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The CJEU decides in the *Gallaher* case that the UK's legislation at the relevant time, which required an immediate tax charge without the right to deferral on a disposal of assets for market value consideration to a group company outside the UK tax net, was compliant with EU law. The recently published transfer pricing and diverted profits tax statistics show that the Profit Diversion Compliance Facility and the diverted profits tax continue to be a success for HMRC, but taxpayers face longer waiting times to agree APAs and ATCAs. The taxpayer in *Harrison* fails to convince the Upper Tribunal that the doctrine of staleness survived after the Supreme Court's decision in *Tooth*. The Upper Tribunal in *Morrisons* considers when the UT can interfere in an FTT's decision on the application of a multi-factorial test.

Gallaher: group transfer rules imposing immediate tax charge were EU-compliant

Gallaher v HMRC C-707/20 concerned two disposals by Gallaher (a UK company): the 2011 disposal of intellectual property to its Swiss sister company (JTISA), and the 2014 disposal of shares to a Dutch intermediate parent company (JTIH). In both cases the transferee was outside the scope of UK corporation tax, and so prevented from having no gain/no loss treatment applied to those transfers under TCGA 1992 s171, or the equivalent for intangible fixed assets in CTA 2009 s775 and s776. The question was whether the UK's group transfer rules were contrary to EU law because they triggered an immediate tax charge with no option for deferring payment of the charge (for example, by permitting payment in instalments).

The Upper Tribunal (UT) requested a preliminary ruling from the CJEU on 30 December 2020, just before the Brexit transition period ended. The CJEU confirmed the conclusion of the First-tier Tribunal (FTT) that there was no breach of EU law in respect of the 2011 transfer. There was no restriction on freedom of establishment of the Dutch common parent company because the same tax charge would have arisen for Gallaher on a transfer to a third country even if the parent company had had its tax residence in the UK, and no restriction of Gallaher's freedom of establishment because the transferee was outside the EU. Although the 2011 disposal involved a third country transferee, free movement of capital could not be relied on in an intra-group situation.

Where the CJEU's decision gets more interesting, however, is in respect of the 2014 disposal. The CJEU decision accords with the FTT's that the UK legislation imposed a restriction on freedom of establishment but where the decisions diverge is on the question of proportionality. The FTT (Judge Beare) had determined that in the context of the 2014 disposal, although the immediate tax charge could be justified by the objective of securing the balanced allocation of taxing powers, he determined it was not proportionate because there was no provision to pay by instalments. Judge Beare concluded it was not possible to read into the legislation a requirement to apply exit tax instalment provisions as there was a choice of different instalment provisions in other UK legislation and he said it was not for the court/tribunal to decide which to apply. He instead disapplied the exclusion from s171 for intra-group disposals to transferees outside the UK tax net with the result that a £1.5m gain on the disposal of shares would escape the UK tax net altogether. This was a rather surprising result at the time and is not supported by the CJEU which concluded that an immediate tax charge is a justified and proportionate restriction on the freedom of establishment where, as here, the taxpayer has obtained by way of consideration for the disposal of the assets an amount equal to the full market value of the assets.

The taxpayer's arguments drew upon a line of CJEU case law which established that, for exit taxes to be proportionate, there had to be a deferral or instalment regime. However, this argument makes more sense when applied to unrealised gains that are deemed to be triggered when a company leaves the jurisdiction and in such circumstances the taxpayer would face a liquidity problem. The taxpayer's attempt to extend this proportionality argument to realised gains when an asset is sold intragroup for full market value failed. In such circumstances, the taxpayer does not have a liquidity problem paying the tax and the risk to HMRC that the tax will not be paid may increase with time, so an immediately recoverable tax charge appears proportionate to the objective of a balanced allocation of taxing power without the possibility of deferring payment having been granted to the taxpayer.

Although this case is mostly of historic interest to the UK, the legislation having since been amended to permit payment of the exit tax in instalments, it will be of greater interest to EU countries because there are a lot of fundamental questions and concepts here which will be relevant to them. From a UK perspective, it will be interesting to see if the instalment payment regime for such exit taxes remains on the statute book as drafted!

Latest transfer pricing and diverted profits tax statistics for 2021-2022

In the latest statistics, the good news for taxpayers is that transfer pricing enquiries (including real-time interventions) settled within the year have increased by 51 to 175 from the previous year and the average age of settled enquiries has dropped by 2 months to 34 months. This is despite the fall in the number of staff working on international issues involving MNEs.

The Profit Diversion Compliance Facility (PDCF) launched in 2019 has secured over £516m additional revenue from resolution proposals and changes in taxpayer behaviour. HMRC reports that the PDCF is proving to be successful - around two-thirds of the large businesses targeted decided to use the facility to bring their tax affairs up to date quickly and efficiently. HMRC is reviewing how the PDCF can be expanded to help address other areas of tax risk.

Diverted profits tax (DPT) has also been a winner for HMRC with over £7.8 billion in tax being secured since DPT was introduced in 2015, comprised of the net amount of DPT from charging notices, additional corporation tax from transfer pricing disputes settled and additional VAT from business restructuring to stop the profit diversion. Up to March 2022, DPT helped HMRC to settle over 170 investigations for additional corporation tax - this yield is included in additional corporation tax from adjustments to transfer pricing. A further £2.4 billion of tax is under consideration as at the end of March 2022 in around one hundred reviews into multinationals with arrangements to divert profits (including those who have registered under the PDCF).

There has also been improvement in the mutual agreement procedure (MAP) statistics which show the number of MAP cases resolved in the year more than doubled from the previous year and the average time to resolve cases has decreased to 21.1 months from 34.4 months. It is not such good news for taxpayers requesting Advance Pricing Agreements (APAs), however, as the number of applications made has increased since the previous year but the number of APAs agreed during the year has gone down and the average time to reach agreement is now 58.3 months – nearly 3 months longer than the previous year.

The number of Advance Thin Capitalisation Agreements (ATCAs) agreed in the year has dropped sharply (from 23 to 7) and the time taken to reach agreement has increased significantly from 28.1 months to 44 months. The number of ATCAs in force also declined from 97 to 44. HMRC note that it is possible that, following the introduction of the corporate interest restriction (CIR), some groups may no longer apply for ATCAs as their interest deductions may be restricted under the mechanical CIR rules to lower amounts than would otherwise be permitted under the arm's length principle or to amounts that do not make the expense of an ATCA worthwhile.

Harrison: staleness does not prevent a discovery assessment from being valid

Notwithstanding the Supreme Court's decision in HMRC v Tooth [2021] UKSC 17, the taxpayer in Harrison v HMRC [2023] UKUT 38 (TCC) thought it worth having a go at arguing that HMRC's discovery was stale and invalid because it sat on the information for too long before making an assessment. In May 2021, in *Tooth* the Supreme Court had set out its comprehensive reasoning why Charlton [2012] UKUT 770 (TCC), which was the basis for the decision by the Court of Appeal in *Tooth* that staleness was a doctrine that could prevent a discovery assessment being valid, was wrongly decided on this issue. As the Supreme Court decided the case on another ground, the comments on staleness were *obiter*.

In *Harrison*, the taxpayer's argument was that *ratio* of a lower court trumps *obiter* of a higher court. The taxpayer argued that the UT should ignore the Supreme Court in *Tooth* because what it said about staleness was obiter and instead be bound by the Court of Appeal's decision that staleness did exist as that was the ratio of the decision. The UT disagreed and confirmed, with a reference to Monty Python's parrot, that the doctrine of staleness is most definitely deceased.

Morrisons: application of multi-factorial tests

At first glance, Morrisons v HMRC [2023] UKUT 20 (TCC) may appear like yet another niche case on classification of edibles for VAT purposes. But the discussion of the threshold for challenging the FTT's conclusion in respect of the application of a multi-factorial test is of wider interest. In addition to VAT classifications, multi-factorial tests are used in legislation to determine, for example, the source of interest, whether an activity amounts to a trade or whether a person should be regarded as an employee. So, this case could have a wide impact.

HMRC had denied Morrisons' application for a VAT refund on the basis that, as the Nakd and Organix bars were 'confectionary', their supply was standard-rated. The FTT sided with HMRC, so Morrisons appealed to the UT arguing that the FTT had wrongly treated the following two factors as irrelevant to the question whether the bars were confectionary: their healthiness and the absence of ingredients, such as cane sugar, butter and flour, associated with traditional confectionary.

To set aside the FTT's decision, the UT would first have to find an error of law and then it is a matter for the UT's discretion. Where multi-factorial tests are concerned, there is a need for appellate caution so the UT must accord due deference to the FTT's role in conducting the multi-factorial evaluation. The UT reasoned that this appellate caution really relates to the weighing of different factors and matters of degree. The situation where the FTT has taken into account an irrelevant factor or failed to take into account a relevant factor is rather different. Taking into account the wrong factors is itself an error of law.

The question is then whether the error of law is sufficiently material to set aside the decision. The materiality threshold in these circumstances is whether the FTT might have reached a different decision had it taken into account the correct factors - not whether it would have reached a different conclusion, as HMRC had argued.

This is clearly good news for taxpayers looking to challenge a first instance decision involving a multi-factorial test - although succeeding in such a challenge may not necessarily lead to an immediate resolution of the dispute. Indeed, in this case the UT did not remake the FTT's decision but referred it back to a differently-constituted FTT as further detailed findings of fact may be required and the UT wished to avoid concern that if remitted to the original FTT, the panel might be considered to have been subconsciously influenced by its earlier decision.

What to look out for:

- The Spring Finance Bill is expected to be published on 23 March.
- The regulations to implement the OECD's mandatory disclosure rules in the UK (repealing and replacing DAC6) come into effect on 28 March.
- The Upper Tribunal is scheduled to hear the appeal in *JTI Acquisition Company v HMRC* on 29 and 30 March on the loan relationships unallowable purpose rule.
- A number of rate changes are due to take place from 1 April including an increase in the rate of corporation tax to 25% for profits over £250,000 and a corresponding increase in the rate of diverted profits tax to 31%. The rate of corporation tax surcharge on banking companies will reduce to 3% (down from 8%) whilst the surcharge allowance will increase from £25m to £100m.

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