[2011] UKUT 420 (TCC)

Appeal number: FTC/50/10

DOUBLE TAXATION TREATIES – non-discrimination – group relief

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Appellants**

- and -

FCE BANK PLC **Respondent**

TRIBUNAL: MR JUSTICE HENDERSON
JULIAN GHOSH QC
(TRIBUNAL JUDGES)

Sitting in public at The Royal Courts of Justice, London WC2 on 6 May 2011

Ian Glick QC and David Ewart QC, instructed by the General Counsel and Solicitor to HM Revenue & Customs, for the Appellants

John Gardiner QC and John Brinsmead-Stockham, instructed by Slaughter and May, for the Respondent

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DECISION

Introduction

1. Since the law was changed in 2000, it has been possible for the group relationship necessary to found a claim for group relief to be traced through companies resident outside, as well as within, the UK. Thus group relief is now available between two UK-resident 75% subsidiaries of a common parent company, even if that parent company is resident in the USA. Before 2000, however, the position was different, and a qualifying group relationship could be traced only through companies resident in the UK. It follows that, as a matter of domestic English law, group relief could not be claimed between the two UK-resident subsidiaries in the example which we have given, even if the type of relief claimed (for example a surrender of trading losses by one subsidiary to the other) had no effect at all on the UK tax position of the US parent.
2. The issue in the present case is whether the pre-2000 position outlined above was overridden by the non-discrimination article in the 1975 double taxation agreement between the UK and the USA, scheduled to the Double Taxation Relief (Taxes on Income) (The United States of America) Order 1980 (SI 1980/568), which we will call "the Treaty". In the decision under appeal, which concerned the refusal of a group relief claim for a sample accounting period ending on 31 December 1994 of the respondent FCE Bank Plc ("FCE"), the Tax Chamber of the First-tier Tribunal (Judges Avery Jones and Sadler) held that it was, with the result that group relief was available. The Commissioners for Her Majesty's Revenue & Customs ("HMRC") now appeal against that decision, with permission granted by the First-tier Tribunal on 25 May 2010.
3. The parties were represented before us by the same counsel who had appeared below, Mr John Gardiner QC and Mr John Brinsmead-Stockham for FCE and Mr Ian Glick QC and Mr David Ewart QC for HMRC. Both sides agreed that the point in issue is a very short one, and the oral argument before us occupied

barely two hours, the ground having been comprehensively covered in the parties' helpful skeleton arguments.

Facts

4. The relevant facts were agreed, and could hardly be simpler. At all material times FCE was a UK-resident company, as was Ford Motor Company Limited ("FMCL"). Both FCE and FMCL were directly owned subsidiaries of a US-resident company, Ford Motor Company ("FMC"). As at 31 December 1994 FMC was the direct beneficial owner of 78.24% of the shares in FCE, and 81.33% of the shares in FMCL. The remainder of the shares in FCE, and all but 0.4% of the remainder of the shares in FMCL, were owned by other direct subsidiaries of FMC (one resident in the USA, and the other resident in Germany). There had been some slight changes in some of these figures in the course of 1994, but nothing turns on them. The important point is that throughout 1994 each of FCE and FMCL was a "75 per cent subsidiary" of FMC within the meaning of the definition of that expression in section 838(1) of the Income and Corporation Taxes Act 1988 ("ICTA 1988"). In addition, FMC would have been beneficially entitled to not less than 75% of any assets of those companies available for distribution to their equity holders on a winding-up by a liquidator, so (leaving aside the question of residence) the further requirement to that effect in section 413(7) of ICTA 1988 was also satisfied.
5. FCE made a claim for group relief for its 1994 accounting period. FMCL, its fellow UK subsidiary, had trading losses in excess of that amount available for surrender for the period. The claim was validly made, but was refused by HMRC on the sole ground that the shareholding relied upon to establish the necessary group relationship between FCE and FMCL was held by a non-UK resident company, namely FMC. It is common ground that FCE and FMCL otherwise satisfied all of the requirements to enable trading losses to be surrendered between them by means of a claim for group relief. A valid appeal was then made against the refusal of group relief.
6. Similar claims were made by FCE for its five subsequent accounting periods, and by certain other companies in the Ford group for some of the same

periods. All of these claims were likewise validly made, refused on the same ground, and validly appealed. The parties agreed that FCE's appeal for 1994 would be the lead case, and that its result would determine the outcome of all the other appeals. The total amount at stake (i.e. the total amount of tax of which repayment is sought from HMRC) is £76,625,782 exclusive of interest.

Relevant statutory provisions

7. At the relevant times a claim for group relief was made under section 402 of ICTA 1988, which provided that:

> "(1) Subject to and in accordance with this Chapter … relief for trading losses and other amounts eligible for relief from corporation tax may, in the cases set out in sub-sections (2) and (3) below, be surrendered by a company ("the surrendering company") and, on the making of a claim by another company ("the claimant company") may be allowed to the claimant company by way of a relief from corporation tax called "group relief".
>
> (2) Group relief shall be available in a case where the surrendering company and the claimant company are both members of the same group.
>
> A claim made by virtue of this subsection is referred to as a "group claim"."

8. The definition of a "group" was found in section 413, as follows:

> "(3) For the purposes of this Chapter –
>
> (a) two companies shall be deemed to be members of a group of companies if one is the 75 per cent subsidiary of the other or both are 75 per cent subsidiaries of a third company;
>
> …
>
> (5) References in this Chapter to a company apply only to bodies corporate resident in the United Kingdom; and in determining for the purposes of this Chapter whether one company is a 75 per cent subsidiary of another, the other company shall be treated as not being the owner –

…

(c) of any share capital which it owns directly or indirectly in a body corporate not resident in the United Kingdom.

…

5 (7) Notwithstanding that at any time a company ("the subsidiary company") is a 75 per cent subsidiary … of another company ("the parent company") it shall not be treated at that time as such a subsidiary for the purposes of this Chapter unless, additionally at that time –

10 (a) the parent company is beneficially entitled to not less than 75 per cent … of any profits available for distribution to equity holders of the subsidiary company; and

(b) the parent company would be beneficially entitled to not less than 75 per cent … of any assets of the subsidiary company

15 available for distribution to its equity holders on a winding-up."

9. The definition of "75 per cent subsidiary" was contained in section 838:

"(1) For the purposes of the Tax Acts a body corporate shall be deemed to be –

20 …

(b) a "75 per cent subsidiary" of another body corporate if and so long as not less than 75 per cent of its ordinary share capital is owned directly or indirectly by that other body corporate;

…

25 (2) In subsection (1)(a) and (b) above "owned directly or indirectly" by a body corporate means owned, whether directly or through another body corporate or other bodies corporate or partly directly and partly through another body corporate or other bodies corporate.

(3) In this section references to ownership shall be construed as

30 references to beneficial ownership."

10. Double taxation relief was conferred by Part XVIII of ICTA 1988, of which it is necessary to cite only the following provisions in section 788:

> "(1) If Her Majesty by Order in Council declares that arrangements specified in the Order have been made with the government of any territory outside the United Kingdom with a view to affording relief from double taxation in relation to –
>
> (a) income tax,
>
> (b) corporation tax in respect of income or chargeable gains, and
>
> (c) any taxes of a similar character to those taxes imposed by the laws of that territory,
>
> and that it is expedient that those arrangements should have effect, then those arrangements shall have effect in accordance with subsection (3) below.
>
> …
>
> (3) Subject to the provisions of this Part, the arrangements shall, notwithstanding anything in any enactment, have effect in relation to income tax and corporation tax in so far as they provide –
>
> (a) for relief from income tax, or from corporation tax in respect of income or chargeable gains;
>
> …"

The Treaty

11. The relevant article in the Treaty is article 24, which is headed "Non-Discrimination" and paragraph (5) of which provides:

> "Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected."

As the First-tier Tribunal pointed out in paragraph 5 of its decision, this wording is identical to article 24(5) of the OECD Model Tax Convention on Income and Capital.

The issue

12. FCE's case is that article 24(5) requires its claim for group relief to be allowed, thereby providing "relief … from corporation tax" within section 788(3)(a) and so having effect "notwithstanding anything in any enactment". It is common ground that the latter words in section 788(3) would override the provisions of section 413(5) to the extent necessary to allow FCE's claim for group relief to succeed, if the effect of section 413(5) is to breach article 24(5). Thus the only issue between the parties, and the short point on which this case turns, is whether the operation of section 413(5), and in particular its exclusion of bodies corporate resident outside the UK, would breach article 24(5). FCE says that it would; HMRC that it would not.

The rival arguments

13. FCE's basic argument is simply stated. If FCE and FMCL had been owned by a common UK-resident parent, which is agreed by HMRC to be the comparison required by article 24(5), FCE's claim for group relief would unquestionably have succeeded. Therefore the way in which the group relief legislation denied FCE and FMCL relief clearly discriminated against them, and it did so on the sole ground of their foreign ownership or control. As it applies to the present case, article 24(5) requires that:

> "Enterprises of [the UK], the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of [the USA], shall not be subjected in [the UK] to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of [the UK] are or may be subjected."

The treatment of FCE and FMCL, and the refusal to them of group relief, subjects them to taxation which is both "other" and "more burdensome" than the taxation under the group relief legislation of a purely UK group. The only

reason for this difference of treatment lies in the foreign ownership or control of the two UK companies. It follows that a breach of article 24(5) is established.

14. HMRC's response to this argument is essentially as follows. HMRC accept that the comparison required by article 24(5) is with an enterprise owned or controlled by a resident of the UK, which in the present context means a company resident in the UK. HMRC also accept that a two stage test has to be applied. The first question is whether there is discrimination (in the sense of treatment which is other or more burdensome) between the way in which the actual case is treated under the group relief legislation, and the way in which the notional comparator would be treated. It is common ground that this test is satisfied: in the former case group relief is not available, whereas in the latter case it would be. The second question is whether the sole ground, or reason, for the discrimination is that the capital of the UK claimant company is (in terms of article 24(5)) "wholly or partly owned or controlled, directly or indirectly" ("owned" for short) by the US parent company. It is at this point where HMRC join issue with FCE. They argue (negatively) that the US residence of FMC was not the sole reason for the refusal of group relief, and they seek to support this submission by reference to the reasoning of Lord Hoffmann, and certain examples which he gave, in his speech in Boake Allen Limited v Revenue and Customs Commissioners [2007] UKHL 25, [2007] 1 WLR 1386. They also argue (positively), at least in their written submissions, that the real reason for the discrimination lies in the fact that FCE and FMCL did not have a common corporate shareholder resident in the UK, and not in the fact that ultimate ownership and control of those companies lay in the USA. Thus, it is submitted, the discrimination did not fall within the ambit of article 24(5), and accordingly there was no breach of the article which has to be remedied.

Boake Allen

15. It is convenient at this point to consider whether HMRC's reliance on Boake Allen is justified. The issues in the case, and the relevant parts of the decision

for present purposes, are succinctly and accurately summarised in the head note at [2007] 1 WLR 1386:

> "The claimants, as United Kingdom subsidiaries of parent companies resident in the United States and in Japan, were unable to make a group income election pursuant to section 247 of [ICTA 1988] whereby companies incorporated in the United Kingdom could pay dividends to a parent company also incorporated in the United Kingdom free of advance corporation tax. The claimants commenced proceedings in the High Court against the revenue for, inter alia, a declaration that section 247 was contrary to the prohibition against discrimination contained in double taxation conventions entered into by the United Kingdom with the United States and with Japan, and for restitution and damages. The judge held that section 247 infringed the anti-discrimination provisions of the double taxation conventions, but that those provisions could only give rise to a cause of action in English law in so far as they fell within section 788(3) of the 1988 Act and that although section 788(3)(a) gave effect to arrangements in double taxation conventions relating to enactments providing relief "from corporation tax in respect of income or chargeable gains", that provision did not extend to advance corporation tax. The Court of Appeal upheld the judge's decision.
>
> On the claimants' appeal –
>
> *Held,* dismissing the appeal, that a group income election under section 247 of the 1988 Act was a joint decision by two entities paying and receiving dividends that one rather than the other would be liable for advance corporation tax and as such could not apply when one of the entities was not liable for the tax by reason of residence abroad; that it followed that the denial of the right of election was not on the ground of the company's foreign control but by reason of section 247 being inapplicable where the parent company was not liable to advance corporation tax and so did not infringe the double taxation conventions; …"

16. The leading judgment was given by Lord Hoffmann, with whose opinion on the first issue (that is to say the question whether denial of the right to make a group income election infringed the non-discrimination article in the double taxation conventions) Lord Woolf, Lord Walker of Gestingthorpe, Lord Mance and Lord Neuberger of Abbotsbury agreed. Although the version of the US Treaty considered in Boake Allen was the 1980, rather than the 1975, version, the wording of the non-discrimination article was unchanged from that which we have to apply.

17. Lord Hoffmann's reasoning on the first issue is contained in paragraphs 14 to 23 of his opinion. The paragraphs upon which HMRC place particular reliance are paragraphs 16 and 17, but in order to place them in context we think it desirable to cite most of the relevant passage:

> "14. The reasoning of the judge and the Court of Appeal was that article 24(5) of the US DTC (for example) requires one to compare the positions of the UK-resident subsidiary of a US parent and the UK-resident subsidiary of a UK parent. If the latter can elect under section 247 and the former cannot, that is discrimination contrary to article 24(5). It is irrelevant that an election would transfer liability for ACT to the UK parent but not to the US parent. The DTC is concerned with the taxation of enterprises in the UK and not with the tax position of their foreign-resident shareholders. The authoritative commentary on the equivalent article of the OECD Model Convention with Respect to Taxes on Income and on Capital 1963 says that its object is:
>
> > "to ensure equal treatment for taxpayers residing in the same state, and not to subject foreign capital, in the hands of the partners or shareholders, to identical treatment to that applied to domestic capital".
>
> 15. I respectfully think that this particular observation does not take the matter much further forward because it is directed to a different point. It draws attention to the limited application of the non-discrimination article, which provides only for treatment of resident tax payers and does not prevent a state from discriminating in its treatment of the

income of foreign shareholders; for example, by imposing a withholding tax. It does not say that parentage cannot be a relevant characteristic of a resident tax payer.

16. The question, as it seems to me, is whether section 247 discriminates against a UK company *on the ground that* its capital is "wholly or partly owned or controlled, directly or indirectly" by residents of the US, or Japan, or some other foreign state. In relation to article 24(1) of the OECD Model Convention, which prohibits discrimination between residents on grounds of nationality, the commentary says that the "underlying question" is whether two residents are being treated differently "solely by reason of having a different nationality". It does not repeat this observation in relation to article 24(5), but the principle must be the same. Does section 247 discriminate on the grounds that the capital of the subsidiary is controlled by a non-resident company?

17. In my opinion it plainly does not. For example, if a US parent were to interpose a UK-resident holding company between itself and its UK-resident subsidiary, the control would remain in the US but there would be no objection to an election by the UK subsidiary and its immediate, UK-resident parent. On the other hand, an individual US shareholder and the company he controls in the UK could not elect, but the reason is not because the company is subject to US control. An individual UK shareholder and his company could not elect either, for the same reason that a non-resident company cannot elect. It is because an individual is not liable to corporation tax. An election is a joint decision by two entities paying and receiving dividends that one rather than the other will be liable for ACT. This is not a concept which can meaningfully be applied when one of the entities is not liable for ACT at all.

18. Unfortunately the judge and the Court of Appeal did not have the benefit of the discussion of the nature of the section 247 election in the speeches in this House in *Pirelli Cable Holding NV v Inland Revenue*

Commissioners [2006] 1 WLR 400. The point was luminously made by Lord Nicholls of Birkenhead, at para 19, in a speech with which the rest of their Lordships agreed:

> "A group income election is a *group* election. A group income election cannot be made by a subsidiary alone. It is an election made jointly by the subsidiary paying the dividend and the parent receiving the dividend. By making such an election both companies seek the fiscal consequences of making the election. One consequence is that by making the election the subsidiary will obtain the advantage of not paying ACT in respect of the relevant dividend. Another consequence is that the subsidiary will obtain this advantage at the cost of depriving the parent of a tax credit in respect of the dividend. These two fiscal consequences are inextricably linked. You cannot have one without the other. That is why the election has to be made jointly. The advantage to the paying subsidiary comes at a price to the recipient parent."

19. In my respectful opinion, it is not possible to decouple the positions of parent and subsidiary as the judge and the Court of Appeal sought to do. To allow an election by a group with a US-resident parent would not be to give a relief available to a group with a UK-resident parent. It would be something different in kind. It would not be an election as to who would be liable for ACT but as to whether the group should pay it at all.

…

22. … In my opinion, the denial of the right of election was not on the ground of the company's foreign control but on the ground that section 247 cannot be applied to a case in which the parent company is not liable to ACT.

23. It follows that in my view the lower courts were wrong in holding that section 247 imposed discrimination on subsidiaries of US and Japanese parent companies, contrary to the respective DTCs."

18. In our view it is clear from this passage, read as a whole, that the reason why there was no breach of the non-discrimination article in Boake Allen is that section 247 was incapable of application to a case in which the parent company, being non-UK resident, was not liable to ACT. Lord Hoffmann explained why this was so in the latter part of paragraph 17 and in paragraphs 18 to 19. He then repeated his conclusion, in unambiguous language, in paragraph 22. Since the concept of a joint election was incapable of meaningful application in a cross-border context, there could be no discrimination against a US-parented group because it was denied the right to make an election which only made sense in a purely domestic context. In other words, the reason for the difference in treatment (which prohibited the non-UK tax-resident company from being a party to a group income election) was not the foreign ownership of the UK tax-resident subsidiary's share capital but rather the absence of any charge to ACT on the non-UK tax-resident parent.

19. We observe at this point that this crucial part of Lord Hoffmann's reasoning has no relevance to the present case, because the claim for group relief was a claim that only affected the UK tax position of the two UK subsidiaries. The claim had no effect at all on the tax position of the US parent, and the only relevance of the parent company was to establish (or not, as the case may be) the necessary group relationship between the two UK companies which surrendered and accepted the trading losses. It is conceptually quite irrelevant whether the US common parent is within the charge to UK corporation tax or not, in relation to the question of whether two UK tax resident companies are sufficiently connected to each other so as to form a group which permits the surrender of losses from one to another.

20. Lord Hoffmann's conclusion needed no further reasoning to support it, but in paragraph 17 he began his discussion of the topic by pointing out that residence could not have been the sole ground for denial of the right to make an election because it is easy to posit other examples where there would have been some other explanation. His first example was the interposition of a UK-resident holding company, with the result that (indirect) control of the UK

subsidiary would remain in the USA, but an election would now have been possible because both of the parties to it (the UK subsidiary and its immediate UK parent) were UK-resident. This example shows that the critical question is whether the two parties to the election were UK taxpayers, not whether they were under foreign ownership or control. Lord Hoffmann's second example was of an individual US shareholder who controlled a UK company. Here an election would not have been possible, but the reason lies not in the foreign control of the company but in the fact that an individual (wherever resident) is outside the charge to corporation tax.

21. Read in their context, these examples provide an illuminating introduction to the core of Lord Hoffmann's reasoning. But it does not follow that they can be transposed to different contexts where the alleged discrimination consists of something other than the denial of a group income election. Yet that is what, in our judgment, HMRC's argument seeks to do in the present case, without making any allowance for the crucial difference between a group income election (which necessarily involved both a parent and a subsidiary company, each of which had to be liable to ACT) and a claim for group relief of the present type (which involved only two UK-resident subsidiaries, so long as they were in the necessary group relationship). Thus it is argued by HMRC that the US ownership of FCE and FMCL was not the sole reason for the refusal of the claim, because the claim would have been allowed if (as in Boake Allen) an intermediate UK-resident holding company had been interposed. That is of course true; but in our view it is just another way of saying that the reason why group relief was not available is because the actual (and not a hypothetical) parent of the two companies was in fact US-resident. The point of Lord Hoffmann's example in Boake Allen was to show the need for the parent, as well as the subsidiary, to be UK-resident if a group income election was to be capable of being made. There is no corresponding necessity in the present case, save for the purpose of establishing the necessary group relationship. This shows that the real, and sole, reason for refusal of the claim to group relief was indeed the US residence of FMC.

22. Similarly, it does not advance the argument in any way to point out that group relief would not have been available if the common owner of the shares in FCE and FMCL had been an individual. Group relief only exists in a corporate context, and to introduce a comparison with an individual shareholder is no longer to compare like with like. For the purposes of testing the application of article 24(5) of the Treaty, the comparison must plainly be with a UK-resident group of companies.

23. In oral argument Mr Glick QC frankly accepted that he was unable to advance any positive case to explain why, in cases of the present type, group relief was confined to UK-parented groups. He confirmed, in answer to a question from the Tribunal, that there was no discernible fiscal mischief which might be thought to justify the restriction. He speculated that the draftsman may just have wished, for whatever reason, to ensure that all the members of a group were within the charge to corporation tax. But we cannot attach any weight to speculation of this nature, unsupported as it was by any reasoning; and, to be fair, Mr Glick did not ask us to do so. It follows, however, that he had to place all the weight of HMRC's case on what he termed his negative argument, namely that the fact of foreign ownership cannot have been the sole reason why group relief was not available, as is demonstrated (he said) by the example of an interposed UK-resident holding company. But, as we have already explained, we consider that in the present context this example is just another way of saying that the real reason for the refusal of the relief was the US residence of the parent. In truth, it seems to us that HMRC's negative argument is no more than a lightly disguised tautology.

24. For these short reasons, which are we think essentially the same as those developed in more detail by the First-tier Tribunal in paragraphs 10 to 20 of its full and cogently reasoned decision, we are satisfied that this appeal must be dismissed. The First-tier Tribunal found further support for its conclusion in the fact that rulings consistent with it have been given by courts at the highest level in at least three other countries (the Netherlands, Finland and Sweden). We respectfully agree with the importance attached by the First-tier Tribunal to the principle "that courts give consistent interpretations of treaty provisions

contained in the OECD Model that are widely used in tax treaties" (paragraph 21 of the decision); but as we have nothing of any value to add to the analysis of those decisions by the First-tier Tribunal, and as we agree that there is nothing in the decisions which is inconsistent with the conclusion we have reached, we prefer to say no more about them.

MR JUSTICE HENDERSON AND MR JULIAN GHOSH QC

TRIBUNAL JUDGES
RELEASE DATE: 13 October 2011