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INTERNATIONAL TAX CASE SUMMARY

UK vs GLENCORE ENERGY

NOVEMBER 2017

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HEAD OF ACADEMICS

Welcome to the Academy of Tax Law's case and judgment summaries. These documents have been carefully curated to support professionals, students, and researchers navigating the complex landscape of international tax and transfer pricing. At the Academy, we understand that tax law is ever-evolving, with key rulings continuously shaping its practice.

Each summary you'll find here is designed to provide not just the facts, but the context and implications of pivotal legal decisions. These case summaries are created to serve as a valuable resource for legal teams, multinationals, revenue authorities, and academics, offering insights that go beyond the surface. Our goal is to ensure you remain informed and prepared, whether you are dealing with tax planning, dispute resolution, or risk management.

We believe that knowledge is the foundation of sound decision-making, and with these resources, we hope to empower you in your professional journey. As you delve into the analysis, remember that staying ahead in tax law requires not just understanding the rules but how to apply them in a dynamic, global environment.

Thank you for choosing the Academy of Tax Law as your partner in this ongoing learning experience.

Sincerely,
Dr. Daniel N Erasmus

PART 1

SUMMARY

JUDGEMENT SUMMARY

CASE OVERVIEW

Court: Court of Appeal (Civil Division)

Case No: C1/2017/1845

Applicant: Glencore Energy UK Limited

Defendant: The Commissioners for Her Majesty's Revenue and Customs (HMRC)

Judgment Date: 02 November 2017

Full Judgment: CLICK FOR FULL JUDGMENT

View Online: CLICK TO VIEW SUMMARY ONLINE

JUDGMENT SUMMARY

This case examines the boundaries of judicial review in tax disputes involving the Diverted Profits Tax (DPT), a tax introduced by the Finance Act 2015 to prevent profit shifting by multinationals. Glencore Energy UK Limited (GENUK), a subsidiary of the Swiss-based Glencore International AG (GIAG), was assessed under the DPT framework after HMRC deemed the service fees paid by GENUK to GIAG under a Risk and Services Agreement (RSA) to be excessive. The arrangement allegedly diverted profits from the UK to Switzerland, reducing GENUK's tax liability.

HMRC issued a Charging Notice for £21.3 million based on its assessment of taxable diverted profits. GENUK challenged the notice, claiming procedural errors in the evaluation process and asserting that the RSA complied with the arm's length principle. The High Court rejected GENUK's application for judicial review, stating that statutory remedies, including the review process and subsequent appeal to the First-tier Tribunal (FTT), were adequate. GENUK appealed this decision to the Court of Appeal.

The Court of Appeal upheld the High Court's ruling. It emphasised that judicial review should not be used to bypass statutory mechanisms designed to resolve tax disputes. The judgment reiterated that GENUK's objections, such as those regarding the economic substance test and calculation methods, were better addressed through the statutory review and appeal process. The court underscored Parliament's intention for the DPT framework to include robust safeguards via these statutory remedies.

This case is significant as it clarifies the limited role of judicial review in tax matters, particularly where specific statutory remedies exist. It also highlights the complexities of assessing intercompany arrangements under the DPT and reinforces the need for multinationals to ensure robust compliance with transfer pricing principles.

KEY POINTS

OF THE JUDGMENT

BACKGROUND

The Diverted Profits Tax was introduced in 2015 to deter multinationals from using artificial arrangements to shift profits to low-tax jurisdictions. GENUK, a UK-resident subsidiary of GIAG, engaged in a Risk and Services Agreement (RSA) under which it paid 80% of its net profits to GIAG in exchange for services, including priority access to oil storage facilities and loss insurance. HMRC contended that these payments were excessive and did not align with arm's length principles, thereby creating a tax mismatch.

HMRC issued a Preliminary Notice in September 2016, later followed by a Charging Notice in November 2016, demanding £21.3 million in DPT. GENUK paid the amount but argued that the RSA had economic substance and that HMRC's calculations were flawed. The company sought judicial review, alleging that HMRC failed to adequately consider its representations.

The High Court dismissed the judicial review application, asserting that GENUK had adequate remedies through the statutory review and appeal process. The Court of Appeal was then tasked with deciding whether judicial review was appropriate in this context, given the existence of statutory mechanisms to address disputes under the DPT framework.

KEY POINTS
OF THE JUDGMENT

CORE DISPUTE

The primary issue was whether HMRC's assessment of the RSA under the DPT regime was procedurally and substantively fair. GENUK argued that the agreement with GIAG had sufficient economic substance and complied with transfer pricing rules, making the DPT charge unjustified.

GENUK's grounds for judicial review included:

1. HMRC's failure to apply the stricter test for issuing the Charging Notice.
2. Insufficient consideration of GENUK's representations, particularly regarding the valuation of services under the RSA.
3. Alleged irrationality in HMRC's calculation methods, such as assigning a nil value to certain non-routine services.
4. The economic substance test was misapplied, and the effective tax mismatch was not adequately substantiated.

On the other hand, HMRC argued that the statutory review process, followed by an appeal to the FTT, provided sufficient recourse for GENUK to challenge the assessment. They maintained that the Charging Notice was issued in accordance with the Finance Act 2015 and was based on the best available evidence, given the lack of detailed information provided by GENUK.

The dispute highlighted the tension between taxpayers' procedural rights and revenue authorities' need to enforce tax compliance effectively.

KEY POINTS
OF THE JUDGMENT

COURT FINDINGS

The Court of Appeal upheld the High Court's decision, concluding that GENUK's objections could be adequately addressed through the statutory review and appeal process. The judgment noted:

1. **Adequacy of Remedies:** The Finance Act 2015 provided a comprehensive mechanism for resolving DPT disputes, including a statutory review and a full merits appeal to the FTT. Judicial review was deemed inappropriate unless exceptional circumstances existed.

2. **Economic Substance and Arm's Length Principle:** The court found that HMRC's application of the economic substance test and transfer pricing adjustments fell within the scope of its authority. GENUK's challenges on these grounds were better suited to the review process.

3. **Procedural Fairness:** While GENUK alleged procedural deficiencies, the court held that these did not warrant bypassing the statutory remedies.

The judgment reinforced the principle that judicial review is a remedy of last resort, particularly in tax matters where statutory mechanisms are designed to ensure fairness and accuracy.

KEY POINTS
OF THE JUDGMENT

OUTCOME

The Court of Appeal dismissed GENUK's application for judicial review, affirming the High Court's position that judicial review was not the appropriate avenue for challenging HMRC's Diverted Profits Tax (DPT) assessment. GENUK was instructed to utilise the statutory review and appeal mechanisms provided under the Finance Act 2015 to contest the £21.3 million tax charge.

The Court emphasised that the statutory review and subsequent appeal to the First-tier Tribunal (FTT) offered GENUK a comprehensive framework for addressing its objections, including those related to procedural fairness, the economic substance of the Risk and Services Agreement (RSA), and the transfer pricing adjustments made by HMRC. The judgment reinforced the notion that judicial review should only be entertained where statutory remedies are either unavailable or inadequate.

This outcome underscored Parliament's intention to ensure tax disputes are resolved through structured statutory mechanisms, which allow for a thorough examination of facts and legal issues. By limiting judicial intervention in cases where statutory remedies exist, the Court upheld the integrity of the tax collection system and the DPT framework.

For GENUK, the dismissal signified a prolonged path to resolution, involving engagement in HMRC's review process and potential appeal to the FTT. For HMRC, the decision validated its approach in using the DPT regime to combat profit shifting and tax base erosion. It also reaffirmed HMRC's authority to assess complex intercompany arrangements, provided its actions adhered to statutory requirements. The decision thus balanced taxpayer rights against the broader imperative of effective tax enforcement.

TP METHOD
HIGHLIGHTED (IF ANY)

The Transfer Pricing Method implicitly relied upon was the Comparable Uncontrolled Price (CUP) Method and aspects of the Transactional Net Margin Method (TNMM). Although not explicitly named in the judgment, the case involved key elements that align with these methodologies as HMRC scrutinised the intercompany pricing under the arm's length principle.

Key Details of the Transfer Pricing Methodology:

1. **Economic Substance Test (Aligned with CUP Method Principles):** HMRC examined whether the Risk and Services Agreement (RSA) between Glencore Energy UK Limited (GENUK) and its Swiss parent, Glencore International AG (GIAG), provided real economic value. The fees charged under the RSA—amounting to 80% of GENUK's net operating profits—were compared to market-based benchmarks for similar services. HMRC determined that the service fees were excessive and did not reflect arm's length pricing.

2. **Analysis of Non-Routine Services:** HMRC applied a valuation approach akin to the CUP Method for specific services rendered under the RSA. In the absence of comparable data or sufficient documentation from GENUK to substantiate the value of these non-routine services, HMRC assigned a nil value, arguing that the payments were disproportionate.

3. **Thin Capitalisation Analysis (Related to TNMM):** To reassess the appropriate remuneration for intercompany arrangements, HMRC applied thin capitalisation benchmarks. Using a hypothetical debt-to-equity ratio (1:1), HMRC recalculated GENUK's working capital needs and adjusted the deductible intercompany payments. This adjustment was indicative of TNMM principles, which assess profitability based on a benchmarked financial ratio.

4. **Tax Mismatch Adjustment:** The DPT framework evaluated the mismatch created by the intercompany payments under the RSA. HMRC sought to determine whether the profits retained by GIAG were disproportionately high compared to the functions and risks assumed, suggesting a profit diversion inconsistent with the arm's length standard.

PART 2

SIGNIFICANCE

MAJOR ISSUES

AREAS OF CONTENTION

Several contentious points arose during the dispute:

1. **Interpretation of Economic Substance:** GENUK contended that the RSA provided substantial benefits to its operations, such as risk mitigation through loss insurance and access to strategic facilities. HMRC, however, argued that these arrangements lacked sufficient economic substance and were not reflective of arm's length pricing. The divergence lay in the valuation of these benefits and whether they justified the significant fees paid to GIAG.

2. **Validity of Transfer Pricing Adjustments:** A significant point of contention was HMRC's recalibration of GENUK's working capital needs and the assignment of a nil value to non-routine services. GENUK challenged the methodologies used and claimed they were inconsistent with transfer pricing principles.

3. **Prepayment of Tax:** The requirement for GENUK to pay the £21.3 million DPT charge before appealing was a critical issue. GENUK argued that this prepayment imposed an undue financial burden, particularly given the complexity and uncertainty of the DPT framework.

The dispute illustrated the challenges multinational enterprises face in navigating the DPT regime, especially where subjective judgements regarding economic substance and valuation are involved.

EXPECTED
OR CONTROVERSIAL?

The decision was both expected and controversial. On one hand, it adhered to established principles that judicial review is not a substitute for statutory remedies. On the other hand, it highlighted contentious aspects of the DPT regime, particularly its requirement for taxpayers to prepay disputed amounts.

Critics argued that this requirement places an unfair financial burden on taxpayers, potentially deterring legitimate challenges. In GENUK's case, the £21.3 million prepayment represented a significant outlay, compounded by the prospect of a lengthy review and appeal process.

The novelty of the DPT framework also contributed to the controversy. Introduced in 2015, the regime remains subject to interpretation, particularly regarding the application of the economic substance test and the valuation of intercompany arrangements. GENUK's case underscored these ambiguities, raising broader questions about the balance between combating tax avoidance and ensuring procedural fairness for taxpayers.

For HMRC, the decision reinforced the legitimacy of its enforcement strategies under the DPT regime. However, the case highlighted the need for clear guidance and consistent application of the rules to minimise disputes and enhance taxpayer confidence in the system.

SIGNIFICANCE
FOR MULTINATIONALS

This case serves as a critical reminder for multinational enterprises (MNEs) of the need to ensure robust compliance with transfer pricing regulations and the arm's length principle. The judgment highlights several key takeaways:

1. **Economic Substance:** MNEs must demonstrate that intercompany arrangements have genuine economic substance. This requires comprehensive documentation of the benefits provided and the rationale for intercompany payments.
2. **Transfer Pricing Methodologies:** Taxpayers should anticipate scrutiny of their transfer pricing methods, particularly for non-routine transactions or services. Benchmarking analyses, such as thin capitalisation studies, must be well-supported and reflective of arm's length terms.
3. **Tax Risk Management:** The case underscores the importance of proactive tax risk management. By implementing internal review processes and engaging experts, MNEs can mitigate exposure to tax disputes and regulatory penalties.

SIGNIFICANCE

FOR REVENUE SERVICES

For revenue authorities, the judgment reinforces the efficacy of the DPT regime as a tool for combating profit shifting and protecting the tax base. Key implications include:

1. **Support for Enforcement Strategies:** The decision validates HMRC's approach to challenging artificial arrangements and emphasises the importance of rigorous economic substance assessments.
2. **Judicial Endorsement:** By upholding the statutory remedies under the Finance Act 2015, the Court reinforced the credibility of the DPT framework and its mechanisms for resolving disputes.
3. **Guidance for Taxpayers:** The case serves as a precedent for future disputes, providing clarity on how intercompany arrangements will be assessed under the DPT regime.

RELEVANT CASES

CHEVRON VS AUSTRALIA

This case is relevant for its focus on thin capitalisation and transfer pricing of intercompany loans. HMRC's recalibration of GENUK's debt-to-equity ratio parallels the Australian Taxation Office's efforts to challenge artificial financial arrangements that result in profit shifting. Both cases stress the need for robust documentation and defensible financial terms.

CLICK HERE TO READ THE CASE SUMMARY

FIAT FINANCE VS EU

The Fiat case highlights issues surrounding selective tax advantages granted through transfer pricing rulings, similar to HMRC's assessment of GENUK's Risk and Services Agreement. Both cases involve the economic substance of intercompany transactions and whether such arrangements distort competition or deviate from market-based standards.

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APPLE VS EU

This case involved HMRC challenging intercompany pricing arrangements within a multinational group, focusing on the economic substance of transactions. Similar to GENUK, GlaxoSmithKline faced scrutiny over whether its intercompany agreements adhered to the arm's length principle, making it a pertinent comparison for understanding HMRC's enforcement approach.

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PART 3

PREVENTION

ENGAGING EXPERTS

Engaging transfer pricing experts is essential for multinational enterprises (MNEs) to navigate complex regulations and mitigate the risks associated with intercompany arrangements. These experts bring specialised knowledge in key areas, including benchmarking, compliance, and documentation, ensuring transactions align with the arm's length principle.

1. **Navigating Complexity:** Transfer pricing experts assist MNEs in interpreting and applying intricate global tax rules, particularly in jurisdictions with unique regulatory frameworks like the Diverted Profits Tax.

2. **Defending Against Challenges:** Experts provide robust analysis and documentation to defend pricing structures during audits or disputes. Their insights help taxpayers anticipate tax authority challenges and respond effectively.

3. **Benchmarking and Economic Analysis:** Transfer pricing professionals use advanced methodologies and databases to benchmark intercompany pricing against comparable uncontrolled transactions. This ensures compliance and reduces the likelihood of adjustments.

4. **Strategic Planning:** With the increasing focus on economic substance and profit allocation, experts help MNEs structure transactions to reflect genuine business operations while minimising tax risks.

5. **Comprehensive Reporting:** Experts prepare transfer pricing reports that satisfy regulatory requirements, demonstrating transparency and compliance.

By engaging transfer pricing specialists, MNEs not only strengthen their tax compliance frameworks but also safeguard their global operations from costly disputes and penalties.

PREVENTATIVE
MEASURES TO AVOID SIMILAR CASES

TAX RISK MANAGEMENT PROCESS

Implementing a comprehensive tax risk management process is essential to identify, assess, and mitigate tax risks associated with cross-border transactions. This process should involve:

- Regular reviews of intra-group transactions to ensure they have genuine economic substance.
- Proactive engagement with tax authorities to seek clarity on the application of anti-abuse rules.
- Thorough documentation of the business rationale for each transaction to support

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https://support.academyoftaxlaw.com/product/tax-intelligence-by-prof-dr-daniel-n-erasmus/

PREVENTATIVE
MEASURES TO AVOID SIMILAR CASES

TAX STEERING COMMITTEE

Establishing a tax steering committee can help ensure that tax policies are aligned with the broader business strategy and that transactions are vetted for both commercial and tax implications. A tax steering committee can:

- Review all significant cross-border transactions before they are executed.
- Ensure that tax decisions are made in the context of overall business objectives, not solely for tax savings.
- Monitor changes in international tax laws to ensure ongoing compliance and avoid disputes like the X BV case.

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DRIVING TAX COMPLIANCE: THE ESSENTIAL ROLE OF THE TAX STEERING COMMITTEE

The eBook "Driving Tax Compliance: The Essential Role of a Tax Steering Committee" by Prof. Dr. Daniel N. Erasmus, Renier van Rensburg, and Gilbert Ferreira, emphasizes the critical importance of establishing a Tax Steering Committee (TSC) within multinational corporations to ensure tax compliance and manage tax-related risks effectively.

https://support.academyoftaxlaw.com/product/essential-role-of-the-tax-steering-committee/

INTERNATIONAL TAX

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