted to precisely the same restriction on JTIH's freedom to establish in the UK as in the case where JTISA is the transferee. The fact that, in the former case, there would also have been a restriction on JTIH's freedom to establish in France was neither here nor there.

277. In support of his position, Mr Baker added the following:

> (a) a group headed by a non-UK resident company is more likely to make intra-group cross-border disposals than a group headed by a UK resident company. Thus, whilst a group headed by a UK resident parent company would suffer the same immediate tax liability as did the Appellant, upon making an intra-group disposal to a member of the group located outside the UK tax net, it is more likely that that group's intra-group disposals would be to companies within the UK tax net and therefore benefit from the deferral for which the Group Transfer Rules provide in such cases;
>
> (b) in any event, a restriction on the freedom of establishment can exist even if there is no discrimination against parent companies which are resident in Member States other than the UK as compared to parent companies which are resident within the UK. All that is required in order for the restriction to exist is that there is domestic legislation in place which renders the exercise of the freedom of establishment less attractive. In this case, the existence of the immediate tax charge which arises when a UK resident company such as the Appellant makes an intra-group disposal to a transferee which is outside the UK tax net renders it less attractive for a parent company which is resident in another Member State such as JTIH to exercise its freedom of establishment in the UK by acquiring the Appellant; and

(c) finally, the decision in *Thin Cap* is on all fours with the facts in this case because *Thin Cap* concerned UK legislation which gave rise to certain restrictions on the deductibility of interest paid by a UK resident borrower to a group lender which was outside the UK tax net whereas no such prohibition existed in relation to interest paid by a UK resident borrower to a group lender which was within the UK tax net. As such, the facts in that case were almost identical to the facts in this case in that a benefit available to a UK resident company which borrowed from a group member that was within the UK tax net was denied if the UK resident company in question borrowed instead from a group member that was outside the UK tax net. And, in the course of its decision in that case, the CJEU held that the rules on interest deductibility referred to above amounted to a restriction on the freedom of a parent company which was resident in a Member State other than the UK regardless of whether the interest in question was paid to that parent company, a subsidiary of that parent company resident in a Member State other than the UK or a subsidiary of that parent company resident in a jurisdiction outside the EU.

278. I will return to the decision in *Thin Cap* below because I agree that, at first blush, the restriction which was in issue in *Thin Cap* appears to be almost identical to the restriction which is applicable in this case.

279. However, leaving that decision aside for the moment, I must say that I can see no basis for Mr Baker's submission to the effect that UK rules that impose a tax liability on an intra-group disposal made to a transferee which is outside the UK tax net and which do not impose such a tax liability on an intra-group disposal made to a transferee which is within the UK tax net can amount to a restriction on the freedom of a parent company which is resident in a Member State other than the UK to establish a UK resident subsidiary when those same rules would have applied even if the parent company had been resident in the UK.

280. The key point in this context is that, before the domestic legislation of a Member State can amount to a restriction on the freedom of a resident of another Member State to establish in the first-mentioned Member State, that domestic legislation must give rise to a difference in tax treatment which is based on the involvement in the arrangement of that foreign resident. A difference in tax treatment which exists between disposals to a resident of the Member State in question and disposals to a resident of another Member State can amount to a restriction on the freedom of establishment – namely, the freedom of the disponor (or, for that matter, the common parent of the disponor and the transferee) to establish in the other Member State – but, if that difference exists regardless of where the parent company of the disponor is resident, it cannot amount to a restriction on the freedom of the parent company of the disponor to establish in the Member State of the disponor.

281. The CJEU cases demonstrate this by revealing that there are two distinct categories of tax-related restrictions on the freedom of establishment. Those two distinct categories are described in the following passage in *Papillon*, although the

same point is made in a number of other CJEU cases (see, amongst many examples, *X AB and Y AB* at paragraph [26], *NGI* at paragraph [35] and *Holböck* at paragraph [27]):

"16. Even though, according to their wording, the provisions of the EC Treaty concerning freedom of establishment are directed to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation (Case C-264/96 ICI [1998] ECR I-4695, paragraph 21; Case C-298/05 Columbus Container Services [2007] ECR I-10451, paragraph 33; and Lidl Belgium , paragraph 19)."

282. It can be seen from this passage that the CJEU is distinguishing between the two distinct categories of restriction, as follows:

(a) category 1 - restrictions placed by a host Member State on foreign nationals, which involve treating transactions involving those foreign nationals differently from transactions involving only residents of the host Member State; and

(b) category 2 - restrictions placed by a Member State of origin on nationals of that Member State, which involve hindering the establishment in another Member State by nationals of that Member State.

283. Given that Switzerland is not in the EU, neither the Appellant (nor, for that matter, JTIH) has a right to establish itself in Switzerland and therefore the second category of restrictions is not relevant in this case. Instead, we are here concerned with only category 1 restrictions.

284. The CJEU decision in *X and Y* is helpful in drawing out the distinction between the two categories. In that case, the CJEU was considering the tax treatment in Sweden of transfers of shares at an undervalue. In doing so, it compared transfers of shares to a foreign legal person in which the transferor or his family had a holding (type A transfers), transfers to a Swedish company in which such a foreign legal person had a holding (type B transfers) and transfers to a Swedish company other than one of the kind described in relation to type B transfers in which the transferor or his family had a holding (type C transfers). Under the Swedish legislation at the time, a transferor was entitled to defer paying tax on the gain arising at the time of making the transfer in the case of type C transfers but not in the case of type A transfers or type B transfers. In rejecting Sweden's argument that the difference in treatment in that case was not susceptible to a challenge under Article 49 of the TFEU because the various types of transfer were wholly internal to Sweden, the CJEU noted that:

"34. That argument cannot be upheld. The national provision at issue in the main proceedings requires that there be a foreign element, clearly relevant to the freedom of establishment conferred by the Treaty, namely, for type A share transfers, the fact that the transferee company is established in another Member State, and, for type B share transfers, the fact that a company established in another Member State has a holding in the transferee company and that this foreign element is the basis for a difference in tax treatment within one Member State."

285. Thus, in the case of type B transfers, the Swedish legislation amounted to a category 1 restriction. It was a restriction on the freedom of establishment of the foreign parent in Sweden because the difference in tax treatment in Sweden was based on the fact that the parent of the transferee was established in another Member State and not in Sweden. In contrast, in the case of type A transfers, the Swedish legislation amounted to a category 2 restriction. It was a restriction on the freedom of establishment of the transferor in the other Member State because the difference in tax treatment in Sweden was based on the fact that the transferee was established in another Member State and not in Sweden.

286. In my view, Mr Baker's submission in relation to this part of the Appellant's case represents an attempt to rely on a difference in tax treatment which, were JTISA to have been resident in a Member State other than the UK, would have amounted to a category 2 restriction on the Appellant's (or JTIH's) freedom of establishment in that Member State as the basis for arguing that there is a category 1 restriction on JTIH's freedom of establishment in the UK. I therefore believe that the argument fails on the grounds that the difference in tax treatment which is the source of the complaint – the more beneficial tax treatment accorded to intra-group disposals to transferees within the UK tax net as compared to intra-group disposals to transferees outside the UK tax net - would have applied even if JTIH had been a UK resident company. The difference in tax treatment is therefore incapable of constituting a category 1 restriction.

287. If Mr Baker's argument were to be correct, then any tax liability arising by virtue of the UK legislation would be susceptible to challenge as constituting a restriction on the freedom of a parent company resident in another Member State to establish in the UK because the existence of that tax liability would make it less attractive for that parent to exercise its freedom to establish in the UK than if the tax liability did not exist. That simply cannot be right.

288. For completeness, I see no validity in the argument that a group which is headed by a UK resident parent company is less likely to make intra-group disposals of assets to transferees which are outside the UK tax net than a group which is headed by a parent company which is outside the UK tax net. Of course there are wholly-domestic UK groups which, by definition, are incapable of making intra-group disposals to transferees which are outside the UK tax net. But there are also many UK resident parent company-headed multinational groups in relation to whom that would not be the case. Since the difference in tax treatment on which the Appellant relies applies to such groups as well as to multinational groups headed by parent companies which are outside the UK tax net, there is no reason to consider this to be a relevant factor in identifying whether the legislation in issue amounts to a restriction on the freedom of companies resident in Member States other than the UK to establish in the UK.

289. I also do not follow how the opinion of Advocate General Mengozzi in *Picart*, which Mr Baker mentioned in his submissions, advances the Appellant's position in relation to this issue. *Picart* related to the extent to which an individual who migrated from France to Switzerland would have been able to rely on the exit tax case law of the CJEU if he had been entitled to the benefit of the AFMP. The Advocate General

was of the view that, had Mr Picart been entitled to rely on the AFMP in relation to his move to Switzerland, then the exit tax case law of the CJEU would have been relevant to his position. However, that is saying no more than that, by virtue of the terms of the AFMP, he would then have been treated as if he had the freedom to establish himself in Switzerland and therefore his position would be the same as a company exercising its freedom to establish itself in another Member State. (This is made clear by the CJEU in *Wächtler*, another case in relation to rights under the AFMP, at paragraph [38].) As Switzerland is not a Member State, so that neither the Appellant nor, for that matter, JTIH, has the freedom to establish itself in Switzerland, the view expressed in the opinion has no relevance to the question which is at issue here – namely, whether the imposition of an immediate tax liability in respect of an intra-group disposal to a Swiss resident company could amount to a restriction on the Dutch resident parent company's freedom to establish in the UK. The same is true of the CJEU decision in *Wächtler*, the most recent case in relation to rights under the AFMP.

290. In summary, and before taking into account the decision in *Thin Cap*, I consider that the fact that the Group Transfer Rules distinguish between an intra-group disposal to a transferee which is within the UK tax net and an intra-group disposal to a transferee which is not would amount to a restriction on the freedom of the Appellant (or JTIH) to establish in the jurisdiction of the transferee if that jurisdiction were to be another Member State. However, since the same difference in treatment arises regardless of whether the UK resident disponor is itself the parent company of the group, a subsidiary of a UK resident parent company of the group or a subsidiary of a non-UK resident parent company of the group, it cannot be regarded as restricting the freedom of JTIH to establish in the UK. Put simply, the legislation in question does not involve any discrimination against parent companies which are resident in Member States other than the UK in comparison to parent companies which are resident in the UK because exactly the same provisions apply regardless of the residence of the parent company.

291. It may be seen from the above that, were it not for the decision in *Thin Cap*, I would have little difficulty in reaching the conclusion that the fact that the exclusion in the Group Transfer Rules for intra-group disposals to transferees outside the UK tax net means that the Appellant became subject to an immediate tax liability upon the disposal of the Brands and related asset to JTISA does not create a restriction on JTIH's freedom to establish the Appellant in the UK.

292. However, the similarity of the legislation which was in issue in *Thin Cap* and the legislation which is in issue in this case has inevitably given me pause for thought.

Thin Cap

293. *Thin Cap* related to the UK's deemed distribution and transfer pricing rules, which distinguished between payments of interest to group members which were within the UK tax net and payments of interest to group members which were not. Broadly, the former were deductible by the payer of the interest whilst the latter were either not deductible at all (unless a double tax convention applied) or not deductible

to the extent that they exceeded the amount which would have been paid between parties dealing at arm's length.

294. Mr Baker argues that the facts in *Thin Cap* are analogous to the facts in this case because, in *Thin Cap*, the disadvantageous treatment which was accorded to interest paid by a UK resident borrower to a sister subsidiary which was outside the UK tax net applied regardless of whether the parent company of the group was UK resident or non-UK resident and, in that case, the CJEU held that, where the parent company was resident in a Member State, the legislation in question gave rise to a restriction on the parent company's freedom of establishment regardless of whether the sister subsidiary acting as lender was resident in a Member State or resident in a jurisdiction outside the EU. As so described, the parallel between the facts in *Thin Cap* and the facts in this case, where the Group Transfer Rules apply to all intra-group disposals to transferees which are outside the UK tax net regardless of whether the group in question is headed by a parent company which is outside the UK tax net, is obvious.

295. However, before setting out my analysis of the decision, I should make the point that the analogy between the Group Transfer Rules and the legislation which was in issue in *Thin Cap* is not as close as the description of that legislation in paragraph 294 above suggests.

296. There were three distinct sets of provisions which were in issue in *Thin Cap*:

> (a) Sections 209(2)(e)(iv) and 209(2)(e)(v) of the ICTA, prior to amendments made to the UK legislation by the Finance Act 1995;
>
> (b) Section 209(2)(da) of the ICTA, from the date on which that provision was introduced by the Finance Act 1995 until the date in 2004 when the UK transfer pricing rules in Schedule 28AA of the ICTA were amended to extend the same arm's length testing to payments made to companies within the UK tax net as applied to payments made to companies outside the UK tax net; and
>
> (c) Schedule 28AA of the ICTA, from the date on which that schedule was introduced by the Finance Act 1998 until the date in 2004 referred to in paragraph 296(b) above.

297. None of the above provisions applied in exactly the same way to a borrower paying interest to a sister subsidiary which was outside the UK tax net regardless of whether the borrower was a subsidiary of a UK resident parent company or was a subsidiary of a non-UK resident parent company.

298. So far as the provisions mentioned in paragraph 296(a) are concerned, Section 209(2)(e)(iv) of the ICTA applied to interest paid by a borrower to a sister subsidiary if that sister subsidiary was a subsidiary of a non-UK resident parent company, whilst Section 209(2)(e)(v) of the ICTA applied to interest paid by a borrower to a sister subsidiary if that sister subsidiary was a subsidiary of a UK resident parent company but only if less than 90% of the shares in the borrower were directly owned by a UK resident company. Thus, under those provisions, groups headed by UK resident parent companies were at a significant advantage in comparison to groups headed by

non-UK resident parent companies in that a borrower in which 90% or more of the share capital was held by a UK resident company was not subject to the restriction if its parent company was UK resident but was so subject if its parent company was not. (To make that difference clear in the context of the present facts, if, at the time when that legislation applied, the Appellant had paid interest to JTISA, then, before taking into account the terms of any available double tax agreement, that interest would not have been deductible by the Appellant (pursuant to Section 209(2)(e)(iv) of the ICTA) whereas, had JTIH been a UK resident company, that interest would have been deductible by the Appellant (because neither Section 209(2)(e)(iv) nor Section 209(2)(e)(v) of the ICTA would have applied).)

299. So far as the provision mentioned in paragraph 296(b) is concerned, the provision itself applied to a borrower paying interest to a sister subsidiary outside the UK tax net regardless of whether or not the common parent company of the two parties was UK resident. However, when one examines the provisions in Sections 209(8A) et seq. of the ICTA – the provisions which elaborated upon the assets which a borrower was entitled to take into account in determining whether or not its interest payments were arm's length – one finds that a borrower which was a subsidiary of a UK resident company was at an advantage in comparison to a borrower which was a subsidiary of a non-UK resident company in that the former was able to take into account the assets of the entire group or sub-group which was headed by the UK resident parent company, whereas the latter was confined to taking into account only the assets of its own subsidiaries (see Section 209(8D) of the ICTA).

300. Similarly, so far as the provisions mentioned in paragraph 296(c) are concerned, the Schedule as a whole applied to transactions between companies within the UK tax net and related parties but there was an exclusion in paragraph 5 of the Schedule for cases where the related party was within the UK tax net and met certain conditions. This meant that a borrower within the UK tax net would be entitled to rely on a guarantee given by a parent company within the UK tax net in order to avoid an adjustment under the Schedule to the deduction for its interest payments to a related party outside the UK tax net, even though the guarantee would not have been given by a person dealing at arm's length. (The non-arm's length transaction in that case would be the provision of the guarantee, which would fall outside the terms of the Schedule by virtue of paragraph 5.) However, the same would not be true of a guarantee given by a parent company which was outside the UK tax net.

301. Thus, it can be seen that, in the case of all three sets of provisions, whilst the relevant legislation did not baldly say that the restrictions in question applied if the parties to the transaction were subsidiaries of a non-UK resident parent company and did not apply if the parties to the transaction were subsidiaries of a UK resident company, it is plain that, in their very different ways, each of them meant that a borrower which was a subsidiary of a UK resident parent company was at an advantage in comparison to a borrower which was a subsidiary of a non-UK resident company and that circumstances could arise in which interest that was not deductible by a borrower which was a subsidiary of a non-UK resident parent company would have been deductible if the parent company had instead been a UK resident company.

302. It follows that I am not convinced by the analogy drawn by Mr Baker between the manner in which the legislation which was in issue in *Thin Cap* applied and the manner in which the exclusion contained within the Group Transfer Rules applied in relation to the 2011 Disposal. In *Thin Cap*, depending on the precise facts of the test cases, the restrictions which were the subject of the decision would not necessarily have applied if the relevant parent company had been UK resident whereas, in this case, the Group Transfer Rules would have operated in precisely the same manner in relation to the 2011 Disposal if JTIH had been a UK resident company.

303. However, in the context of this case, what matters is not so much what the legislation in question actually said but rather what Advocate General Geelhoed and the CJEU assumed that it said in analysing the position and reaching their respective ultimate conclusions in *Thin Cap*.

304. Turning then to the terms of the decision in *Thin Cap*, the following questions were (inter alia) raised with the CJEU:

(1) Is it contrary to Articles 43 [EC], 49 [EC] or 56 EC for a Member State ("the State of the borrowing company") to keep in force and apply provisions such as those in sections 209, 212 and schedule 28AA of [ICTA] ("the national provisions") which impose restrictions upon the ability of a company resident in that Member State ("the borrowing company") to deduct for tax purposes interest on loan finance granted by a direct or indirect parent company resident in another Member State in circumstances where the borrowing company would not be subject to such restrictions if the parent company had been resident in the State of the borrowing company?

(2) What difference, if any, does it make to the answer to Question 1:

(a) if the loan finance is provided not by the parent company of the borrowing company but by another company ("the lending company") in the same company group sharing a common direct or indirect parent company with the borrowing company and both that common parent and the lending company are resident in Member States other than the State of the borrowing company?

(b) if the lending company is resident in a Member State other than that of the borrowing company but all common direct or indirect parent companies of the borrowing company and the lending company are resident in a third country?

(c) if all the common direct or indirect parent companies of the lending company and the borrowing company are resident in third countries and the lending company is resident in a Member State other than that of the borrowing company, but advances the loan finance to the borrowing company from a branch of the lending company situated in a third country?

(d) if the lending company and all the common direct or indirect parent companies of the lending company and the borrowing company are resident in third countries?

(3) Would it make any difference to the answers to Questions 1 and 2 if it could be shown that the borrowing constituted an abuse of rights or was part of an artificial arrangement designed to circumvent the tax law of the Member State of the borrowing company? If so, what guidance does the Court of Justice think it appropriate to provide as to what constitutes such an abuse or artificial arrangement in the context of cases such as the present?" (see paragraph [22])

305. The CJEU answered the first question (and the third question so far as it pertained to the first question) in the manner which one would have expected, given that the UK legislation in question clearly discriminated between interest paid to a parent company which was within the UK tax net and interest paid to a parent company which was not. It said as follows:

"61 …it must be held that a difference in treatment between resident subsidiaries which is based on the place where their parent company has its seat constitutes a restriction on freedom of establishment, since it makes it less attractive for companies established in other Member States to exercise freedom of establishment and they may, in consequence, refrain from acquiring, creating or maintaining a subsidiary in the Member State which adopts that measure (see *Lankhorst-Hohorst,* paragraph 32)."

306. It went on to hold that that difference went beyond what was necessary to prevent abusive practices (and was therefore disproportionate) unless it allowed the subsidiary which was being denied the ability to deduct the interest an opportunity to show that there was a commercial justification for the transaction. It concluded:

"92 The answer to Questions 1 and 3 must therefore be that Article 43 EC precludes legislation of a Member State which restricts the ability of a resident company to deduct, for tax purposes, interest on loan finance granted by a direct or indirect parent company which is resident in another Member State or by a company which is resident in another Member State and is controlled by such a parent company, without imposing that restriction on a resident company which has been granted loan finance by a company which is also resident, unless, first, that legislation provides for a consideration of objective and verifiable elements which make it possible to identify the existence of a purely artificial arrangement, entered into for tax reasons alone, and allows taxpayers to produce, if appropriate and without being subject to undue administrative constraints, evidence as to the commercial justification for the transaction in question and, secondly, where it is established that such an arrangement exists, such legislation treats that interest as a distribution only in so far as it exceeds what would have been agreed upon at arm's length."

307. However, it is the second question which is the more pertinent to the facts in this case, because the CJEU went on to consider whether its answer would be different if, instead of having been made by the parent company of the UK resident borrower, the loan giving rise to the interest had been made by a subsidiary of that parent company. In answering that question, the CJEU said as follows:

"94 In that regard, it must be noted, first of all, that, as was stated in paragraph 61 of this judgment, national legislation such as the legislation at issue in the main proceedings which, in treating interest paid by a resident subsidiary to a parent company as a distribution, applies a difference in treatment between resident subsidiaries which is based on the place where their parent company has its seat, constitutes a restriction on freedom of establishment, since it makes it less attractive for companies established in other Member States to exercise freedom of establishment and they may, in consequence, refrain from acquiring, creating or maintaining a subsidiary in the Member State which adopts such a measure.

95 It follows that legislation of this kind constitutes a restriction on freedom of establishment which is prohibited, in principle, by Article 43 EC, both where a resident borrowing company is granted a loan by a company which is established in another Member State and has a direct or indirect holding in the capital of the borrowing company, conferring on it definite influence

on the decisions of that company and allowing it to determine its activities, and where a borrowing company is granted a loan by another non-resident company which, irrespective of where it is resident, is itself controlled by a company which is resident in another Member State and which has, directly or indirectly, such a holding in the capital of the borrowing company.

96 The answer given to Question 1 therefore also applies to the situation referred to in the first indent to Question 2.

97 As regards the situations referred to in the second, third and fourth indents to Question 2, it must be noted, as was stated in paragraph 36 of this judgment, that Article 43 EC, read in conjunction with Article 48 EC, entails, for companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community, the right to exercise their activity in the Member State concerned through a subsidiary, branch or agency.

98 Article 43 EC has accordingly no bearing on the application of national legislation such as the legislation at issue in the main proceedings to a situation in which a resident company is granted a loan by a company which is resident in another Member State and which does not itself have a controlling shareholding in the borrowing company and where each of those companies is directly or indirectly controlled by a common parent company which is resident, for its part, in a non-member country.

99 Where, in such a situation, the Member State which has adopted that legislation treats interest paid by the borrowing company as a distribution, that measure affects freedom of establishment, not as regards the lending company, but only as regards the parent company which enjoys a level of control over each of the other companies concerned allowing it to influence the funding decisions of those companies. In so far as that related company is not established in a Member State for the purposes of Article 48 EC, Article 43 EC is not applicable.

100 For the same reasons, Article 43 EC has no bearing on the application of that legislation to a situation in which both the lending company and the common parent company are resident in a non-member country, nor does it have any bearing on a situation in which a lending company which is resident in another Member State and does not itself control the borrowing company grants the loan through a branch established in a non-member country, where the common parent company is also resident in a non-member country.

101 As regards the other provisions of the Treaty relied on by the claimants in the main proceedings, it must be pointed out that, as was stated in paragraphs 33 and 34 of this judgment, legislation such as the legislation at issue in the main proceedings, which is targeted only at relations within a group of companies, primarily affects freedom of establishment. Even if it were to be accepted that such legislation might have restrictive effects on the freedom to provide services and the free movement of capital, such effects must be seen as an unavoidable consequence of any restriction on freedom of establishment and do not justify an independent examination of that legislation in the light of Articles 49 EC and 56 EC.

102 The answer to Question 2 must therefore be that Article 43 EC has no bearing on legislation of a Member State, such as the legislation referred to in Question 1, where that legislation applies to a situation in which a resident company is granted a loan by a company which is resident in another Member State or in a non-member country and which does not itself control the borrowing company and where each of those companies is controlled, directly or indirectly, by a common parent company which is resident in a non-member country."

308. It can be seen from the above extract that the CJEU was of the view that:

(a) since a parent company which was resident in a jurisdiction outside the EU was not entitled to the benefit of the freedom of establishment, no reliance could be placed on Article 49 of the TFEU in relation to a difference in tax treatment between interest paid to lenders within the UK tax net and interest paid to lenders outside the UK tax net in circumstances where the interest in question had been paid to a subsidiary of that parent company, regardless of whether that subsidiary was resident in a Member State or resident in a jurisdiction outside the EU; but

(b) since a parent company which was resident in a Member State was entitled to the benefit of the freedom of establishment, reliance could be placed on Article 49 of the TFEU in relation to a difference in tax treatment between interest paid to lenders within the UK tax net and interest paid to lenders outside the UK tax net in circumstances where the interest in question had been paid to a subsidiary of that parent company, regardless of whether that subsidiary was resident in a Member State or resident in a jurisdiction outside the EU.

309. It is the second of these holdings which is the basis for the Appellant's position in this part of its case because the Appellant contends that the holding suggests that a difference in the tax treatment which is accorded to an intra-group disposal to a transferee which is outside the UK tax net and resident outside the EU as compared to an intra-group disposal to a transferee which is within the UK tax net is capable of amounting to a restriction on the freedom of establishment of the EU resident common parent company of the two entities to the transaction.

310. I believe that there is a simple answer to this and it is to be found in the wording of the questions which the CJEU was addressing, as set out in paragraph 304 above.

311. It can be seen that Question (1) was addressing a situation in which interest was being paid to a parent company of the borrower and therefore dealing with "restrictions upon the ability of a company resident in [the UK] to deduct for tax purposes interest on loan finance granted by a direct or indirect parent company resident in another Member State <u>in circumstances where the borrowing company would not be subject to such restrictions if the parent company had been resident in the State of the borrowing company"</u> [my emphasis].

312. Question (2) then simply asked whether the answer to Question (1) would have been different if the lending company had been, inter alia, a sister company, and not the parent company, of the borrowing company. In my view, in phrasing Question (2) in that way, the national court necessarily incorporated into Question (2) the language

from Question (1) set out in paragraph 311 above which I have underlined. So, in answering Question (2), the CJEU was assuming that the restrictions on the deductibility of the interest paid to the sister subsidiary of a common non-UK resident parent company which it was there considering "would not" have applied if that common parent company had been resident in the UK.

313. In the light of the points which I have made in paragraphs 297 to 302 above, one might debate the accuracy of that assumption as so expressed. As I have explained in those paragraphs, as a general matter and before taking into account the actual facts of the test cases, the differences between the circumstances involving a common non-UK resident parent company and the circumstances involving a common UK resident parent company were a little more nuanced than might be inferred from the simple statement that the borrower "would not" be subject to such restrictions in the latter case. Examining those provisions as a general matter and without reference to the specific facts of the test cases, one might conclude that a more accurate way of phrasing the relevant question in the context of Question (2) might have been to say "might not" instead of "would not".

314. On the other hand, there is no evidence in terms of the descriptions of the test cases in the Advocate General's opinion or the CJEU decision that the nuances to which I have referred in paragraphs 297 to 302 above were in fact relevant in the context of *Thin Cap*. It is perfectly possible that, based on the facts in the test cases, the phrase "would not" was either an accurate statement of the position or, on the contrary, completely inaccurate (because precisely the same outcome would have occurred if the borrowers had been subsidiaries of UK resident parent companies). In the latter case, of course, the CJEU would have been addressing a completely hypothetical question which bore no relationship to how the UK legislation actually applied in the context of the test cases - as to which, see further in paragraph 331 below.

315. However, regardless of one's views on whether or not the assumption was appropriately expressed, there is no doubt in my mind that, in answering Question (2), the CJEU was assuming that the legislation that it was considering would not have applied if the common parent company had been UK resident.

316. It is therefore not surprising that the CJEU answered, as it did, that the restrictions on deductibility which applied to interest on a loan made by a sister subsidiary of a common parent company resident in another Member State would amount to a restriction on that parent company's freedom to establish in the UK regardless of whether the sister company was resident within or outside the EU. That would obviously be the case if, had that parent company been UK resident, the relevant restrictions would not have applied because, in that event, the UK legislation would be treating a borrower which was a subsidiary of a parent company resident in another Member State adversely in comparison to a borrower which was a subsidiary of a UK resident parent company. In effect, on the basis of the assumption which the CJEU was making in addressing the question, the legislation in question would be giving rise to what I have described above as a category 1 restriction.

317. There are two further pieces of evidence within the CJEU's decision, apart from the express cross-reference to Question (1) in Question (2), which support this interpretation.

318. First, although it appears in the course of answering Question (1), the CJEU in paragraph [59] of its decision refers to "the difference in treatment to which the subsidiaries of non-resident parent companies are, by virtue of legislation such as the legislation at issue in the main proceedings, subjected in comparison with subsidiaries of resident parent companies" and it is plain that, in referring generically to "the legislation at issue in the main proceedings" it is referring to the legislation which is pertinent to both Question (1) and Question (2). Secondly, it is clear from the way in which paragraphs [94] and [95] are expressed that Question (2) is also being answered in the light of the assumption that the UK legislation confers a more beneficial tax treatment on groups headed by UK resident parent companies than it does on groups headed by parent companies resident in other Member States because, having noted in paragraph [94] that "the legislation at issue in the main proceedings …applies a difference in treatment between resident subsidiaries which is based on the place where their parent company has its seat", the CJEU goes on to say in paragraph [95] that "[i]t follows that legislation of this kind constitutes a restriction on freedom of establishment which is prohibited, in principle, by Article 43 both where a resident borrowing company is granted a loan by a company which is established in another Member State and has a direct or indirect holding in the capital of the borrowing company, conferring on it definite influence on the decisions of that company and allowing it to determine its activities, and where a borrowing company is granted a loan by another non-resident company which, irrespective of where it is resident, is itself controlled by a company which is resident in another Member State and which has, directly or indirectly, such a holding in the capital of the borrowing company".

319. Mr Baker made two submissions by way of disagreeing with the analysis set out above.

320. First, he said that the language from Question (1) which I believe is to be read into Question (2) should not be so read because it is plain from other decisions of the CJEU that, where the CJEU considers that questions should be considered together, it does so and, in this case, Question (2) is clearly distinct from Question (1). In Mr Baker's view, the only words from Question (1) which should be read into Question (2) were those which referred to the relevant articles of the TFEU.

321. Secondly, he said that it was clear from the language used both in the CJEU decision and in the opinion of the Advocate General in *Thin Cap* that the CJEU and the Advocate General were well aware that the restrictions on the deductibility of interest paid to a sister subsidiary of a common parent company applied regardless of the residence of the common parent company and therefore should be regarded as having taken that into account in reaching their respective answers to Question (2).

322. I do not agree with either of the above submissions.

323. In relation to the first submission, given the way in which Question (2) is expressed, relative to the expression of Question (1), I do not see how it is possible to read Question (2) in any way other than its incorporating within it the reference to the

differing tax treatment under UK law based on the residence of the parent company which is the central feature of Question (1).

324. I would add that the fact that the words at the end of Question (1) are intended to apply for the purposes of Question (2) as well as for the purposes of Question (1) can also be shown in:

> (a) the slight difference between the terms of Question (1), as it is set out in paragraph [22], and the way in which Question (1) is answered by the CJEU in paragraph [92]. The latter – already pre-figuring the CJEU's response to Question (2) later in the decision – includes the words "or by a company which is resident in another Member State and is controlled by such a parent company" after repeating the reference to the direct or indirect parent company to which Question (1) was actually confined; and
>
> (b) the way in which, at the end of its decision, the CJEU formally answers the questions which have been asked of it. In those answers, the CJEU deals with interest paid to Member State-resident parent companies and Member State-resident subsidiaries of Member State-resident parent companies in its answer numbered 1 (reflecting the terms which it used in its answer to Question (1) in paragraph [92] but not the terms of Question (1) itself) and deals with interest paid to subsidiaries (resident both within and outside the EU) of non-Member State-resident parent companies in its answer numbered 2. Thus, as it happens, neither of those formal answers covers the situation which is analogous to the present case (of a non-Member State-resident subsidiary of a Member State-resident parent company). More significantly in this context, the CJEU is plainly responding to Question (1) and Question (2) together in its answers numbered 1 and 2.

325. In relation to the second submission, even if one ignores the fact that, as I have mentioned in paragraphs 297 to 302 above, there might well have been circumstances in which the same restrictions would not have applied if the common parent company had been UK resident, it is clear that neither the Advocate General nor the CJEU were particularly focused on what the position would have been if the relevant borrowers had been subsidiaries of a UK resident parent company instead of a non-UK resident parent company. Instead, they were focusing on the fact that interest paid by a borrower which was a subsidiary of a non-UK resident parent company was being treated differently depending on whether that interest was being paid to a UK resident lender or a non-UK resident lender.

326. It is true that there are a few places in the CJEU decision and the opinion of the Advocate General where the references to the non-deductibility of interest paid to non-UK resident group members are generic in nature and therefore can be read as applying to such interest payments regardless of the residence of the common parent company – see, for example, paragraphs [7] and [12] in the Advocate General's opinion. However, these are simply general descriptions of the relevant provisions and are not in any way focused on the question of whether the same restrictions might also apply in the context of groups headed by UK resident parent companies.

327. In addition, there are other references – such as in paragraphs [18] and [33] of the Advocate General's opinion and paragraph [5] of the CJEU decision – which show that the CJEU and the Advocate General were very firmly focused on the restrictions in the context of groups headed by non-UK resident parent companies and did not have, at the forefront of their minds, the fact that the same rules might have applied even if the parent company in question had been UK resident. That focus can be seen in the way in which paragraph [7] of the Advocate General's opinion – which, in describing the restriction in Sections 209(2)(e)(iv) and 209(2)(e)(v) of the ICTA, says that this restriction applies "in particular" to payments to a sister subsidiary of a common non-UK resident parent – morphs into paragraph [5] of the CJEU decision – which says only that the restriction applies to payments to a sister subsidiary of a common non-UK resident parent.

328. There are two final points which I should make in relation to *Thin Cap*.

329. The first is that, given the clear principles in relation to differences in tax treatment within a Member State which can amount to a restriction on the freedom of establishment, as described in paragraphs 275 to 291 above, if the CJEU and the Advocate General had taken into account, in reaching their respective decisions, the fact that the same restrictions on the deductibility of interest which they were considering in relation to payments of interest to a sister subsidiary of a common parent company resident in another Member State would also have applied to such interest if the common parent company had been UK resident, then one would have expected both the CJEU decision and the Advocate General's opinion to contain some express reference to that fact.

330. This is because, if the CJEU and the Advocate General were intending to hold that limitations on the deductibility of interest paid to a sister subsidiary of a common parent company which would have applied regardless of the residence of the common parent company amounted to a restriction on the freedom of a common parent company resident in another Member State to establish in the UK, they would surely have known that they were thereby establishing a principle that was not laid down in any earlier CJEU decision and would have felt it necessary to explain their thinking in that regard. The fact that there is no such explanation strongly suggests that they were not deciding that at all.

331. The second is that, even if one were to say (based on my analysis of the decision in *Thin Cap* in paragraphs 303 to 327 above) that the CJEU, in answering Question (2), was answering a hypothetical question, which did not accurately reflect the state of the UK legislation at the time, and that the CJEU is entitled to refuse to answer questions raised with it which are obviously hypothetical, there is a presumption that questions which are raised with the CJEU are not hypothetical. In the words of the CJEU in *LabTec* at paragraphs [28] and [29], "according to settled case-law, questions on the interpretation of European Union law referred by a national court in the factual and legislative context which that court is responsible for defining, and the accuracy of which is not a matter for the Court to determine, enjoy a presumption of relevance". See also in this regard *DMC* at paragraph [24]. Thus, in this case, the CJEU was entitled to answer the second question in the form in which that question

had been put to it by the UK courts even if the question was based on an assumption as to the manner in which the relevant UK legislation operated which was not correct. And, in any event, as I have explained in paragraphs 297 to 302, 313 and 314 above, depending on the facts of the test cases before the CJEU, that assumption may not have been incorrect – it is possible that it was either entirely accurate or merely expressed a little too broadly – ie "would not" instead of "might not".

332. In summary, I consider that the decision in *Thin Cap* does not affect the conclusion which I reached in paragraph 290 above because, in this case, the application of the Group Transfer Rules in the context of the 2011 Disposal would have led to the same outcome even if JTIH had been a UK resident company and therefore the relevant legislation in this case is distinguishable from the legislation which was assumed by the Advocate General and the CJEU to be at issue in Question (2) in *Thin Cap*.

333. For the reasons set out in paragraphs 275 to 332 above, I have concluded that the imposition of an immediate tax liability on the Appellant in relation to the disposal of the Brands and related assets to JTISA did not amount to a restriction on either the freedom to move capital or the freedom of establishment. It therefore follows that, in my view, in relation to the 2011 Appeal, the EU Law Issue should be determined in favour of the Respondents and the Valuation Issue needs now to be determined.

334. However, in case consideration of the EU Law Issue in the context of both Appeals proceeds further – which, given the complexities to which it gives rise, seems highly likely - I should make two final points.

335. The first is that I was not persuaded by Mr Baldry's argument that the differing language used in Section 775 as compared to Section 171 means that, in connection with the application of the objective comparability test, the Appellant was even less able than it was in relation to JTIH in the context of the 2014 Disposal to show that JTISA was in an objectively comparable situation to the situation of a transferee of the Brands and related assets which was within the UK tax net. In my view, the answer in relation to the question of objective comparability is precisely the same in the case of JTISA in the context of the 2011 Disposal as it is in the case of JTIH in the context of the 2014 Disposal. This is because, in both cases, the precise language which is used in the Group Transfer Rules in question is irrelevant in the light of the substantive effect of the rules and the significant number of cases in which the CJEU has held that the mere fact that, in the course of the transactions under consideration, the relevant assets left the tax net of the Member State imposing the liability did not mean that those transactions were not objectively comparable to transactions in which the assets remained in that tax net.

336. The second is that, had I found that the application of the Group Transfer Rules in the context of the 2011 Disposal amounted to a disproportionate restriction on JTIH's freedom to establish in the UK, the same reasoning as is set out in relation to the 2014 Disposal would have led me to the conclusion that disapplication of the relevant rules in circumstances where their application would otherwise give rise to a restriction on that freedom was the appropriate remedy. I am not persuaded that the

answer in relation to the justification for, or the proportionality of, the restriction which I reached in relation to the 2014 Disposal should be in any way altered in the context of the 2011 Disposal by the fact that Switzerland is not within the EU and therefore was not a party to the Multilateral Convention at the time of the 2011 Disposal. I say this because:

(a) there is a double tax convention between the UK and Switzerland, Article 25 of which has been in effect since 1 January 2011 and provides for exchanges of information between the two jurisdictions;

(b) JTIH, the parent company of JTISA, is resident in the Netherlands and was therefore within the scope of the Multilateral Convention at the time of the 2011 Disposal; and

(c) the disponor of the intangibles, the Appellant, remains within the UK (so that the deferred corporation tax liability would still be capable of being enforced against it) and has undertaken to provide the Respondents with an annual statement confirming that the intangibles either remain within the sub-group headed by JTIH or have left that sub-group. In *Denmark* and *A Oy*, similar facts to those were considered to be material factors in the CJEU's decision in those cases to treat the immediate imposition of tax as disproportionate – see paragraph [47] in *Denmark* and paragraph [39] in *A Oy*.

Conclusion

337. For the reasons which are set out above:

(a) in relation to the 2014 Appeal, the EU Law Issue is determined in favour of the Appellant and the 2014 Appeal is upheld; and

(b) in relation to the 2011 Appeal, the EU Law Issue is determined in favour of the Respondents and the Valuation Issue needs now to be determined.

338. For the reasons set out in this decision, I do not think that it is necessary or appropriate to refer to the CJEU any question in relation to the interpretation of the TFEU in the context of this case as I believe that the application of the TFEU in this regard is clear, based on the existing CJEU case law.

Right to appeal

339. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later

than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

TONY BEARE
TRIBUNAL JUDGE

RELEASE DATE: 25 MARCH 2019