EUDTG Newsalert
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CJEU annuls the European Commission decision that financing company provisions in the UK Controlled Foreign Company Tax Regime constituted State Aid

On 19 September 2024 the Court of Justice of the European Union (CJEU) rendered its judgment in the joined cases *United Kingdom v European Commission, ITV plc v European Commission and LSEGH (Luxembourg) Ltd and Others v European Commission* (C-555/22, C-556/22 and C-564/22). The case concerned an annulment application in respect of a decision by the European Commission that certain parts of the UK's controlled foreign company (CFC) regime constituted state aid. The case was an appeal against the General Court's earlier decision to uphold the Commission's state aid determination.

The CJEU decided that the Commission had incorrectly identified the reference system as the CFC regime, whereas the reference system should have been regarded as the wider UK corporation tax regime. This error was sufficient to vitiate the Commission's decision. As such, the CJEU upheld the appeal and annulled the Commission's state aid determination.

Background and facts

The UK's CFC regime charges corporation tax on UK resident companies in respect of certain profits of their non-UK resident subsidiaries. Chapter 5 of the UK's CFC rules imposes a tax charge on certain non-trading finance profits of such subsidiaries, principally profits derived from (i) significant people functions carried out in the UK (UK SPFs) or (ii) capital investment from the UK. Prior to 2019, Chapter 9 of the CFC rules provided an alternative approach for certain intra-group loan relationships where the ultimate borrower is not a UK company (referred to as qualifying loan relationships); this alternative approach provided for a charge on 25% of the profits of qualifying loan relationships, reducing to zero in certain circumstances

On 2 April 2019 Commission determined that the application of the Chapter 9 provisions constituted a state aid scheme in cases where the finance profits would have been taxable in full under Chapter 5 on the basis that they derived from UK SPFs. In determining whether the Chapter 9 provisions gave rise to a selective advantage, the Commission determined that:

- The reference system was the UK's CFC regime (rather than the wider UK corporation tax regime, as argued by the UK) on the basis that the CFC regime had its own objective which was sufficiently distinct from that of the wider corporation tax regime, and contained the rules which determined the subject matter and basis of any CFC charge.
- The Chapter 9 provisions offered a more favourable treatment for CFCs receiving finance income from qualifying loan relationships than the general CFC finance income rules at Chapter 5.
- CFCs receiving finance income from qualifying loan relationships were in a comparable legal and factual position to CFCs receiving finance income from other sources. In particular, CFCs benefitting from the Chapter 9 provisions were comparable to CFCs lending to UK group companies (which can not benefit from Chapter 9).
- Where the finance income of a CFC was derived from UK SPF's there was no justification for not imposing a charge on the full amount of the profits under Chapter 5.

From 1 January 2019, UK domestic law was amended such that the Chapter 9 provisions are no longer available for financing income of a CFC which is derived from UK SPFs.

The UK and a number of taxpayers applied to annul the Commission's decision. On 8 June 2022, the General Court dismissed the annulment applications brought by the UK and ITV plc (T-363/19 and T-456/19). An appeal was made to the CJEU.

Judgment of the CJEU

In relation to admissibility, the Commission argued that the General Court's assessment of national law - and hence its determination of the reference framework - was a question of fact not subject to review in this case. The CJEU held whether the General Court had correctly determined the reference framework was a question of law (and of the application of Art 107(1) TFEU) which the CJEU must be entitled to review.

In relation to the reference framework, the CJEU observed that where a specific set of tax rules were classified as ‘a corollary to’, ‘supplementary to’ or ‘an extension of’ a wider set of rules, those specific rules could not be regarded as clearly severable from the wider set of rules, and so the specific rules could not be regarded in and of themselves as a reference framework.

In assessing whether this was the position in the case at hand, the CJEU followed the principles set out in *Engie & Luxembourg v Commission* (C-451/21 and C-454/21), which held that, as a consequence of the duty of sincere cooperation for state aid investigations, the Commission was obliged to accept a member State’s interpretation of its own national law unless this was contraindicated by the wording of the law, case law or administrative practice.

Here, the UK stated the CFC rules were intended to supplement the wider UK corporation tax regime by taxing the profits of certain CFCs which posed a higher risk of artificial diversion of profits from the UK, and the purpose of the Chapter 9 provision was to ensure that certain situations which did not pose sufficiently high risks of diversion were not subject to a CFC charge but were rather dealt with under the normal territorial corporation tax system. Following this approach the CFC rules were therefore not separable from the general corporation tax system as a whole. The CJEU considered that this constituted an interpretation of national law which was consistent with the wording of the relevant provisions and therefore according to the *Engie* principles set out above should have been followed in the Commission in their analysis.

On the basis of the above, the CJEU determined that the correct reference system was the wider UK corporation tax rules rather than the CFC regime as identified by the Commission. This error in the choice of reference system was sufficient to vitiate the Commission’s state aid determination.

The CJEU therefore allowed the appeal and annulled the state aid determination.

Takeaway

Following the Commission’s 2019 state aid determination, the UK enacted specific legislation under which charging notices would be issued to recover the state aid. Where – as has occurred – the Commission’s decision has been annulled, this legislation requires the UK government to bring forward regulations to reverse these charging notices and put taxpayers in the same position they would have been in had the Commission’s state aid determination never been made. These regulations when issued should therefore give rise to repayments of any amounts recovered from taxpayers. We await further announcements from the UK regarding the publication of these regulations and the way forward.

Let's talk

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