

The General Court of the EU has dismissed both the UK and ITV plc's applications made in respect of the European Commission's UK Controlled Foreign Company State aid decision

On 8 June 2022, the General Court of the European Union dismissed both cases (T-363/19 and T-456/19) in their entirety.

The facts of the case

In April 2019, the European Commission (EC) announced that it had found that the Group Financing Exemption (GFE) within the UK Controlled Foreign Company (CFC) rules to constitute unlawful State aid in certain circumstances.

The UK CFC rules are rules which broadly allow the UK to tax the income of overseas subsidiaries controlled by a UK corporate parent where that income is regarded as artificially diverted from the UK.

The provisions in question, relating to the GFE, were introduced as part of the 2012 revision of the UK CFC rules and apply to offshore group financing arrangements with the result that, in certain circumstances, only 25% of the finance income is subject to a CFC charge (and in certain circumstances none at all).

The EC focused on the two ways in which income might be regarded as related to the UK:

- (1) Where the loans are financed with funds or assets which derive from capital contributions from the UK
- (2) Where activities relevant to managing the financing operations are located in the UK

The EC considered that where the GFE provided an exemption for arrangements which fall into the first category above, this was justified since the exemption avoids a complex and burdensome intragroup tracing exercise.

However, where the GFE had been applied to arrangements in the second category, the EC considered that the exemption was not justified and instead constituted unlawful State aid.

The UK and a number of affected groups including ITV plc made applications to the General Court seeking to annul this decision.

As a result of UK amendments effective from 1 January 2019, the EC decision is only relevant to periods up to 2018.

The Judgment of the General Court of the EU

The General Court considered that the reference system was the CFC regime, rather than the UK corporation tax system as a whole. They concluded that the objective of the CFC regime was to tax profits which are regarded as having been artificially diverted from the UK. They further concluded that where any activities relevant to managing the financing activities are located in the UK, then the corresponding profits are, under the CFC rules, to be regarded as profits artificially diverted from the UK. As a result they ruled in favour of the EC and agreed that companies applying the GFE benefited from a selective advantage (to the extent that the relevant activities took place in the UK). The Court also dismissed the arguments made regarding justification, concerning administrative simplicity and compliance with the fundamental freedoms.

Takeaway

It remains to be seen whether this decision is appealed to the Court of Justice of the EU. In the meantime, affected groups will also need to consider what further action if any to take regarding the ongoing domestic recovery proceedings.

Let's talk

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