Neutral Citation: **[2023] UKUT 00257 (TCC)**

Case Number: UT/2022/000091

UPPER TRIBUNAL
(Tax and Chancery Chamber)

Rolls Building, London

JUDICIAL REVIEW – whether a Diverted Profits Tax notice issued to claimants (which used a "profit-split" method of arm's length pricing), was inconsistent with an earlier Advance Pricing Agreement the claimants had entered into for Transfer Pricing purposes (which used a "cost-plus" method of arm's length pricing) – no – claim dismissed

Heard on: 17 and 18 July 2023
Judgment date: 20 October 2023

Before

MR JUSTICE MICHAEL GREEN
JUDGE SWAMI RAGHAVAN

Between

THE KING (on the applications of)

(1) REFINITIV LIMITED
(2) REFINITIV UK EASTERN EUROPE LIMITED
(3) LIPPER LIMITED
(4) THOMSON REUTERS CORPORATION

Claimants

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS
Defendants

Representation:

For the Claimants: Julian Ghosh KC, Sam Grodzinski KC, Laura Ruxandu, Counsel, instructed by Baker & McKenzie LLP

For the Defendants: Jonathan Bremner KC, Counsel, instructed by the General Counsel and Solicitor to His Majesty's Revenue and Customs

DECISION

INTRODUCTION

1. This is a judicial review claim against HMRC's decision to issue Diverted Profits Tax ("**DPT**") notices on the claimants charging them to tax in the amount of approximately £167 million. The DPT regime was introduced in 2015 to address the situation where multi-national groups deploy arrangements to divert profits away from the UK to lower tax jurisdictions.

2. The claimants include UK companies in the Thomson Reuters group in relation to which valuable IP was, at the relevant time, held centrally in a Swiss-resident entity (Thomson Reuters Global Resources - "**TRGR**") whose income was taxed at lower rates. The judicial review claim concerns the services the UK entities had provided to TRGR. Those services enhanced the IP held by TRGR which TRGR used to make profits. HMRC asserted that the UK entities did not receive the compensation for providing those services that they would have done if those enhancement services had been provided at arm's length.

3. The claimants argue that the DPT notices were unlawful in public law terms because they used a method of calculating arm's length pricing of the above services which was inconsistent with the method that HMRC had previously agreed in respect of the same services in an earlier Advance Pricing Agreement ("**APA**"). APAs are negotiated agreements between HMRC and taxpayers with statutory force made for transfer pricing purposes under Part 5 of the Taxation (International and Other Provisions) Act 2010 ("**TIOPA"**). Transfer pricing refers to the provisions within the corporation tax regime which are also typically concerned with situations where multi-national groups can achieve better tax results than would arise if the transactions had been between independent parties negotiating at arm's length. Part 4 of TIOPA, in essence, taxes the transaction that would have happened if it had taken place at arm's length.

4. There are various methods to calculate arm's length pricing. One of these is "cost-plus". As the name suggests, this entails pricing the service provision by adding a specified percentage to the cost of providing the relevant service. Cost-plus was the method used for compensating the services in the APA which the claimants and HMRC agreed on 24 January 2013 for various transactions between the claimants and TRGR for the period 1 January 2010 to 31 December 2014, and a "roll-back" period of 1 October 2008 to 31 December 2009.

5. The IP held by TRGR in respect of which the services had been provided continued to generate profits and was subsequently disposed of in 2018 for a significant gain. HMRC issued a series of DPT notices, including one for the period 2018, on 20 August 2021. The charges contained in the notices were calculated by reference to what HMRC asserted was the arms' length compensation for IP services that the claimants should have received for providing their services that enhanced the IP held centrally by the Swiss entity (TRGR) within the group. That arm's length compensation was calculated, however, using a different method: "profit-split". For 2018, that entailed apportioning both TRGR's annual profit and its profit on its disposal of the IP in 2018. This was on the basis that the services that the UK entities had provided, which had enhanced the IP assets over the previous years (including 2008-2014), had contributed to the profits generated by the IP assets and the profits on their disposal.

6. Thus the claimants argue that HMRC's DPT notice for 2018 applying the "profit-split" method encroached upon the terms of the earlier APA; that APA used "cost-plus" in respect of the same subject matter, that is the arm's length compensation for services in the period 1 October 2008 to 31 December 2014. (The claimants accept that the APA does not restrict HMRC from asserting that application of the profit-split method is the right method for pricing the services provided after 31 December 2014.)

7. HMRC's response to the claim is that there is no inconsistency with the APA and therefore that no public law illegality arises. That is because the APA was time limited and only applied to the calculation of profits in the accounting periods from 2008 to 2014. The APA could not, and did not, affect the calculation of profit in the later accounting period in 2018.

8. On 16 June 2022, the Administrative Court (Foster J) granted permission for the judicial review claim to proceed. The claim was subsequently transferred to this tribunal. The order the claimants seek include i) quashing the DPT notices to the extent the notices conflict with the APA; and ii) declaring the DPT notices unlawful to the extent the notices conflict with the APA.

THE LAW

Corporation Tax, Transfer Pricing and APAs

9. The transfer pricing provisions operate within the corporation tax framework. Under s2(1) of the Corporation Tax Act 2009 ("**CTA 2009**") corporation tax is "charged on the profits of companies for any financial year for which an Act so provides" (s2(1) CTA 2009).

10. Section 8 CTA 2009 (How tax is charged and assessed) provides that:

> "…
>
> (2) Corporation tax is calculated and chargeable, and assessments to corporation tax are made, by reference to accounting periods.
>
> (3) Corporation tax which is assessed and charged for an accounting period of a company is assessed and charged on the full amount of profits arising in the accounting period.
>
> (4) Subsection (3) is subject to any contrary provision in the Corporation Tax Acts."

11. Companies in a group have the potential, because of their common control, to structure intra-group transactions in such a way as to depress the income of a particular entity or inflate its expenses so as to reduce the amount of profit, and therefore its corporation tax liability, as compared with the position that would have arisen if the transactions had been priced as if they had been undertaken by two independent parties acting at arm's length.

Part 4 TIOPA

12. The transfer pricing provisions in Part 4 TIOPA, in summary, entail comparing "the actual provision", that is the provision "made or imposed as between any two persons…by means of a transaction or series of transactions" (s147(1)(a)), with "the arm's length provision" that "would have been made as between independent enterprises" (s147(1)(d)). Where the "actual provision confers a potential advantage in relation to United Kingdom taxation" (s.147(2)), "the profits and losses of the potentially advantaged person are to be calculated for tax purposes as if the arm's length provision had been made or imposed instead of the actual provision" (s147(3)).

13. Section 155 TIOPA explains that an actual provision confers a "potential advantage in relation to United Kingdom taxation" on a person if, inter alia, that person's taxable profits for "any chargeable period" are smaller in amount as an effect of the provision not being arm's length (and/or the person's losses are greater).

14. The statutory transfer pricing provisions in Part 4 must be read consistently with the transfer pricing guidelines of the OECD to the extent provided for in s164(1). Section 164(4)(a) defines "the transfer pricing guidelines" for the purposes of the subsection as including:

"the version of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations approved by the Organisation for Economic Co-operation and Development (OECD) on 22 July 2010 as revised by the report, Aligning Transfer Pricing Outcomes with Value Creation, Actions 8–10 – 2015 Final Reports, published by the OECD on 5 October 2015."

15. We were shown excerpts from the 2017 report (which of course post-dated the date the APA entered here), but nothing turns on that for the purposes of the issue before us and HMRC confirmed that report had incorporated the 2015 report amendments referred to above.

Part 5 TIOPA - APAs

16. Part 5 of TIOPA deals with the meaning and effect of APAs.

17. Section 218 (meaning of "advance pricing agreement") provides:

"(1) In this Part "advance pricing agreement" means a written agreement that—

(a) is made by the Commissioners with any person ("A") as a consequence of an application by A under section 223,

(b) relates to one or more of the matters mentioned in subsection (2), and

(c) declares that it is an agreement made for the purposes of this section.

(2) Those matters are—

(a) if A is not a company, the attribution of income to a branch or agency through which A has been carrying on a trade in the United Kingdom or is proposing to carry on a trade in the United Kingdom,

(b) if A is a company, the attribution of income to a permanent establishment through which A has been carrying on a trade in the United Kingdom or is proposing to carry on a trade in the United Kingdom,

(c) the attribution of income to any permanent establishment of A's, wherever situated, through which A has been carrying on, or is proposing to carry on, any business,

(d) the extent to which income that has arisen or may arise to A is to be taken for any purpose to be income arising in a country or territory outside the United Kingdom,

(e) the treatment for tax purposes of any provision made or imposed, whether before or after the date of the agreement, as between A and any associate (see section 219) of A's, and

(f) the treatment for tax purposes of any provision made or imposed, whether before or after the date of the agreement, as between an oil-related ring-fence trade carried on by A (see section 206) and any other activities carried on by A."

18. The relevant subsection in this case is s218(2)(e).

19. Section 220 deals with the effect of the agreement on a party to it:

"220 Effect of agreement on party to it

(1) Subsection (2) applies if a chargeable period is one to which an advance pricing agreement relates.

(2) The Tax Acts have effect in relation to the chargeable period as if, in the case of the person with whom the Commissioners made the agreement,

questions relating to the matters mentioned in section 218(2) are to be determined—

(a) in accordance with the agreement, and

(b) without reference to the provisions in accordance with which they would otherwise be determined.

(3) Subsection (2) is subject to— subsections (4) and (5), and section 221.

(4) A question is to be determined as mentioned in subsection (2) only so far as the agreement provides for the question to be determined in that way.

(5) In the case of so much of a question as—

(a) relates to any matter mentioned in paragraph (e) or (f) of section 218(2), and

(b) is not comprised in a question that relates to a matter within another paragraph of section 218(2), reference to a provision is capable of being excluded under subsection (2) by an advance pricing agreement only if the provision is in Part 4."

20. There is no dispute here that, given the relevant matter falls under s218(2)(e), pursuant to s220(5), the displacement effect of s220(2) only applies to such provisions which would otherwise have effect under Part 4 TIOPA.

21. Section 224 enables the APA to cover chargeable periods ending or beginning before the APA is made as follows:

"(1) An advance pricing agreement may contain provision relating to chargeable periods ending before the agreement is made, subject to subsection (2).

(2) An advance pricing agreement may not contain provision relating to chargeable periods ending before 27 July 1999.

(3) If an advance pricing agreement—

(a) relates to a chargeable period beginning or ending before the agreement is made, and

(b) provides for the manner in which adjustments are to be made for tax purposes in consequence of the agreement, the adjustments are to be made for those purposes in the manner provided for in the agreement."

22. HMRC's Statement of Practice elaborates on the purpose and duration of APAs. The Statement which applied at the time the relevant APA here was entered into explained:

"An APA is a written agreement between a business and the Commissioners of HMRC which determines a method for resolving transfer pricing issues in advance of a return being made...it provides assurance to the business that the treatment of those transfer pricing issues will be accepted by HMRC for the period covered by the agreement. …"

…An APA will be operative for a specified period from the date of entry into force as set out in the agreement. The business should propose an initial term for the APA taking into account the period over which it is reasonable to assume that the method for dealing with the relevant transfer pricing issues will remain appropriate. Typically the term is from three to five years."

23. SP2/10, last updated 12 July 2019, adds that "a longer term will only be considered in exceptional circumstances".

Diverted profits tax

24. The Diverted Profits Tax regime is set out in Finance Act 2015 ("**FA 2015**") and under s116(5) FA 2015, DPT has effect in relation to accounting periods beginning on or after 1 April 2015.

25. As summarised by Sales LJ, as he then was, in *R(Glencore Energy UK Ltd) v HMRC* [2017] EWCA Civ 1716 (at [8]):

> "DPT is a tax introduced to counter the use of aggressive tax planning deployed by multinational corporate groups to divert profits which would otherwise have been subject to corporation tax in the UK away from the UK to low tax jurisdictions, thereby eroding the UK tax base."

26. Section 77 (Introduction to the tax) FA 2015 provides:

> "(1) A tax (to be known as "diverted profits tax") is charged in accordance with this Part on taxable diverted profits arising to a company in an accounting period…"

27. Under s79 (Charge to tax):

> "(1) A charge to diverted profits tax is imposed for an accounting period by a designated HMRC officer issuing to the company a charging notice"

28. DPT is calculated by reference the "relevant alternative provision" ("**RAP**") defined in s82(5) as:

> "the alternative provision which it is just and reasonable to assume would have been made or imposed as between the relevant company and one or more companies connected with that company, instead of the material provision, had tax (including any non-UK tax) on income not been a relevant consideration for any person at any time."

29. Various procedural requirements are specified. The charge is imposed by a designated HMRC officer (s79 FA 2015). HMRC must first issue a preliminary notice (s93) in relation to which the taxpayer may make representations. HMRC must, having considered such representations in accordance with s94, decide whether to issue a charging notice. The taxpayer has the right to appeal the charging notice to the First-tier tribunal (which will be treated in the same way as appeals against assessments in the Taxes Acts) (s102).

Interaction between DPT and Transfer Pricing

30. As regards the differing scope of the transfer pricing and DPT provisions, the scope of the RAP under DPT is conceptually broader than "arm's length" pricing under the transfer pricing regime. It is possible, on the facts of the case however, for the arm's length pricing for transfer pricing and the RAP to be the same, in other words that the hypothetical transaction posited as the one that would have taken place had tax not been a relevant consideration, to simply be the same transaction but one which was priced at arm's length. That is true of this case (and was also acknowledged in the FTT case of *Vitol Aviation UK Ltd and others v HMRC* [2021] UKFTT 0353 (TC)). There is no dispute here that the RAP entails precisely the same exercise of positing an arm's length transaction between the parties.

31. HMRC's guidance in relation to DPT (INTM48966) notes that where an APA is in force:

> "broadly speaking […] a DPT charge would not normally arise under section 80 or section 81 in respect of covered transactions of an APA. A DPT charge will however always need to be considered if the rules relating to basing any DPT charge on the relevant alternative provision applied."

32. HMRC accordingly acknowledges that if a "live" APA had applied to the 2018 accounting period the result in practice would have been that no additional DPT would have arisen in respect of the APA-covered transactions because the arm's length pricing (under the RAP) would have been determined by reference to the APA.

Public law principles

33. As regards the relevant principles of public law, we deal with these briefly given that HMRC accepts that if the DPT notices were inconsistent with the APA then they would be unlawful and the judicial review claim would succeed.

34. As Mr Grodzinski KC for the claimants helpfully articulated, the key dispute in this case is thus whether there is such an inconsistency. It is not a case, that sometimes arises in the context of legitimate expectation claims, where the public authority seeks to argue that, even if there is an inconsistency, such inconsistency is justified in the public interest. We agree with him that it does not much matter whether the unlawfulness is characterised as entailing: a) an error of law by HMRC; or b) an abuse of HMRC's statutory power and/or HMRC having acted irrationally. Reflecting the initial impression Foster J formed of the case when she granted permission, that its public law focus lay in a similarity with legitimate expectation cases, we consider the most apt analogy is with the kind of unfairness Lord Templeman referred to in *Preston v IRC* [1985] 1 AC 835. In that case, which concerned a taxpayer who had withdrawn claims for tax relief and paid tax on the basis a Revenue inspector had told the taxpayer the inspector did not intend to raise further inquiries, Lord Templeman considered that there would be "unfairness" amounting to an abuse of power entitling the taxpayer to judicial review (at 867B) where:

> "the commissioners have been guilty of conduct equivalent to breach of contract or breach of representations on their part."

35. Thus, as Mr Grodzinski argued, the judicial review claim should be granted if we are persuaded that HMRC made an error of law by misconstruing the effect of a document to which it was required to give legal effect; and /or where it acted in a way which amounted to, or was, a breach of contract; and hence constituted an abuse of power. As Mr Grodzinski pointed out, if the claimants' case regarding inconsistency with the APA is made out, the argument that that then gave rise to an abuse of power is all the more apparent given the statutory force given to such agreements under Part 5.

36. The order that the claimants seek include quashing the DPT notices to the extent the notices conflict with the APA. There is no dispute that, as matter of principle, this remedy, to the extent it would involve a declaration of partial validity, is possible under the applicable principles of administrative law.

BACKGROUND EVIDENCE AND FACTS

WITNESSES

37. We received evidence in the form of witness statements from three witnesses on behalf of HMRC covering: HMRC's policy and practice in relation to APAs (Shane Booth); the DPT regime (Stefan Ellender); and also from the HMRC officer responsible for issuing the DPT charging notices (Andrew Page) which exhibited the correspondence leading up to the issue of the notices. The witnesses were not required to give oral evidence or to be cross-examined. In the end, beyond setting out the basic background facts, and key documents such as the APA, nothing of significance turns on this evidence for the purpose of resolving the issue before us. As indicated above, it is not in dispute that if the DPT notices are inconsistent with the APA then that would give rise to public law unlawfulness. Whether the DPT notices are inconsistent turns on the scope of the APA and the regime under which it was agreed on the one hand, and

the nature and scope of the DPT charges on the other. That is essentially a matter of the legal construction of the two regimes and the APA.

BACKGROUND /FACTS

38. There are no material disputed issues of fact concerning the underlying background facts and the content of the APA. In this section we outline the facts and excerpts from the APA and surrounding the DPT notices for the purpose of putting the arguments the parties raised before us in context.

39. The first to third claimants ("TRUK") are UK tax resident companies who were part of the Thomson Reuters group in the relevant period. (The fourth claimant is a corporation which agreed to indemnify a purchaser of a business unit in Thomson Reuters in respect of tax liabilities, and which include those which are the subject of this claim.)

40. The Thomson Reuters Group also included TRGR which was tax resident in Switzerland. Thomson Corp and Reuters merged in 2008. TRGR, in 2008, owned valuable IP assets in Switzerland. The transactions between TRGR and TRUK included contractual arrangements under which TRUK provided various services to TRGR such as services described in the contract as Software and New Product Development, Content Development and Acquisition, and Data Hosting.

41. Following an application to HMRC and detailed negotiations, TRUK agreed an APA which was executed by the claimants on 15 November 2012 and by HMRC on 24 January 2013.

42. The Recitals explained that:

> "(A) Pursuant to Part 5 of TIOPA 2010, Thomson Reuters Markets UK and HMRC (the "Parties") would like to enter into an Advance Pricing Agreement ("APA"') to establish an appropriate transfer pricing methodology in satisfaction of Thomson Reuters Markets UK's obligations under the provisions of Part 4 of TIOPA 2010 in relation to achieving an arm's length allocation of income and expenses for cross border transactions between Thomson Reuters Markets UK and related parties.
>
> (B) The APA has a 5 year term beginning with the accounting periods of Thomson Reuters Markets UK commencing 1 January 2010 and terminating on 31 December 2014, unless renewed by the written agreement of the Parties. Additionally, the APA covers a roll back period from 1 October 2008 to 31 December 2009."

43. Clause 2 defined the term "Covered Transactions" as consisting of various transactions. Amongst these, as set out at 2.1.4, were fees for a number of services (listed below from Clause 5.4.1. onwards).

44. Clause 3 on legal effect was as follows:

> "3.1 This agreement is made pursuant to and for the purposes of the provisions of Part 5 of TIOPA 2010 and binds the parties, for the duration of the agreement, to determine the treatment of the Covered Transactions in accordance with the terms of this agreement.
>
> 3.2 HMRC will be bound by the terms and conditions of this agreement and will not impose during the currency of this agreement any transfer pricing adjustments to the Covered Transactions which might otherwise have been made pursuant to the application of the provisions of Part 4 of TIOPA 2010.

> 3.3 For the avoidance of doubt, nothing in this agreement shall, in relation to years covered by this agreement, prevent HMRC from raising a transfer pricing inquiry in respect of any transaction entered into by Thomson Reuters Markets UK which is not a Covered Transaction."

45. Clause 5 listed the various different transfer pricing methods to be applied, and included at 5.4.1 to 5.4.8 the transfer pricing methods to be applied to the services at issue in this case: "Software and New Product"; "Content Development and Acquisition"; "News and Editorial Services"; "Data Hosting Services"; "Marketing Central and Support Services"; "Advisory"; and "Synergy and Integration".

46. The method in each case, barring that last service, was the "Transactional Net Margin Method". We adopt the terminology "cost-plus" which the parties used to describe the method. It involved adding a specified mark-up percentage to the costs of providing the services ranging from 6% to 15% "for the period of the agreement". The method specified for Synergy and Integration Services (at 5.4.8.1) was a "cost-allocation" approach.

47. Other methods were specified for other transactions. For instance under clause 5.1 a profit-split method was used to determine royalties that TRUK received from TRGR in relation to the use of certain assets. That involved applying a specified percentage which varied year-by-year across the period 2010 to 2014 to revenues derived from distribution activities in respect of third party sales.

48. Clause 7.2 on "Application of Tax Laws" provided that:

> "Notwithstanding anything in this agreement, Thomson Reuters Markets UK remains subject to all applicable UK taxation laws not directly affected by this agreement. Thomson Reuters Markets UK is entitled to any benefits or relief otherwise available under all such laws."

49. Clause 9 headed "Duration of this Agreement" provided:

> "This agreement has a 5-year term beginning with the accounting period commencing 1 January 2010 and terminating on 31 December 2014, unless renewed by written agreement of the Parties.
>
> Additionally, the APA covers a roll back period from 1 October 2008 to 31 December 2009."

50. The claimants sought a new APA for subsequent accounting periods but none was ultimately agreed and the claimants' application was confirmed withdrawn on 13 September 2018.

51. In October 2018, as part of a disposal by Thomson Reuters of its Financial & Risk business unit to Refinitiv Holdings, various IP rights, including those held by TRGR, were sold.

52. Over the course of the period 8 February 2018 to August 2021, HMRC issued a number of DPT charging notices (amounting to £23,965,220.74 for the 2015 chargeable period, £69,148,953.45 for the 2016 chargeable period and £56,339,209,29 for the 2017 chargeable period). This judicial review claim concerns the DPT charging notice for the 2018 chargeable period. The Final Notice was issued by Mr Page on 20 August 2021 in the amount of £167,400,583.57.

53. The DPT notices explained the basis on which the RAP relied on arm's length pricing as follows:

> ""III. The RAP [relevant alternative provision], as defined in s82(5) FA 2015, is that if tax on income had not been a relevant consideration for any person

at any time, it is just and reasonable to assume that legal ownership of the non-trademark IP rights would be centralised and arm's-length pricing would be maintaining, protecting and exploiting those assets

IV. Under the RAP, [TRUK] would have additional income in the form of arm's-length compensation paid to it by the legal owner of the non-trademark Intellectual Property rights [*i.e.TRGR*] for the performance of DEMPE functions. *["DEMPE" was the abbreviation the parties used for the "development, enhancement, maintenance, protection and exploitation" of intangibles (as referred to in the OECD guidelines – see [57] below*]). This is because the evidence provided suggests the vast majority of the DEMPE functions with respect to the Intellectual Property rights covered by the material provision are carried out in the UK and the US."

54. For present purposes it is sufficient to note that HMRC accepted that some of the DPT charge was referable to the services provided between 2008 and 2014. This appeared from the exchanges of correspondence that took place in the run-up to the issue of the final notices in response to the claimants' representations on HMRC's preliminary DPT notices.

55. In those representations Baker McKenzie's letter of 19 June 2021 set out its understanding of HMRC's basis for taxation including that:

> "b) TRUK made an ongoing contribution to the development of the IP assets owned by TRGR through the performance of value-adding services in the periods 2008 through 2018
>
> …
>
> d) At arm's length, TRUK would have been rewarded for its ongoing contribution (i.e. the performance of those value-adding services) through an allocation of profits from exploitation of the IP assets, which in HMRC's view includes the value of the assets crystallised on TRGR's divestiture of its portion of the Financial & Risk business to a third party in October 2018."

56. HMRC responded in its email of 22 June 2021 to those sub-paragraphs as follows:

> "b) Yes, HMRC's view is that TRUK has been performing value-adding functions (including development and risk control functions) with regards to IP assets owned by TRGR during the 2008-2018 period under the services contracts between TRUK and TRGR"
>
> …
>
> d) TRUK, through its value-adding services, makes a significant contribution to the value of TRGR's intangibles and, therefore, it is appropriate that it is compensated by reference to a share of the returns earned by TRGR from the exploitation of the intangibles. In 2018, TRGR generated returns from exploiting intangibles in two ways: first, by using the intangibles to sell products and services as part of its commercial operations; and second, by selling the intangibles as part of the disposal of the F&R business. Therefore, it is in line with the arm's length principle for TRUK to be rewarded by reference to a share of the profits generated by TRGR from both the use of the intangibles to sell products and services to customers and the IP value crystallised on the sale of the F&R business in 2018."

57. The approach whereby it was considered that TRUK should be compensated by reference to its share of returns was, in HMRC's view, consistent with OECD transfer pricing guidelines (see [15 above]). Those explained at para 6.32 that:

> "In transfer pricing cases involving intangibles, the determination of the entity or entities within an MNE group which are ultimately entitled to share in the

> returns derived by the group from exploiting intangibles is crucial. A related issue is which entity or entities within the group should ultimately bear the costs, investments and other burdens associated with the development, enhancement, maintenance, protection and exploitation of intangibles. Although the legal owner of an intangible may receive the proceeds from exploitation of the intangible, other members of the legal owner's MNE group may have performed functions, used assets, or assumed risks that are expected to contribute to the value of the intangible. Members of the MNE group performing such functions, using such assets, and assuming such risks must be compensated for their contributions under the arm's length principle."

58. The claimants could have, but chose not to, bring claims for judicial review in respect of the DPT notices for the earlier years. The same concern regarding a profit-split of TRGR income arose in 2015-2017 (but the amounts were smaller because there was no substantial sale of IP to a third party in these periods). The claimants do not however accept the DPT notices were correct for those years. HMRC does not pursue any point on this; it accepts that the claimants' decision not to litigate these years (as part of the judicial review claim) does not assist in construing the relevant statutory provisions at issue concerning the application of the APA to 2018.

PARTIES' ARGUMENTS IN SUMMARY

59. The claimants' case is that the APA and DPT cover the same subject matter (arm's length pricing of services in the period 2008-2014) but do so inconsistently, undermining the written agreement and the statutory regime (which enables the APA to replace the statutory provisions with statutory effect). HMRC might have sought to agree a "profit-split" (it did for other services) in the APA but did not do so in respect of the relevant services.

60. HMRC's case in response emphasises that the DPT notices concern an accounting period subsequent to the APA, the year 2018. The arm's length calculation of services that went into the profit in 2018 is not covered by the APA (which is time-limited). The arm's length services must therefore be calculated according to legislation under Part 4 TIOPA. HMRC were thus entitled to use the profit-split basis to calculate arm's length compensation for the services TRUK provided to enhance etc. the IP in working out the DPT due in the accounting period in 2018.

DISCUSSION

61. The parties' agreement on many matters, which we outline below, means resolution of the claimants' case turns on the following narrow question: Were the DPT notices inconsistent with the APA to the extent that they calculated the arm's length price of the services provided in 2008-2014 on a profit-split basis in 2018 which was in addition to the previous calculation of the arm's length price for those services on a cost-plus basis in accordance with the APA?

62. Mr Ghosh KC, for the claimants, accepted as a general proposition (subject to a legitimate expectation case being made out on the particular facts of a given case) that, were it not for the APA, HMRC *would* be able to change their method of arm's length pricing from one accounting period to another, for instance by using a cost-plus method in earlier years and then, in a later period, changing to profit-split. It is the fact that the cost-plus method was included in the APA which is central to the claimants' case that HMRC has acted inconsistently and therefore unlawfully in public law terms, whether that is put in terms of an error of law, an abuse of power, or irrationality.

63. There is no dispute here that the public law question of abuse/irrationality is resolved by that question of inconsistency between the DPT charging notices and the APA. In other words, HMRC accepts that, if we find that there is such an inconsistency, then the claimants' judicial review claim succeeds. There is also no dispute that in this case (as was also highlighted in

Vitol) the issue of arm's length pricing underlies both the subject matter of the DPT charging notices and the APA. That is because the RAP for DPT purposes involves precisely the same task of ascertaining profits on an arm's length basis as does transfer pricing in this case. And, as Mr Ghosh rightly highlighted, there was also no dispute on the part of HMRC, that the enhancement services provided by TRUK in the period 2008-2014, which were covered by the APA, contributed to the profit realised in 2018. This was apparent from the correspondence above at [56] which occurred in earlier periods and was reiterated in the oral submissions of Mr Bremner KC for HMRC.

64. The fundamental issue therefore is the scope of the APA. It clearly applies to the earlier accounting periods between 2008 and 2014, but the central dispute is as to whether the APA also relates to the 2018 period. The claimants' case is that it does. That is because they say that services provided during 2008-2014 and which were taxed on the basis of the arm's length pricing in the APA are sought to be taxed again on a different basis through the calculation of the profits for that 2018 period.

65. That dispute engages foremost a question of statutory interpretation of the Part 5 TIOPA provisions on APAs, in particular the meaning of the words in s220 TIOPA: "chargeable period…to which an advance pricing agreement relates". As applied to the facts of this case the question becomes: Is the 2018 accounting period a chargeable period to which the APA "relates" for the purposes of s220?

Construction of s220(1) – meaning of "chargeable period…to which an [APA] relates"

66. Mr Bremner submitted that corporation tax is assessed on an accounting period by accounting period basis (under s2(1) CTA 2009). Where s220(1) TIOPA refers to a chargeable period to which an APA "relates", that can only be a chargeable period within the term of the APA agreement. Chargeable periods falling outside the APA term are not periods to which the APA "relates". Therefore HMRC's position is that the 2018 accounting period is not a period to which the APA "relates" (as it is outside the term of the APA).

67. Mr Ghosh argued that "relates to" is not the same as "referred to in". First, as a matter of text, s220(1) does not say that the chargeable period is the one covered by, or specified in, the APA. In his submission the statutory words ask whether there is a connection between the APA and the relevant chargeable period. Second, the very fact that HMRC has accepted that the profits in 2018 are "referable" in part to the same services which were priced by the APA constitutes the necessary relationship between the 2018 chargeable period and the APA.

68. In support, Mr Ghosh referred to the Court of Appeal's reasoning in *R (Veolia ES Nottinghamshire Ltd) v Nottinghamshire County Council* [2010] EWCA Civ 1214 for the proposition that "relating to" cannot be given the narrow meaning of "expressed in" or "referred to in".

69. That case concerned whether certain documents concerning a waste management contract between the claimant, Veolia, and a county council could be inspected by an elector under s15(1) of the Audit Commission Act 1998. That allowed the elector, as an "interested person" to:

> "…(a) inspect the accounts to be audited and all books, deeds, contracts, bills, vouchers and receipts relating to them…"

70. The Court of Appeal (per Rix LJ with whom Etherton and Jackson LJJ agreed) rejected Veolia's grounds for resisting disclosure which had included that the contract was not referred to in the accounts, setting out a number of reasons why the concept of "relating to" was not drawn as narrowly as Veolia suggested ([98]-[101]). Rix LJ's reasoning noted, amongst other matters, the auditing context in which that relation arose, and the way in which "relating to"

was used elsewhere in the legislation: the relationship was established by the nature and function of the document rather than whether such document happened to be explicitly referred to in the accounts.

71. Mr Ghosh relied on a passage from [45] which it is convenient to set out in full:

> "Section 6(1) provides:
>
> > "An auditor has a right of access at all reasonable times to every document relating to a body subject to audit which appears to him necessary for the purposes of his functions under this Act."
>
> This is a wide provision, albeit expressly subjected to the purposes of the auditor's statutory functions. Subject to that restriction, the documents to which the auditor is entitled to access, at all reasonable times, only have to relate to the body subject to audit and not to the accounts themselves.
>
> Moreover, it is clear that the expression "relating to" in the phrase "relating to a body" cannot be given the narrow meaning of "expressed in" or "referred to in" which Veolia wishes to give to the expression "relating to" in section 15(1)."

72. We note Rix LJ's later reasoning (at [99]) on the interpretation of s15(1), being the section which was the focus of the Court of Appeal's consideration (s 6(1) above being referred to by way of comparison) would also appear, at least on the face of it, to support Mr Ghosh's argument that "relating to" should not be interpreted too narrowly. In Rix LJ's judgment:

> "..the words "relating to", where the relation is between one document and another, simply do not mean the same as "referring to".

73. As we indicated at the hearing, the claimants can derive little assistance from *Veolia.* The use of "relating to" at [45] was in conjunction with the very different setting of a relationship with "a body". More generally the interpretation of the words took place in the statutory context of elector inspection rights and where the relation in question was "between one document and another". What *Veolia* is an example of however is the necessity of considering the words requiring interpretation in the wider statutory scheme in which they appear, and also the benefit of considering how the words have been deployed in other parts of that scheme.

74. Here, the statutory scheme is one whereby agreements entered into between the tax authority and the taxpayer are given statutory force as an exception to the statutory provisions that would otherwise apply. As a starting observation that might well suggest erring on the side of an interpretation that is less expansive rather than more. While the statutory scheme sets some parameters around the subject matter that the agreement can cover (i.e. the matters referred to in s218 TIOPA), and that it can apply to one or more chargeable periods, it leaves open the precise scope. That is entirely to be expected given that the point of having a framework which gives effect to agreements with individual taxpayers is to reflect the particular circumstances of the taxpayer.

75. Accordingly, in contrast to the way "related to" was used in the relevant legislation in *Veolia* there is no difficulty with understanding that term as meaning s220 will only apply to the chargeable periods to which the APA says it applies. That way the suspension of the statutory provisions that might otherwise apply will keep in step with what the parties have specified. The wider interpretation of the scope of "related to" that was apposite in the context of inspection rights of interested persons in *Veolia* does not seem appropriate for the purposes of Part 5; rather than respecting a bright line between what is covered by the agreement under Part 5 and what is not and therefore under Part 4, it would open up more scope for argument

as to the reach of the APA. We acknowledge the legislation does not use the term "specified in" or "covered by" but the concept of "relating to" is capable of different degrees of breadth and we consider the context in which the words "..to which an [APA] relates" appears here is consistent with the more constrained interpretation we have suggested.

76. We are reinforced in this view in the way "relating to" is used in s224 TIOPA (set out above at [21]). Mr Ghosh submitted that this provision is neutral as between the competing interpretations of the requisite relationship but we consider that the use of "relating to" in the phrase "may contain provision relating to chargeable periods" gives the clear impression that the legislation envisages that the APA agreement drafters will need to turn their minds to, and specify, the chargeable periods to which the agreement is to apply, not least so as to ensure that the agreement does not infringe the backstop date of 27 July 1999, mentioned in s224(2). We asked at the hearing whether anything could be drawn from the fact that s224 only referred to past periods and not future periods but Mr Ghosh submitted that no such negative inference could arise from that. The specific provision in s224, he argued, is needed to give the requisite "vires" for backdating whereas there was no need to provide for future periods as they (i.e. periods after the agreement) were exactly what APAs are there to cater for. We can certainly see that that would be the case insofar as the future periods are those specified in the agreement - indeed the proposition that future periods are to be covered is reflected by the fact the agreements are called *advance* pricing agreements. But, s224 having made clear that the APA can look backwards (and that this must be done, we consider, with specific charging periods in mind) we do think that this implies that an APA cannot extend to future periods which are not so specified in the APA. Taking that more restrictive approach is also consistent with our starting observation above that one should err on the side of a less expansive interpretation of the scope of APAs (given their effect of disapplying the statutory regime that would otherwise apply).

77. We therefore reject the claimants' argument that the necessary relationship under s220(1) is satisfied by any sort of connection between the relevant chargeable period and the APA. That conclusion does not dispose of the claims however because the question of what chargeable periods the APA does relate to under s220(1), even if our narrower interpretation is taken, is disputed, as regards the particular terms of this APA. It is to that matter which we now turn.

To which chargeable periods does the APA relate?

78. The key provisions are set out above at [42] to [49] above. HMRC's case is that the chargeable periods to which the APA "relates" are 2008 to 2014 only, and categorically not 2018. Mr Bremner emphasised the clauses on legal effect (Clause 3) and duration (Clause 9). Clause 3.1 binds the parties "for the duration of the agreement" (defined in Clause 9 as having "a 5 year term beginning with the accounting period commencing 1 January 2010 and terminating on 31 December 2014" and the "roll back period from 1 October 2008 to 31 December 2009"). Clause 3.2 binds HMRC to the agreement and prevents it from making transfer pricing adjustments to the Covered Transactions "during the currency of this agreement" which HMRC says refers to the 5 year term described in Clause 9.

79. Mr Ghosh argued that the above misunderstands the function of clause 3.2. Central to that, he submitted, is the fact that the definition of Covered Transactions (which included the various services TRUK provided to TRGR) had no time limit. (Mr Ghosh accepted that some services were time limited by the way they were in turn defined - so Advisory Services were limited to y/e 31 December 2010 and 2011 and the roll back period; and Synergy and Integration Services were not undertaken from 2012 onwards.) He said that the role of clause 3.2 was not to govern HMRC's conduct but to establish that the pricing was protected for only those Covered Transactions undertaken "during the currency of [the] agreement".

80. Critically, Mr Ghosh submitted that the APA priced those services, which he emphasised were actual services that were provided between 2008 and 2014 at "cost-plus" on an exhaustive basis. HMRC's response, that corporation tax and DPT are annual taxes calculated on an accounting period by accounting period basis and that the calculation of profits for 2018 is an entirely different matter that is not covered by the agreement, is no answer, Mr Ghosh said; the 2018 profits must come from somewhere. In both the transfer pricing and the DPT regime, there needs to be a relevant "provision" to which the arm's length treatment or RAP (which in this case is also arm's length) is applied. On HMRC's own case those profits derive in part from the provision of services in the period 2008 to 2014, services that were, Mr Ghosh argued, already arm's length priced at cost-plus under the APA. That the taxes are annual and calculated on an accounting period basis does not entitle HMRC to reach back and recompute profits of historic periods. The very referability of the 2008 to 2014 services to the calculation of profits in 2018 is enough to constitute the necessary relationship between the APA and the 2018 chargeable period for the purposes of s220, such that the APA "relates to" 2018.

81. We reject the above reasoning. A crucial step, as Mr Bremner pointed out, has been overlooked. That is that the arm's length pricing of the services as set out in the APA can only be relevant as a matter of law under s220 once it is established that the APA relates to the 2018 chargeable period. To rely on the pricing of services in the APA as the means by which the necessary relationship is established is a "bootstraps" argument: the APA cost-plus pricing would only ever become relevant once the relationship is already established. It cannot be the means by which the relationship is established. Thus the claimants' reference to HMRC "reaching back" and "re-computing" provisions of services in earlier periods assumes the very point in issue; whether the APA computation method for those services in earlier years applied.

82. Another way in which Mr Ghosh put his submissions was to interpolate the terms of the APA into s220(2) so as to read "the Tax Acts have effect in relation to the chargeable period as if, in the case of [TRUK], questions relating to [*the treatment for tax purposes of any compensation for transactions between TRGR and TRUK which occurred during the currency of the APA*] are to be determined – a) in accordance with the agreement." However that interpolation only works if the condition in s220(1) is met and the 2018 chargeable period is one to which the APA relates.

83. As regards the reference to "the Tax Acts" having effect in relation to the chargeable period it was argued that the DPT notices in respect of 2018 did do that as they "affected" the arm's length price already established for the chargeable periods 2008-2014. Again this argument is only relevant once it is established that 2018 is a chargeable period to which the APA relates under s220(1).

84. As to Mr Ghosh's emphasis on the 2018 profit calculation having to rest on a "provision" (in the sense of the transfer pricing and DPT legislation, and on the facts here, the services provided in 2008-2014), it is true that there cannot be a "chargeable period" without some kind of such provision giving rise to a charge. However this does not advance the claimants' case once it is recognised that such provision does not exist in isolation but is inextricably bound up with the calculation of profit for a particular accounting period.

85. That is apparent when one puts the task of arm's length pricing of the "provisions" in s147 TIOPA, which forms the basis for the APA in this case, in its proper context. That is to calculate profits for the purpose of corporation tax. The function of s147 is to do that calculation on an arm's length basis as opposed to the actual basis; under s147(3) "profits and losses" of the identified person ("potentially advantaged") are at arm's length. But that arm's length price is not calculated as an abstract exercise and as an end in itself; it sits within the mandate to calculate profit. That profit can only be calculated in respect of a particular accounting period.

Similarly, the "provision" referred to in s218(1)(e) in the context of Part 5 does not exist in isolation; it is a provision which is relevant to calculating taxable profits in a given accounting period.

86. Mr Ghosh referred in reply to the OECD guidelines (on the ownership of intangibles and transactions involving the development, enhancement, maintenance, protection and exploitation of intangibles) at paragraph 6.32 (see [57] above). That, he submitted, made clear that the profit-split methodology arose through enterprises doing something, in other words, by the provisions they made. No mention was made of accounting periods. However there is nothing in those passages which is inconsistent with the fact that the notion of provisions does not exist in isolation but in the context of the calculation of particular accounting periods. The paragraph makes a general observation about the need for entities enhancing and developing intangibles to be compensated under the arm's length principle. It is hardly surprising in that context that no mention is made of the underlying mechanics of the tax calculation.

87. That inextricable focus on the accounting period provides the backdrop for interpreting the terms of this particular APA. It explains why the claimants' submission that the APA priced the 2008-2014 service provision exhaustively is misconceived because it begs the question as to what it is exhaustive of. In the statutory context in which arm's length pricing is undertaken, that pricing could only be "exhaustive" as regards the pricing of services for the purposes of calculating the profits for the particular accounting periods which the APA covered.

88. The straightforward reading of clause 3.2 is that it focusses on HMRC's conduct, as Mr Bremner suggested. Its role is to inhibit HMRC's ability to make alternative transfer pricing adjustments during that same 5 year term. If the intention had been for the 5 year term to circumscribe a period in which *Covered Transactions* were undertaken the clause would have been expressed differently and most likely located elsewhere. Clause 3.2 must also be read in conjunction with the rest of the clause and the recitals. Clause 3.1 states that the parties are bound "for the duration of the agreement". That must plainly refer to the 5 year term in Clause 9 ("Duration of Agreement")). Recital B also refers to a 5 year term defined by reference to specified accounting periods. The obvious effect, when all of clause 3 and the recitals are taken into account, is to apply the treatments set out in the APA only to the accounting periods for the stated 5 year term.

89. Mr Ghosh pointed out that the commencement date of 1 October 2008 (this, it will be recalled, was in relation to the "roll-back" period 1 October 2008 to 31 December 2009). He suggested that the use of that date showed that the APA was aligned to "provisions", not accounting periods. We were not referred to any evidence on whether the accounting periods were different at the time; it appears from the factual summary in the claimants' grounds that the 1 October 2008 date coincided with the time the IP was held by the Swiss-resident entity, TRGR. But even if that date was mid-way through an earlier accounting period it would not detract from the point that the parties to the APA were rightly keen to pin down and did pin down the accounting periods in respect of which the APA applied.

90. HMRC's acceptance that the 2018 profits were referable to the provision of services in 2008-2014 does not therefore assist the claimants' case. The APA had terminated and had no effect in relation to the pricing of services for the purposes of calculating profits in 2018. The referability did not mean the services had to be priced under an APA that did not have effect.

91. In conclusion there is accordingly no inconsistency between the DPT notices that HMRC issued in respect of 2018 and the APA. The DPT notices concerned an accounting period in relation to which the APA had no effect.

Other arguments

92. Mr Ghosh pointed out that, if HMRC had made a corporation tax amendment on the same basis (i.e. using the profit-split method which was applied in part or was referable to services provided earlier in 2008-2014) then that would equally be permissible. That is correct, but gives rise to no difficulty. The same reasoning would apply. The APA could not affect the calculation of profits in relation to a period to which it did not apply, even if the same services covered by the APA were referable to the later profit calculation.

93. The claimants made a number of other submissions regarding the arbitrary, unfair and retrospective nature of the position that follows if HMRC's position was accepted. These submissions have however been addressed by the preceding analysis as to why the APA did not have any application to the calculation of profits in 2018.

94. The fact that (as HMRC accepted), if TRGR had sold the IP during the APA period there would have been no additional amounts attributed is not arbitrary but merely a function of the APA being time limited and a different treatment applying before the APA expires to the one that applies after it expires.

95. There is also no retrospectivity, or, as mentioned above, "reaching back" in the 2018 profits being calculated in a different way to that set out in the APA because the 2018 calculation of profits is a fresh exercise which is not affected by an APA which has expired.

96. Mr Ghosh illustrated the claimants' position using the example of a garage providing services over a number of years to a customer who had bought a classic car (for £1000) in Year 1 and then who got the garage to add improvements to the car such as brakes, electrics, and a new interior, over each of Years 2 to 4. The garage charged £100 in each of the 3 years (made up of £80 costs and a garage profit of £20). The customer, having spent £300 on the improvements then sold the car in Year 5 for £1500, a gain of £200. It was submitted that HMRC's case here was analogous to treating a share in the £200 gain as extra compensation for the services the garage provided in Years 2-4 despite £300 fees having already been agreed contractually for the services in Years 2-4. Mr Ghosh also emphasised the unfairness in HMRC obtaining a cost-plus treatment which, in contrast to the contingent nature of a "profit-split", guaranteed HMRC tax, irrespective of whether any actual profit was made. Having obtained tax on that basis it was unfair that HMRC could then obtain further tax on the basis of a profit-split in respect of those same services when it was known that such a profit had been made. The unfairness was compounded by the fact that HMRC could have sought to include a profit split in the APA (as they had done for other items) but had chosen not to.

97. Again, these submissions overlook that the calculation of profits in 2018 was a separate exercise that was not affected by the treatment that had been agreed in the earlier periods. The unfairness apparent in the car improvement example does not translate to the claimants' situation because the example does not, as Mr Bremner pointed out, take account of the particular nature of APAs under s220 and the specific statutory provisions in Part 4 which take effect once the APA is no longer applicable. The example would have to build in that the compensation in Years 2 to 4 only arose as compensation because of an APA covering those years which said it did and that the compensation sought in Year 5 was compensation for a year that was not covered by an APA but under which a profit split was a permissible way of calculating profit for that year.

98. Mr Ghosh also suggested that under s225(2) TIOPA HMRC could have modified the APA so as to provide for a profit-split in later years but chose not to. However, on the analysis above, there was no need to modify the APA. The periods beyond the termination of the APA simply were not covered. It should also be kept in perspective that the arm's length treatment that HMRC adopted in subsequent years, whether in the context of transfer pricing or as RAP

under the DPT provisions, is not at large but must comply with the relevant statutory constraints and is subject to challenge on appeal to the First-tier Tribunal.

99. In reaching our conclusion above we do not rely on the policy-based arguments which both parties advanced in addition to their arguments on statutory interpretation and interpretation of the APA. The claimants argued that, if HMRC's position is correct, no taxpayer would ever invest in the process of negotiating APAs because they would know that HMRC could disturb the agreed outcome in subsequent years. The proper analysis however is that there is no such disturbance; there would still be merit to achieving certainty for the years the APA did cover and, if certainty was required for subsequent years, then that could equally be the subject of a subsequent APA.

100. For their part, HMRC argued that applying the APA in the way the claimants submitted would have extremely serious consequences for HMRC's APA programme. The APAs have a fixed term because of uncertainties on arm's length pricing longer than that, or as international thinking or HMRC's practice may change. Those concerns appear rather overstated however. If the claimants' interpretation is correct then parties would in future enter into negotiations knowing that to be the case and could incorporate drafting which clarified the precise scope of the agreement accordingly.

101. HMRC had also argued that, even if the claimants were correct in their interpretation of the scope of the APA, it would nevertheless be outside the *vires* of the provisions under which APAs were made (because APAs could not have effect over chargeable periods to which the APA did not relate). However, in responding to Mr Grodzinski's oral submissions, Mr Bremner rightly accepted that, if the claimants were successful in persuading us that s220(2) did capture the 2018 period, then there would be no *vires* issue.

102. Finally, HMRC also flagged that, if we were against it, further analysis would be needed regarding HMRC's legal ability to issue any amended DPT notice to reflect the ruling against it because the review period under the relevant statutory framework had ended. Given our decision is that the claims fail it is not necessary for us to address any such concern.

DECISION

103. For the reasons given above, we dismiss the claimants' judicial review claim.

MR JUSTICE MICHAEL GREEN
JUDGE SWAMI RAGHAVAN

Release date: 23 October 2023