

This balance will determine whether the government delivers on its promise and succeeds in making the UK once again an attractive place to base multinational business. The jury remains out for the time being!

## Are the proposals EU compliant?

**Philip Baker QC**  
**Gray's Inn Tax Chambers**



It is worth remembering the two factors motivating the review of CFC legislation.

The first: UK groups consider the current system as too rigid, intrusive, compliance-costly, and a consideration pushing groups towards relocating abroad.

The second: remaining doubts, even after Cadbury-Schweppes, CFC GLO and Vodafone II, whether the legislation is compatible with EU law.

As to the first factor, the ConDoc unveils essentially the present system, with some tinkering at the edges, a new finance partial exemption, a new and more complex system for calculating apportionments, several TAARs, and probably greater complexity.

Whether this will quiet the concerns of business remains to be seen. The purpose of this comment is to focus on EU law aspects.

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## Because the proposals are pushing the envelope, future challenges may show incompatible elements

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The ConDoc adopts the principle that the same system will apply to EU/EEA subsidiaries and the rest of the world.

The cynic would say this allows the government to pretend that we are not being driven by EU law.

However, this may no longer be a wise policy option. It means that we have to apply the same rules to subsidiaries located in out-and-out tax havens as we apply to subsidiaries in EU/EEA countries despite the different context.

Within the EU/EEA we have extensive exchange of information, and the ability to influence others tax system through the Code of Conduct.

Having one set of rules forces the government to push the envelope of EU law so as to have as much protection against the havens.

The question is whether this approach has burst the envelope.

Appendix I to the ConDoc entitled Interaction with EU Law explains the government's understanding of EU law.

Parts of this Appendix are unimpeachable – CFC legislation is a restriction on the freedom of establishment, but may be justified as combating tax avoidance.

However, some parts raise an eyebrow or three. Surprising reliance is placed on the Thin Cap GLO and the SGI cases, both concerned with arm's-length transfer pricing legislation.

In that context, one can talk of a loan only part of which is an artificial arrangement in that it exceeds arm's length.

However, one cannot extract from this the concept of a partial 'wholly artificial arrangement' applicable to CFCs.

The operation of the new General Purpose Exemption (aka Motive Test II) and the apportionment of UK-diverted profits is constructed on this arm's length approach.

Are the new proposals definitely incompatible with EU law? The answer is: no, not definitely. Equally one cannot say that the proposals definitely are compatible.

Because they are pushing the envelope, future challenges may well show incompatible elements. In which case this exercise – to try to achieve an EU compatible system, impervious to challenge – has failed.

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The government wants the proposals to be competitive for business while protecting the UK tax base. The new regime looks superficially similar to the old rules, but with a closer focus on profits 'artificially diverted' from the UK. Overall, the changes are likely to deliver some benefits, particularly for offshore financing activities, but the