

THE SPECIAL COMMISSIONERS

JANSEN NIELSEN PILKES LIMITED

Appellant

- and -

IAN TOMLINSON (HM INSPECTOR OF TAXES)

Respondent

Special Commissioner: DR JOHN F AVERY JONES CBE

Sitting in public in London on 17 March 2004

Claire Simpson, counsel, instructed by Sanderson Wilson & Co Ltd, chartered certified accountants, for the Appellant

Marie Demetriou, counsel, instructed by the Solicitor of Inland Revenue for the Respondents

DECISION

1. Jansen Nielsen Pilkes Limited appeals against amendments made by the Respondent Inspector on 20 May 2000 to the Appellant's self-assessments to corporation tax for the accounting periods ended 31 December 2000 and 2001. The Appellant was represented by Miss Claire Simpson and the Inspector by Miss Marie Demetriou. I am grateful to both of them for their clear arguments on a novel point.

2. The issue in this appeal is the compatibility with European law of marginal small companies' relief for corporation tax under section 13 of the Taxes Act 1988.

3. Section 13 of the Taxes Act 1988 provides:

“(1) Where in any accounting period the profits of a company which-

(a) is resident in the United Kingdom, and

(b) is not a close investment-holding company (as defined in section 13A) at the end of that period,

do not exceed the lower relevant maximum amount, the company may claim that corporation tax charged on its basic profits for that period shall be calculated as if the rate of corporation tax (instead of being the rate fixed for companies generally) were such lower rate (to be known as the “small companies' rate”) as Parliament may from time to time determine.

(2) Where in any accounting period the profits of any such company exceed the lower relevant maximum amount but do not exceed the upper relevant maximum amount, the company may claim that the corporation tax charged on its basic profits for that period shall be reduced by a sum equal to such fraction as Parliament may from time to time determine of the following amount-

$$(M - P) \times \frac{I}{P}$$

where-

M is the upper relevant maximum amount;

P is the amount of the profits; and

I is the amount of the basic profits.

(3) The lower and upper relevant maximum amounts mentioned above shall be calculated as follows-

(a) where the company has no associated company in the accounting period, those amounts are £300,000 and £1,500,000 respectively;

(b) where the company has one or more associated companies in the accounting period, the lower relevant maximum amount is £300,000 divided by one plus the number of those associated companies, and the upper relevant maximum amount is £1,500,000 divided by one plus the number of those associated companies.

(4) In applying subsection (3) above to any accounting period of a company, an associated company which has not carried on any trade or business at any time in that accounting period (or, if an associated company during part only of that accounting period, at any time in that part of that accounting period) shall be disregarded and for the purposes of this section a company is to be treated as an ‘associated company’ of another at a given time if at that time one of the two has control of the other or both are under the control of the same person or persons.

In this subsection ‘control’ shall be construed in accordance with section 416.....”

4. It is common ground that whereas the company in subsection (1) must be resident in the UK, the definition of “company” and “associated company” applying to subsections (3) and (4) are not restricted to UK resident companies.

5. There was an agreed statement of facts as follows (to which I have added the computations of tax on each of the parties’ contentions):

The Facts

(1) Jansen Nielsen Pilkes Limited (“the Appellant”) is a private limited company, registered in England and Wales and resident in the United Kingdom.

(2) For the accounting periods ended 31 December 2000 and 31 December 2001 (“the Accounting Periods”), the Appellant carried on the trade of the import and sale of timber and is chargeable to United Kingdom corporation tax on its profits for those periods.

(3) The agreed chargeable profits for the Accounting Periods are:

- Period ended 31 December 2000	£229,016
- Period ended 31 December 2001	£608,457

(4) Jansen Nielsen Pilkes BV (“the Parent Company”) is a company registered and resident in the Netherlands and is chargeable to corporation tax in that country. It is not resident in the UK and does not trade through a branch or agency in the UK, and is therefore not “within the charge to corporation tax” in the United Kingdom: s.11(1) of the Income and Corporation Taxes Act 1988 (“ICTA 1988”).¹

Group Structure

(5) The Parent Company is the parent company of the Appellant. It holds 149,999 ordinary £1 shares out of the total issued, allotted and fully paid ordinary shares of the Appellant of 150,000 ordinary £1 shares. The remaining share is held by Robert Jansen, a Dutch resident individual.

(6) During the accounting period ended 31 December 2000, the Parent Company, in addition to its shareholding in the Appellant, held 95% of the share capital in Euroles BV and 100% of the share capital in East European

¹ For the relevant Accounting Periods, s.11(1) reads “A company not resident in the United Kingdom shall not be within the charge to corporation tax unless it carries on a trade in the United Kingdom through a branch or agency.” Finance Act 2003 replaced ‘branch or agency’ with ‘permanent establishment’.

Timber & Trade Company BV and Nieka Beheer BV. In June 2001, the group expanded when the Parent Company acquired 100% of the share capital in Hoogland & ZN BV and its three subsidiaries namely, Houtfactor – En Expeditiebedrijf BV, Overslagbedrijf Oudhaarlem BV and Timber Terminal Amsterdam BV. Apart from the Appellant, the Parent Company and its subsidiaries are not UK resident and are therefore not chargeable to UK corporation tax. A Group tree applicable in each accounting period was provided which it is not necessary to include in this decision.

Trading and Dormant Companies

(7) The Appellant, the Parent Company and Euroles BV were trading companies in each of the Accounting Periods 2000 and 2001. Hoogland & ZN BV and its three subsidiaries were trading companies in the 2001 Accounting Period. Nieka Beheer BV and East European Timber and Trade Company BV were both dormant during each of those Accounting Periods.

Associated Companies

(8) The small companies’ relief from corporation tax available to the Appellant under s.13 ICTA 1988 has been restricted by the Inland Revenue under s.13(3) and (4) ICTA 1988 for each of the Accounting Periods on the grounds that the Appellant has “associated companies”.

(9) For the Accounting Period ended 31 December 2000, the Appellant had two associated companies namely, the Parent Company and Euroles BV.

(10) For the Accounting Period ended 31 December 2001, the Appellant had six associated companies namely the Parent Company, Euroles BV, Hoogland & ZN BV, Houtfactor – En Expeditiebedrijf BV, Overslagbedrijf Oudhaarlem BV and Timber Terminal Amsterdam BV. None of these non-resident companies is within the charge to UK corporation tax.

Tax Chargeable

(11) The following table illustrates the effect of taking into account the non-United Kingdom resident associated companies in applying the small companies’ relief:

<u>Year</u>	<u>Chargeable Profits</u>	<u>Corporation Tax Payable on the Respondent’s Contentions¹</u>	<u>Corporation Tax Payable on the Appellant’s Contentions²</u>
2000	£229,016	£ 61,930.20	£ 45,803.20
2001	£608,457	£182,537.10	£160,248.52

Note 1. These figures reflect the tax liability of the Appellant pursuant to the amendments made by the Inspector to that company’s corporation tax self assessments for the Accounting Periods ended 31 December 2000 and 2001. The amended assessments take into account the Appellant’s non-resident associates for the purposes of calculating marginal small companies’ relief under s.13(3) and (4) ICTA 1988. In the 2000 period there were two associated companies so that the upper relevant maximum amount is

$\pounds 1,500,000/3 = \pounds 500,000$, and the lower relevant maximum amount is $\pounds 300,000/3 = \pounds 100,000$. The marginal relief is $(\pounds 500,000 - \pounds 229,016) \times \pounds 229,016 / \pounds 229,016 \times 1/40 = \pounds 6,774.60$. The corporation tax is $(\pounds 229,016 \times 0.3) - \pounds 6,774.60 = \pounds 61,930.20$. In the 2001 period there were six associated companies and so the upper relevant maximum amount is reduced to $\pounds 1,500,000/7 = \pounds 214,285.71$ which is less than the profits so that the full 30 per cent rate is payable $\pounds 608,457 \times 0.3 = \pounds 182,537.10$

Note 2. These figures reflect the Appellant's contention that non-resident associates should not be taken into account for the purposes of s.13 ICTA 1988. For the 2000 accounting period the corporation tax is $\pounds 229,016 \times 0.2 = \pounds 45,803.20$. For the 2001 period marginal relief is $(\pounds 1,500,000 - \pounds 608,457) \times 0.3 \times \pounds 608,457 / \pounds 608,457 \times 1/40 = \pounds 22,288.58$. The corporation tax is $(\pounds 608,457 \times 0.3) - \pounds 22,288.58 = \pounds 160,248.52$.

6. Article 43 of the EC Treaty, formerly Article 52, provides:

“Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.”

The reference to article 48 is to:

“Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.”

7. Miss Simpson for the Appellant contends that the application of s.13 to groups of companies involving non-resident associated companies is contrary to Community law, and to Article 43 EC in particular:

- (I) it gives rise to indirect discrimination on grounds of nationality; and/or
- (II) it gives rise to a prohibited restriction on the Parent Company's freedom of establishment in the United Kingdom, and on the freedom of the Appellant, of the Parent Company or of any of its Dutch resident subsidiaries to establish themselves in other Member States.

I shall deal with these in reverse order, which is the order in which they are dealt with by article 43 because a restriction on leaving the home state (the state in which the person exercising the freedom of establishment is established) arises before one can consider whether there is discrimination in the host state (the state into which the freedom of establishment is being exercised).

Restriction on exercise of the freedom of establishment

8. Miss Simpson contends that there is a restriction on the freedom of establishment in the sense of the first paragraph of article 43 first, for the Parent Company establishing a UK subsidiary such as the Appellant because, although the Appellant is the only group company within the charge to corporation tax, it will be treated less favourably than a single UK resident company in calculating the small companies' relief. This results from the Appellant having at least one associated company, the Parent Company. Secondly, she contends that there is a restriction on the Parent Company or any of its Dutch subsidiaries establishing a subsidiary in another Member State because this will increase the tax payable by the Appellant. It should be irrelevant to the taxation of the Appellant that its Parent Company has established a new subsidiary in, say, Italy. Thirdly, she contends that there is a restriction on the Appellant company establishing a subsidiary in another Member State because this has the effect of increasing its tax. All three restrictions would be removed by excluding non-resident associated companies from the calculation.

9. Miss Demetriou, for the Inspector, contends that if a comparison is made with a UK company with associated companies resident in the UK there is no restriction; the Appellant and the hypothetical UK resident company with UK resident associated companies pay the same tax. There is also no evidence that the Parent Company has suffered any restriction and, even if it had, it would not be relevant to the Appellant's assessment to tax. A restriction must create a direct and demonstrable inhibition on the establishment of a business by analogy with *Volker Graf* Case C-190/98 [2000] ECR I-493 "...in order to be capable of constituting such an obstacle, they must affect access of workers to the labour market." Rules are deemed to constitute material barriers to market access if it were established that they had actual effects on market actors akin to exclusion from the market (Advocate General's Opinion in *Graf* paragraph 32), or as the Court of Appeal put it in *R (on the application of Professional Contractors Group Ltd) v IRC* [2002] STC 165, at [74] "a direct and demonstrable inhibiting effect on the particular right which is asserted." Here any effect was not akin to exclusion from the market and merely reflects the territoriality principle that companies outside the scope of charge cannot benefit from any tax relief. Nor was there any evidence that section 13 in fact dissuades companies resident in other Member States from establishing subsidiaries in the UK since the decision will be affected by factors other than tax and in any case the rate of tax in the UK is much lower than the 34.5 per cent in the Netherlands.

Reasons for the decision

10. The marginal small companies' relief applies to each UK resident company individually. The rate of tax is a function of the profits of the company concerned and the number of associated companies, whether or not those associated companies are within the charge to corporation tax. No doubt the purpose of the relief is to prevent splitting a company into several smaller companies in order to obtain a lower rate of corporation tax. At first sight therefore the inclusion of associated companies that are not within the charge to corporation tax seems odd. However, if the purpose of

including them is to take account of the UK company's ability to pay there seems no reason why non-resident associated companies should not be included.

11. Under article 43 of the EC Treaty "restrictions on the freedom of establishment of nationals of a Member State [including restrictions on the setting up of...subsidiaries by nationals of any Member State established in the territory of any Member State] in the territory of another Member State shall be prohibited." By article 48 nationals include "companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community," which will include both the Appellant and the Parent Company. The question is what type of restriction is relevant. In the first paragraph of article 43 there is no reference to discrimination presumably because the restriction may be imposed by the home state and so one never reaches the point of considering whether one is discriminated against by the host state. Even though discrimination is not relevant, in order to decide whether a home state rule is a restriction there must be an implied comparison between carrying out the same transaction, here the establishment of a subsidiary, in the home state and in another Member State. This is shown by *AMID* Case C-141/99 [2003] STC 356 in which the Belgian head office made a loss and the Luxemburg branch made a profit which, although not taxable in Belgium, absorbed the Belgian loss. The court made a comparison with a Belgian company that had branches only in Belgium:

"Even if the Belgian tax system were favourable to companies with establishments abroad more often than not, that does not prevent it resulting, where that system proves disadvantageous for those companies, in an inequality of treatment *in relation to companies without establishments outside Belgium* and thus creating a hindrance to the freedom of establishment guaranteed by art.52 [now 43] of the EC Treaty." (judgment para.27, italics added)

12. Where the possible restriction is imposed by the host state there must be an implied comparison between the person entering the market and those already in it. An example made in passing by Miss Simpson was that of paying the company registration fee. That cannot be a restriction because everyone forming a UK company must pay the same fee. Normally one would expect a restriction by the host state to cover the same ground as discrimination by the host state, as in the case where one knows in advance that there will be discrimination in the host state, such as the higher tax rate on the branch profits than that paid by residents in *Royal Bank of Scotland* Case C-311/97 [2000] STC 733. But a restriction by the host state was considered as a separate heading in *R (on the application of Professional Contractors Group Ltd) v IRC* [2002] STC 165. A possible example of a non-discriminatory restriction by the host state is shown by *Futura Participations* Case C-250/95 [1997] STC 1301 in relation to the Luxembourg branch having to keep accounts in accordance with Luxembourg law (which other Luxembourg taxpayers were required to do) in order to carry forward losses. Although this appears to be non-discriminatory it is possible that it was considered to be discriminatory because the requirement for a non-resident to keep accounts in accordance with Luxembourg law applied only to the carrying forward of losses but not in other cases, so that the requirement was not the same as that applying to other Luxembourg taxpayers in all cases (judgment paragraph 37).

13. I should mention that the Appellant did try to join the Parent Company in this appeal which was refused by my colleague Dr Brice at a preliminary hearing. Since the Parent Company is not a UK taxpayer it is difficult to see what purpose could be served by joining it. If the Parent Company suffers a restriction on its freedom of establishment (or discrimination) because of the Appellant paying an increased amount of tax, that can be dealt with in these proceedings.

14. Applying these principles to Miss Simpson's first example of the Parent Company establishing a UK subsidiary concerns a possible restriction imposed by the host state. She makes the comparison between the Appellant, which by definition has at least one associated company, the Parent Company exercising the freedom of establishment, and a stand-alone UK company. I do not consider this to be a fair comparison. The establishment by the Parent Company of a subsidiary in the UK will necessarily result in the UK subsidiary having an associated company. The comparison should therefore be made between the Appellant with its Parent Company, and a UK resident subsidiary established by a UK resident parent. The subsidiary will pay the same amount of tax as the Appellant, and so there is no restriction on the Parent Company's exercise of the freedom of establishment.

15. In her second example, she contends that the UK (a third state) is restricting the Parent Company (or its Dutch subsidiaries) from establishing a subsidiary in another Member State, say Italy. So far as I am aware this is not a situation so far considered by the European Court. Here the comparison is with the Parent Company (or a Dutch subsidiary) doing the identical transaction in the Netherlands by establishing a Dutch subsidiary. The Appellant will pay the same tax in both cases. Accordingly, there is no restriction on the Parent Company's exercise of the freedom of establishment.

16. Her third example is the straightforward one of the UK, as home state, possibly restricting the Appellant from establishing a subsidiary outside the UK. Here the comparison is with the Appellant establishing a UK subsidiary. Again, the Appellant will pay the same tax in both cases and so there is no restriction on the exercise of the Appellant's freedom of establishment.

17. I should add three points in relation to Miss Demetriou's contentions although none of the points arises as I have found that there is no restriction. First, on her contention that the Appellant has not produced evidence that its freedom of establishment was restricted, or that section 13 in fact dissuades companies from establishing subsidiaries in the UK. If UK tax law imposes a restriction, the figures will speak for themselves. Secondly, I do not think that the fact that the tax rate in the UK is lower than in the Netherlands is relevant. If it were relevant, when a UK company exercised its freedom of establishment by setting up a Dutch subsidiary there would in all cases be a restriction. Different tax rates merely reflect the lack of harmonisation of rates. Thirdly, on whether any such restriction must be akin to exclusion from the market or have a direct and demonstrable inhibiting effect, in the latest case of *Hughes de Lasteyrie du Saillant* Case C-9/02 the Court said:

“Moreover, a restriction on freedom of establishment is prohibited by article 52 of the Treaty even if of limited scope or minor importance (see, to that effect, *Commission v*

France, [Case 270/83 [1986] ECR 273], paragraph 21, and Case C-34-98 *Commission v France* [2000] ECR I-995, paragraph 49)." (paragraph 43)

This suggests that Miss Demetriou is putting the test too high.

Indirect discrimination

18. Miss Simpson accepts that section 13(3) and (4) do not directly discriminate on grounds of nationality against non-resident associated companies. However, she contends that treating both resident and non-resident associated companies in the same way amounts to indirect discrimination as "the application of the same rule to different situations" (*Schumacker* Case C-279/93 [1995] ECR I-225 paragraph 20). She contends that the effect of subsections (3) and (4) is to take into account the existence of non-resident associated companies as if they were resident in the UK for the purposes of determining the rate of tax to be applied to the UK resident company. The European Court of Justice decided in *Schumacker* that resident and non-resident companies are not, as a rule, in comparable positions (paragraph 31). The non-resident associated companies are outside the scope of corporation tax and their existence should be ignored for the operation of section 13 for the purpose of calculating the rate of corporation tax payable by the Appellant.

19. Alternatively, Miss Simpson contends that if the Appellant and its non-resident associated companies are in comparable situations, there is indirect discrimination because the small companies' relief that would have been given to UK resident associated companies is not available to the Appellant's non-resident associated companies. While the relief given to the Appellant company is identical to the relief given to a hypothetical UK resident company with the same number of UK resident associated companies, she contends that the Appellant's group with non-resident associated companies are put at a disadvantage by including the non-resident associated companies in the computation, compared to the hypothetical group where the UK resident associated companies receive the advantage of the small companies' rate. The relief that would have been given to the non-resident associated companies if they had been resident she contends should therefore be given to the Appellant.

20. Miss Demetriou contends that section 13 applies to each company individually. The Appellant's associated companies could be making huge profits or none at all in the UK or in other Member States and it will make no difference to the Appellant's small companies' relief. In order to determine whether there is discrimination the Appellant company and its non-resident associates should correctly be compared, not with a UK resident company with no associated companies as the Appellant contends, but with a UK resident company with associated companies resident in the UK. On that basis there is no difference in treatment of the Appellant and its hypothetical equivalent and no discrimination. The facts of this case are the opposite of *ICI v Colmer* Case C-264/1966 [1998] ECR I-4695 and *Lankhorst-Hohorst* Case C-324/00 [2002] ECR I-11779 in that no distinction is made according to the residence of the associated companies.

21. On Miss Simpson's alternative contention Miss Demetriou points out that the taxation of the Appellant's non-resident associated companies is not in issue since

they are outside the scope of corporation tax. It is not discriminatory to restrict tax relief available to non-resident companies compared to resident companies where the differential treatment reflects differences in the underlying liability to taxation, as in *Futura Participations* and the Special Commissioners' decision in *Marks and Spencer v Halsey* [2003] STC (SCD) 70, which has been referred to the European Court. The relief is given on an individual basis to UK resident companies and not on a group basis.

Reasons for the decision

22. Under article 43 of the EC Treaty “freedom of establishment shall include the right to...set up and manage undertakings, in particular companies or firms within the meaning of Article 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected.” By article 48 nationals include “companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community.” This means that the Parent Company is entitled to have the Appellant treated in the same way as any other UK resident company in the same situation. The question is what UK resident company is in the same situation as the Appellant. Although not on this aspect of the case, Miss Simpson pointed to the distortion of competition between a single UK resident company starting in business and paying 19 per cent corporation tax, and a UK subsidiary formed by the Parent Company which pays a higher rate of tax because it has at least one associated company. This does not seem to me to be a comparison of companies in the same situation. The Appellant is part of a group of companies and it is not right to compare it to a single company in order to determine what rate of tax it has the ability to pay. I therefore agree with Miss Demetriou that the correct comparison is between the Appellant with its non-resident associated companies and another UK resident company with UK resident associated companies. On that basis they are treated in the same way and there is no discrimination.

23. On Miss Simpson's alternative argument, the Appellant's non-resident associated companies are outside the scope of corporation tax and pay no tax. The territoriality principle has been recognised by the European Court as not giving rise to any discrimination. In *Futura* the Court made the distinction between Luxembourg resident companies being in principle taxable on worldwide income, and so could carry forward losses on any such income, while the Luxembourg branch of the French appellant company was taxable only on income of the Luxembourg branch, and could carry forward losses of the branch only. The Court said

“Such a system, which is in conformity with the fiscal principle of territoriality, cannot be regarded as entailing any discrimination, overt or covert, prohibited by the Treaty.” (paragraph 22)

A further example is shown by *AMID* where, if the Belgian company had carried on the profitable activities carried on by the Luxembourg branch in Belgium instead of Luxembourg (and had still made the same losses on other Belgian activities), it would have been able to set the profits and losses against each other. As it was, the Court required it to be able to carry forward the loss, so that the result of exercising its

freedom of establishment was worse than if it had not. Even so, the Court held that there was no restriction, thus giving priority to the territoriality principle. There is no reason why the position should be different in relation to discrimination. On that basis there can be no question of giving to the Appellant the relief from tax that its non-resident associated companies would have received had they been resident. They are not taxable and cannot receive any relief which is given as part of the calculation of the rate of tax. I agree with Miss Demetriou that Miss Simpson is effectively trying to apply the relief on a group basis whereas it is given to UK resident companies individually.

24. Since I have decided that there is no restriction or discrimination it is not necessary for me to consider whether, if there were a restriction or discrimination, it could be justified although the point was argued before me.

25. Miss Simpson invited me to make a reference to the European Court in the event that I felt any doubt about the application of the principles of Community law to the present case. I do not consider that there is any doubt.

26. Accordingly I dismiss the appeal.