EU Direct Tax Group

The EUDTG is one of PwC’s Thought Leadership Initiatives and embedded in the International Tax Services Network. The EUDTG is a pan-European network of EU tax law experts and provides assistance to organizations, companies and private persons to help them to fully benefit from their rights under EU law.

UK Court of Appeal allows HMRC’s appeal in the Vodafone 2 case for the ECJ’s Cadbury judgment to be “read down” into the UK Controlled Foreign Company (CFC) legislation

The UK Court of Appeal has today held in the Vodafone 2 case that the UK CFC legislation can be the subject of “conforming interpretation”, so that disapplication is not required.

Vodafone 2 set up a Luxembourg subsidiary, VIL to acquire Mannesmann AG. HMRC gave notice that they intended to enquire into V2’s UK tax return for 2002 and sought information regarding VIL, with a view to assessing VIL’s income on V2 under the UK CFC legislation. V2 appealed, contending that, following the ECJ’s Cadbury judgment, it was unnecessary for V2 to provide any such information, as the UK’s CFC legislation was demonstrably in breach of Articles 43 and 48 EC treaty, freedom of establishment, and incapable of conforming interpretation, and hence had to be disapplied.

The UK High Court (Evans-Lombe, J) agreed with V2 and ordered the disapplication of the UK CFC legislation for companies such as V2, for periods prior to those commencing 6/12/06 or later, for which FA ‘07 introduced s751A/B ICTA ’88, which sought to implement the Cadbury judgment. These provisions are the subject of a formal complaint to the European Commission.

The Court of Appeal unanimously held that they were entitled to have regard to the whole of the UK CFC legislation, and not just the CFC motive test, going beyond and potentially contrary to the ECJ’s judgment (Cadbury, paragraphs 72-74). Consequently, they accepted HMRC’s Counsel’s submission that an additional exception to the UK CFC rules such as “if it (the CFC) is, in that accounting period, actually established in another Member State of the EEA and carries on genuine economic activity there” could be read into s748(3) ICTA ’88.

They so held relying on prior UK caselaw on reading down v disapplication, or in the case of Human Rights Act caselaw, a declaration of incompatibility.

In addition, were disapplication the appropriate remedy (not the CoA’s view), 2 of the 3 judges commented as obiter that such disapplication should be confined to EEA subsidiaries that are genuinely economically established and not wholly artificial arrangements.

Leave to appeal the Court of Appeal’s judgment will have to be sought within 60 days. The consequences of the judgment, if not appealed, will be that EC treaty protection from the historic (pre FA ‘07) UK CFC regime for EEA subsidiaries will have to be sought on a case-by-case basis, demonstrating that each EEA subsidiary is genuinely economically established and not a wholly artificial arrangement.

For more detailed information, please do not hesitate to contact your local PwC contact person or a member of the EUDTG.

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