OPINION OF ADVOCATE GENERAL GEELHOED

delivered on 6 April 2006 [1]

I — Introduction

1. The present case arises from the same underlying legislation as is at issue in the pending Case C-374/04 *Test Claimants in the ACT Group Litigation*, [2] namely, the UK's regime of Advance Corporation Tax ('ACT') in force between 1973 and 1999. While that case concerned the tax treatment of dividends paid by UK-resident companies to corporate shareholders resident in other Member States, however, the present reference concerns the tax treatment of dividends received by UK-resident corporate shareholders from companies resident in other Member States and, as regards one aspect of the UK's regime raised by the national court, third countries.

1 — Original language: English.

2 — See my Opinion of 23 February 2006, not yet reported in the ECR.

II — Legal and economic background to the reference

A — *Overview of context of dividend taxation*

2. Prior to setting out the relevant provisions of the UK tax regime at issue, it is important to outline the broader framework for taxation of distributed company profits (dividends) within the EU, which forms the legal and economic backdrop to the case. In principle, two levels of taxation can arise when taxing the distribution of company profits. The first is at the company level, in the form of corporation tax on the company's profits. The levying of corporation tax at company level is common to all Member States. The second is at the shareholder level, which can take the form of either income taxation on the receipt of the dividends by

the shareholder (a method used by most Member States), and/or withholding tax to be withheld by the company upon distribution. [3]

3. The existence of these two possible levels of taxation may lead, on the one hand, to economic double taxation (taxation of the same income twice, in the hands of two different taxpayers) and, on the other hand, juridical double taxation (taxation of the same income twice in the hands of the same taxpayer). Economic double taxation arises, when, for example, the same profits are taxed first in the hands of the company as corporation tax, and second in the hands of the shareholder as income tax. Juridical double taxation happens, when, for example, a shareholder suffers first withholding tax and then income tax, levied by different States, on the same profits.

4. The present case concerns the legality under Community law of a system set up by the UK with the principal aim and effect of providing a measure of relief for shareholders from economic double taxation.

5. In deciding whether and how to achieve such an aim, there are essentially four systems open to Member States, which may be termed the 'classical', 'schedular', 'exemption' and 'imputation' systems. States with a classical system of dividend taxation tax have chosen not to relieve economic double taxation: company profits are subjected to corporation tax, and distributed profit is taxed once again at the shareholder level as income tax. In contrast, schedular, exemption and imputation systems aim at fully or partially relieving economic double taxation. [4] States with schedular systems (of which various forms exist) choose to subject company profits to corporation tax, but tax dividends as a separate category of income. Those with exemption systems choose to exempt dividend income from income taxation. Finally, under imputation systems, corporation tax at company level is fully or partially imputed onto the income tax due on the dividends at shareholder level, such that the corporation tax serves as a prepayment

3 — See, however, Article 5(1) of Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ 1990 L 225 p. 6) (profits distributed by a subsidiary to a parent company holding 25% or more of the capital of the subsidiary shall be exempt from withholding tax).

4 — A principal motivation for this aim is the avoidance of discrimination against equity financing of companies as compared to debt financing.

for (part of) this income tax. Thus, shareholders receive an imputation credit for all or part of the corporation tax attributable to the profits out of which the dividends were paid, which credit can be set against the income tax due on these dividends.

6. At the time relevant to the present case, the United Kingdom used a partial imputation system of dividend taxation.

B — *Relevant UK legislation*

7. From 1965 (when corporation tax was introduced in the United Kingdom) until 1973, the United Kingdom operated a classical system of dividend taxation which thus, as I described above, did not relieve economic double taxation. In 1973, the United Kingdom moved to a partial imputation system of dividend taxation, with the aim of removing discrimination against distributed profits. [5] This system essentially functioned as follows.

1. ACT: Liability and set-off

8. Companies resident in the United Kingdom which made certain qualifying distributions, including the payment of dividends to their shareholders, were in principle liable to pay ACT calculated on an amount equal to the amount or value of the distribution made, even if these companies had no UK corporation tax liability. [6] The sum of the amount of the distribution and the ACT was called a 'franked payment'. [7]

9. The ACT paid could be set off against a company's normal or 'mainstream' corporation tax ('MCT') liability on its profits for the relevant accounting period, subject to a certain limit. Since the UK operated a partial imputation system, so that the UK corporation tax rate exceeded the ACT set-off rate, the company always faced a marginal corporation tax liability on its profits. Moreover, where a company received credit for foreign tax paid, this reduced the amount of the corporation tax liability available for set-off of ACT. [8] Unrelieved ACT, known as 'surplus' ACT, could be carried back or forward to be set off against mainstream corporation

5 — See 'Reform of Corporation Tax', an official paper presented to the United Kingdom Parliament when moving to a partial imputation system, paragraphs 1 and 5 (Cmnd. 4955).

6 — Section 14(1) of the Income and Corporation Taxes Act 1988 ('TA'), as then in force.

7 — Section 238(1) TA.

8 — Section 797(4) TA.

tax from other accounting periods. [9] Alternatively, the company could transfer ('surrender') this ACT to its UK subsidiaries, which could set it off against their own UK corporation tax liability. [10]

10. A company with surplus franked investment income (i.e., franked investment income which exceeded franked payments) could, if it had losses, set those losses against the surplus franked investment income under section 242 TA and obtain a payment in cash of the amount of the tax credit comprised in that surplus franked investment income. This provision was abolished with effect from 2 July 1997.

11. UK-resident groups could also take advantage of special arrangements whereby the obligation to pay ACT could be avoided on certain intra-group distributions, upon joint election by the two companies (the 'group income election'). [11] These arrangements were the subject of the Court's judgment in *Metallgesellschaft*. [12]

2. Liability to MCT

12. In the case of a UK-resident corporate shareholder receiving a dividend from its subsidiary, although such a company was in principle subject to corporation tax, this was not chargeable on distributions received from another UK-resident company. [13]

13. A UK-resident company was, however, liable to corporation tax on dividends received from non-resident companies, but was granted relief for foreign taxes paid. Such relief was given either unilaterally under domestic rules [14] or under double taxation conventions entered into with other countries. [15] The unilateral arrangements provided for the crediting against a company's UK corporation tax liability of withholding taxes paid on foreign dividends. Where the UK-resident company either directly or indirectly controlled, or was a subsidiary of a company which directly or indirectly controlled, not less than 10% of the voting power of the company paying the dividend, the relief extended to the underlying foreign corporation tax on the profits

9 — Section 239 TA.

10 — Section 240 TA.

11 — Section 247 TA.

12 — Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727.

13 — Section 208 TA.

14 — Section 790 TA.

15 — Section 788 TA.

out of which the dividends were paid. The foreign tax was creditable only up to the amount of the UK corporation tax liability on the particular income. Similar arrangements generally applied under the UK's double taxation conventions ('DTCs') with other countries. [16]

14. For accounting periods beginning on or after 3 June 1986, double taxation relief was taken before ACT set-off. Beforehand the reverse was the case. The position before 1986 was a problem for UK companies as double taxation relief could only be taken in the year in which it arose and, if unused, was lost.

3. Tax credits

15. The payment of ACT gave rise in certain circumstances to a tax credit in the hands of companies and individual shareholders receiving the distribution.

(a) Tax credits: Corporate shareholders

16. In the case of a UK-resident corporate shareholder receiving a dividend from its subsidiary, although such a company was in principle subject to corporation tax, this was not chargeable on distributions received from another UK-resident company. [17] Further, the company was entitled to a tax credit equal to the ACT paid by the subsidiary. [18] Together, the dividend and tax credit constituted what was termed 'franked investment income'. [19] A UK-resident company was liable to pay ACT only in respect of the excess of its franked payments over its franked investment income. This meant that ACT was paid only once in respect of dividends passed up through UK-resident members of groups of companies.

17. A UK-resident company receiving a distribution from a non-resident company

16 — For example, Article 22(b) of the UK-Netherlands DTC provided, at the relevant time, that 'where such income is a dividend paid by a company which is a resident of the Netherlands to a company which is a resident of the United Kingdom and which controls directly or indirectly not less than one-tenth of the voting power in the former company, the credit shall take into account (in addition to any Netherlands tax payable in respect of the dividend) the Netherlands tax payable by that former company in respect of its profit'. See also, the UK's DTCs with France and Spain.

17 — Section 208 TA.

18 — Section 231(1) TA.

19 — Section 238(1) TA.

was, however, not entitled to a tax credit, and the income did not qualify as franked investment income. When a company received franked investment income during an accounting period, it was liable to pay ACT only in respect of the excess of its franked payments over its franked investment income. [20]

(b) The Foreign Income Dividend ('FID') Scheme

18. Experience of the above system showed that companies receiving significant foreign dividend income could generate surplus ACT, for two principal reasons. First, foreign dividends did not attract a tax credit which could be used to reduce the companies' ACT liability on distributions made by them. Second, any credit given for foreign tax reduced the corporation tax liability against which the ACT could be set off.

19. Arrangements were introduced with effect from 1 July 1994 under which a UK-resident company could elect that a cash dividend which it paid to its shareholders was a foreign income dividend ('FID'). [21] The election had to be made by the date the dividend was paid and could not be revoked after that date. ACT was payable on the FID but, if the company could match the FID with foreign profits, a claim for repayment could be made for surplus ACT arising in respect of the FID. This surplus ACT became repayable at the same time as the MCT became payable, i.e., 9 months after the end of the accounting period. It was first set off against any mainstream corporation tax liability for the period. Any excess was then repaid. As ACT was paid 14 days after the quarter in which the dividend was paid, this meant that ACT would remain outstanding under the FID system for between 8½ and 17½ months, depending on when the dividend was paid.

20. A FID did not constitute franked investment income [22] and the shareholder receiving the FID was not entitled to a tax credit under section 231(1) TA, although an individual receiving a FID was treated as receiving income which had borne tax at the lower rate for the year of assessment. However, no repayment was made to individual shareholders of income tax treated as

20 — Section 241 TA.

21 — Section 246A to 246Y TA.

22 — A corporate shareholder could, however, use a FID it received in order to frank a FID paid, so that ACT was paid solely on the excess of FIDs paid over FIDs received.

having been paid, nor could a tax-exempt shareholder such as a UK pension fund reclaim a tax credit similar to that which would have been payable on a non-FID qualifying distribution.

(c) Tax credits: Individual shareholders

21. As regards individual shareholders, UK-resident individual shareholders and certain entities such as pension funds were, upon receiving a dividend from a UK-resident company, entitled to a tax credit equal to such proportion of the amount or value of the distribution as corresponded to the rate of ACT. [23] Income tax was chargeable on the total of the distribution and the tax credit. [24] The tax credit could be set against their income tax liability on the dividend or be paid to them in cash if the credit exceeded their liability. [25]

4. 1999 changes

22. For distributions made on or after 6 April 1999, the ACT system was abolished. Companies no longer had to pay or account for ACT on shareholder dividends and other qualifying distributions. The FID rules were also abolished. [26]

C — *Relevant Community legislation*

23. The principal piece of secondary Community legislation of relevance to the present case is the Parent-Subsidiary Directive, which provides for a framework of tax rules regulating the relations between parent companies and subsidiaries of different Member States, with the aim of facilitating the grouping together of companies. [27] Article 4 of the Parent-Subsidiary Directive expressly allows both the exemption and the credit method of relieving cross-border double taxation, providing that:

'1. Where a parent company, by virtue of its association with its subsidiary, receives distributed profits, the State of the parent company shall, except when the latter is liquidated, either:

— refrain from taxing such profits, or

23 — Section 231(1) TA.

24 — Section 20(1) TA.

25 — Section 231(1)(3) TA.

26 — For companies with brought-forward surplus ACT, a 'shadow ACT' system was introduced, which allowed companies access to their surplus ACT.

27 — See footnote 3.

— tax such profits while authorising the parent company to deduct from the amount of tax due that fraction of the corporation tax paid by the subsidiary which relates to those profits and, if appropriate, the amount of the withholding tax levied by the Member State in which the subsidiary is resident, pursuant to the derogations provided for in Article 5, up to the limit of the amount of the corresponding domestic tax.

2. However, each Member State shall retain the option of providing that any charges relating to the holding and any losses resulting from the distribution of the profits of the subsidiary may not be deducted from the taxable profits of the parent company. Where the management costs relating to the holding in such a case are fixed as a flat rate, the fixed amount may not exceed 5% of the profits distributed by the subsidiary.

3. Paragraph 1 shall apply until the date of effective entry into force of a common system of company taxation.

The Council shall at the appropriate time adopt the rules to apply after the date referred to in the first subparagraph.'

24. Article 6 of the Directive provides that the Member State of a parent company may not charge witholding tax on the profits that company receives from a subsidiary.

III — Factual background and questions referred

25. The claimant companies are Test Claimants in the Franked Investment ('FII') Group Litigation. This litigation is defined by a Group Litigation Order which applies to all claims falling within its defined scope and sets out the various issues common to the claims which need to be determined. At the time of referral, 12 company groups were party to the FII Group Litigation.

26. The Test Claimants are all UK-resident members of the BAT group of companies. [28] They comprise the publicly-owned ultimate parent company of the group and inter-

28 — The Test Claimants are BAT Industries plc, British American Tobacco (Investments) Ltd, British American Tobacco (Holdings) Limited, BAT 1998 Limited, British American Tobacco plc.

mediate parent companies through which non-resident subsidiaries were held. [29] At all relevant times, the ultimate parent and each of the intermediate parents wholly owned numerous subsidiaries resident in most EU Member States and EEA countries, and in many third countries.

27. The test case concerns

(1) dividends paid by non-resident subsidiaries to the Test Claimants beginning in the financial year ending 30 September 1973 and up to the present;

(2) dividends paid by the UK-resident parent to its public shareholders beginning in the financial year ending 30 September 1973 and ending in the quarter ending 31 March 1999;

(3) ACT paid by the Test Claimants beginning in the financial year ending 30 September 1973 and ending on 14 April 1999; and

(4) FID payments made in the period commencing 30 September 1994 and ending 30 September 1997.

28. By Order dated 6 October 2004, the High Court (Chancery Division) referred the following questions to the Court under Article 234 EC:

'(1) Is it contrary to Article 43 or 56 EC for a Member State to keep in force and apply measures which exempt from corporation tax dividends received by a company resident in that Member State ("the resident company") from other resident companies and which subject dividends received by the resident company from companies resident in other Member States ("non-resident companies") to corporation tax (after giving double taxation relief for any withholding tax payable on the dividend and, under certain conditions, for the underlying tax paid by the non-resident companies on their profits in their country of residence)?

29 — Although the essential features of the Test Claimants' group structure did not change during the relevant time, the identity of the ultimate parent changed within the Test Claimant companies.

(2) Where a Member State has a system which in certain circumstances imposes advance corporation tax ("ACT") on the payment of dividends by a resident company to its shareholders and grants a tax credit to shareholders resident in that Member State in respect of those dividends, is it contrary to Article 43 or 56 EC or Article 4(1) or 6 of Council Directive 90/435/EEC for the Member State to keep in force and apply measures which provide for the resident company to pay dividends to its shareholders without being liable to pay ACT to the extent that it has received dividends from companies resident in that Member State (either directly or indirectly through other companies resident in that Member State) and do not provide for the resident company to pay dividends to its shareholders without being liable to pay ACT to the extent that it has received dividends from non-resident companies?

(3) Is it contrary to the provisions of EC law referred to in Question 2 above for the Member State to keep in force and apply measures which provide for the ACT liability to be set against the liability of the dividend-paying company, and that of other companies in the group resident in that Member State, to corporation tax in that Member State upon their profits:

(i) but which do not provide for any form of set off of the ACT liability or some equivalent relief (such as the refund of ACT) in respect of profits earned, whether in that State or in other Member States, by companies in the group which are not residents in that Member State; and/or

(ii) which provide that any double tax relief which a company resident in that Member State enjoys reduces the liability to corporation tax against which the ACT liability can be set?

(4) Where the Member State has measures which in certain circumstances provide for resident companies, if they so elect, to recover the ACT paid on distributions to their shareholders to the extent that distributions are received by the resident companies from non resident companies (including for this purpose companies resident in third countries), is it contrary to Article 43 or 56 EC or Article 4(1) or 6 of Council Directive 90/435/EEC for those measures:

(i) to oblige the resident companies to pay ACT and to reclaim it subsequently; and

(ii) not to provide for the shareholders of the resident companies to receive a tax credit which they would have received on a dividend from a resident company which had not itself received dividends from non-resident companies?

(5) Where, prior to 31 December 1993, a Member State adopted the measures outlined in Questions 1 and 2, and after that date it adopted the further measures outlined in Question 4, and if the latter measures constitute a restriction prohibited by Article 56 of the EC Treaty, is that restriction to be taken to be a new restriction not already existing on the 31 December 1993?

(6) In the event of any of the measures set out in Questions 1 to 5 being in breach of any of the Community provisions referred to herein, then in circumstances where the resident company or other companies in the same group of companies make the following claims in respect of the relevant breaches;

(i) a claim for the repayment of corporation tax unlawfully levied in the circumstances to which Question 1 relates;

(ii) a claim for the reinstatement (or compensation for the loss) of reliefs applied against the corporation tax unlawfully levied in the circumstances to which Question 1 relates;

(iii) a claim for repayment of (or compensation for) ACT which could not be set off against the company's corporation tax liability or otherwise relieved and which would not have been paid (or would have been relieved) but for the breach;

(iv) a claim, where the ACT has been set off against corporation tax, for loss of use of money between the date of payment of the ACT and such set-off;

(v) a claim for repayment of corporation tax paid by the company or by another group company where any of those companies incurred a corporation tax liability by disclaiming other reliefs in order to allow its ACT liability to be set off against its corporation tax liability (the limits imposed on set-off of ACT resulting in a residual corporation tax liability);

(vi) a claim for loss of use of money due to corporation tax having been paid earlier than would otherwise have been the case or for reliefs subsequently lost in the circumstances set out in (v) above;

(vii) a claim by the resident company for payment of (or compensation for) surplus ACT which that company has surrendered to another company in the group and which remained unrelieved when that other company was sold, demerged or went into liquidation;

(viii) a claim, where ACT has been paid but subsequently reclaimed under the provisions described in Question 4, for loss of use of money between the date of payment of the ACT and the date on which it was reclaimed;

(ix) a claim for compensation where the resident company elected to reclaim the ACT under the arrangements described in Question 4 and compensated its shareholders for the inability to receive a tax credit by increasing the amount of the dividend,

in respect of each of those claims set out above, is it to be regarded as:

a claim for repayment of sums unduly levied which arise as a consequence of, and adjunct to, the breach of the above-mentioned Community provisions; or

a claim for compensation or damages such that the conditions set out in Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur and Factortame* must be satisfied; or

a claim for payment of an amount representing a benefit unduly denied?

(7) In the event that the answer to any part of Question 6 is that the claim is a claim for payment of an amount representing a benefit unduly denied:

(i) is such a claim a consequence of, and an adjunct to, the right conferred by the above-mentioned Community provisions; or

(ii) must conditions for recovery laid down in Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur and Factortame* be satisfied; or

(iii) must some other conditions be met?

(8) Does it make any difference to the answers to Questions 6 or 7 whether as a matter of domestic law the claims referred to in Question 6 are brought as restitutionary claims or are brought or have to be brought as claims for damages?

(9) What guidance, if any, does the Court of Justice think it appropriate to provide in the present case as to which circumstances the national court ought to take into consideration when it comes to determine whether there is a sufficiently serious breach within the meaning of the judgment in Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur and Factortame*, in particular as to whether, given the state of the case-law of the Court of Justice on the interpretation of the relevant Community provisions, the breach was excusable or as to whether in any particular case there is a sufficient causal link to constitute a "direct causal link" within the meaning of that judgment?'

29. In accordance with Article 103(4) of the Rules of Procedure, written submissions were lodged by the Test Claimants, the United Kingdom Government, Ireland, and the Commission. An oral hearing was held on 29 November 2005, in which submissions were made by each of these parties.

IV — Analysis

A — *Applicability of Article 43 or 56 EC: Questions 1 to 4*

30. As the national court has raised both Articles 43 and 56 EC in questions 1 to 4, it is necessary as a preliminary matter to consider which of these articles applies in the present case. Just as I observed in my Opinion in *Test Claimants in Class IV of the ACT Group Litigation*,[30] it is my view that the UK legislation at issue may in principle fall

30 — See footnote 2.

within the ambit of either Article 43 or 56 EC, depending on the quality of holding that a given parent company possesses in the relevant foreign subsidiary. The Court has consistently held that a company established in one Member State with a holding in the capital of a company established in another Member State which gives it 'definite influence over the company's decisions' and allows it to 'determine its activities' is exercising its right of establishment. [31] As a result, in the case of UK-resident parent companies whose holdings in non-UK companies satisfy this criterion, therefore, it is the compatibility of the UK legislation with Article 43 EC that should be assessed. The application of this criterion in a given case is a matter for the national courts after analysis of the circumstances of the claimant company.

31. In the case of the test claimants in the present reference, it seems clear from the order for reference that these are UK-resident companies (all members of the BAT group) with wholly-owned non-UK-resident subsidiaries. As a result, the test case falls to be considered under Article 43 EC. As I observed in my Opinion in Test Claimants in Class IV of the ACT Group Litigation, although the exercise of freedom of establishment by these UK-resident companies will also inevitably involve the movement of capital out of the UK insofar as this is necessary to establish a subsidiary, this is a purely indirect consequence of the exercise of freedom of establishment. As a result, Article 43 EC takes priority of application for such companies. [32]

32. In the case of UK-resident companies holding an investment in a non-UK-resident company which does not give them a 'decisive influence' over the latter's activities, or allow them to determine that company's activities, the UK legislation should be assessed for compatibility with Article 56 EC. I note in this regard that the UK legislation at issue clearly concerns what can be termed 'movement of capital'. [33]

31 — Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 22. Although this case concerned a shareholding of a national of a Member State, not a company, the principle applies equally to companies established in that Member State. See also, Article 58(2) EC, which provides that the application of the freedom of movement of capital shall be 'without prejudice to the applicability of restrictions on the right of establishment which are compatible with this Treaty'.

32 — See the observation of Advocate General Alber in *Baars* that, 'where the right of establishment is directly restricted such that the ensuing obstacle to establishment leads indirectly to a reduction of capital flows between Member States, only the rules on the right of establishment apply'. Case C-251/98 *Baars*, footnote 31 above, point 22.

33 — While the Treaty does not contain any definition of this concept, the Court has held that, while the receipt of dividends may not in itself constitute movement of capital, such receipt presupposes participation in new or existing undertakings, which does constitute capital movement: Case C-35/98 *Verkooijen* [2000] ECR I-4071. See also Case C-319/02 *Manninen* [2004] ECR I-7477, where the point was not explicitly discussed.

33. In principle, therefore, due to the nature of the present case as a group action where the particular circumstances and nature of shareholding of each claimant have not been put before the Court, it is necessary to consider the compatibility of the UK legislation at issue with both Articles 43 and 56 EC.

34. I would add that, although the substantive principles for analysis of whether a breach has occurred are the same for both articles, the geographic and temporal scope of Article 56 EC differs from that of Article 43 EC: Article 43 EC applies only to restrictions on the exercise of freedom of establishment between Member States and entered into force as part of the Treaty of Rome, while Article 56 EC also prohibits restrictions on the movement of capital between Member States and third countries and entered into force on 1 January 1994 (although the principle of free movement of capital had already been established by Directive 88/361).[34] Moreover, Article 56 EC is subject to a 'standstill' provision — Article 57(1) EC — as regards third States.

35. As a result, as regards the substantive principles for assessment of compatibility, I will only expressly consider Article 43 EC, as the same principles apply to the assessment under Article 56 EC. I will deal separately with certain issues of temporal and geographic scope particular to Article 56 EC (raised in Question 5).

B — *Question 1*

36. By its first question, the national court asks whether it is contrary to Article 43 or 56 EC for a Member State to keep in force and apply measures which exempt from corporation tax dividends received by a company resident in that Member State from other resident companies and which subject dividends received by the resident company from companies resident in other Member States to corporation tax (after giving double taxation relief for any withholding tax payable on the dividend and, under certain conditions, for the underlying tax paid by the non-resident companies on their profits in their country of residence).

37. The Court has consistently held that, although direct taxation falls within their competence, Member States must none the less exercise that competence consistently

34 — Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty, OJ 1998 L 178, p. 5.

with Community law.[35] This includes the obligation to comply with Article 43 EC, which prohibits restrictions on the setting up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

38. As I observed in my Opinion in *Test Claimants in the ACT Group Litigation*,[36] Article 43 EC is infringed in a case where the different treatment applied by the relevant Member State to its tax subjects is not a direct and logical consequence of the fact that, in the present state of development of Community law, different tax obligations for subjects can apply for cross-border situations than for purely internal situations. In other words, Article 43 EC prohibits restrictions on free movement of establishment that go beyond those resulting inevitably from the fact that tax systems are national, unless these restrictions are justified and proportionate.[37]

39. This means that, in order to fall under Article 43 EC, disadvantageous tax treatment should follow from direct or covert discrimination resulting from the rules of one jurisdiction, and not purely from disparities or the division of tax jurisdiction between two or more Member States' tax systems, or from the co-existence of national tax administrations.[38]

40. In the case of a Member State exercising worldwide (home State) tax jurisdiction, as I noted in my Opinion in *Test Claimants in the ACT Group Litigation*, this principle means essentially that such a State must treat foreign-source income of its residents consistently with the way it has divided its tax base. Insofar as it has divided its tax base to include this foreign-source income — i.e., by treating it as taxable income — it must not discriminate between foreign-source and domestic income.[39] In particular, its legislation should not treat foreign-source income less favourably than domestic-source income.

41. The present question essentially asks whether it is compatible with Article 43 EC for a Member State exercising home State tax jurisdiction to relieve economic double

35 — See, for example, Case C-446/03 *Marks & Spencer* v *David Halsey*, judgment of 13 December 2005, not yet reported in the ECR, paragraph 29, and cases cited therein.

36 — See footnote 2.

37 — See, for extended reasoning on this, points 31 to 54 of my Opinion in *Test Claimants in the ACT Group Litigation*, footnote 2 above.

38 — Ibid., point 55.

39 — Ibid., point 58.

taxation on dividends using an exemption method for domestic-source income, but using a credit method for foreign-source income which

(1) in the case of UK companies holding less than 10% of the voting power of the company paying the dividend (which I will term 'portfolio holdings'), gave credit only for the withholding tax levied by the source State on the dividends, and

(2) in the case of UK companies which directly or indirectly controlled, or were subsidiaries of companies which directly or indirectly controlled, not less than 10% of the voting power of the company paying the dividend (which I will term 'non-portfolio holdings'), gave credit for the underlying foreign corporation tax on the profits out of which the dividends were paid.

42. Dealing first with foreign non-portfolio holdings, as the UK and the Commission observe, the objective of eliminating double economic taxation of dividends is achieved by the UK rules in the case of both domestic-source income and foreign-source dividend income. However, this is achieved by different means: in the case of domestic-source income, by exemption from corporation tax on dividend income in the shareholder's hands; in the case of foreign-source income, by crediting the amount of foreign corporation tax paid on the profits constituted in the dividends.

43. In principle, the choice of whether and how to relieve economic double taxation of dividends lies purely with Member States; that is, whether to use a classical (no relief of economic double taxation), schedular, exemption or imputation system (full or partial relief of economic double taxation). If applied in the same way to foreign-source and domestic-source dividend income, each of these systems is perfectly compatible with Article 43 EC. [40]

44. Thus, for example, it is in principle perfectly possible for a credit-based method of economic double taxation relief to apply in a manner that is consistent with Article 43

40 — See also, for example, Article 4 of the Parent-Subsidiary Directive, footnote 3 above, which provides that the State of a parent company receiving distributed profits may use either an exemption or credit method of dividend taxation.

EC. An example is the solution of the Court in *Manninen*, [41] which concerned Finnish legislation whereby Finland granted a full imputation tax credit to Finnish shareholders for Finnish corporation tax levied on profits distributed as dividends, but no tax credit for foreign corporation tax levied on foreign-source profits distributed as dividends. In holding that Article 56 EC obliged Finland to extend this tax credit to account for corporation tax levied on dividends incoming from another Member State (Sweden), the Court observed that under the Finnish system, where a Finnish taxpayer invested capital in a Swedish company, there was no way of escaping double taxation of the profits distributed by the company in which the investment was made. [42] In contrast, granting a tax credit for Swedish-source dividends would eliminate double taxation on the dividends in the same way as for domestic-source profits. [43]

45. It is of course true that the application of a credit-based system by the UK for relieving double economic taxation on foreign-source dividends, in the case where the underlying foreign corporation tax levied on company profits was at a higher rate than the UK corporation tax rate, would result in a higher tax burden on these foreign-source dividends than on UK-source dividends (as the UK gives credit only up to the UK corporation tax rate, and not for all foreign corporation tax paid). While, in one sense, this could be said to 'restrict' investment in foreign subsidiaries as against UK subsidiaries, this is a good example of a restriction flowing purely from disparities between national tax systems, with which Article 43 EC is not concerned. [44] Likewise, while the fact that taxpayers receiving foreign-source dividends may, in the case of a credit system, be under an obligation to complete additional formalities in order to prove the amount of foreign corporation tax paid in order to qualify for the credit, this is what I have termed a 'quasi-restriction' resulting inevitably from the fact that tax administrations are at present national. [45]

46. In sum, there is in principle no problem under Article 43 EC with the application of a credit system of double economic taxation relief.

41 — See footnote 33 above.

42 — *Manninen*, footnote 33 above, paragraph 36.

43 — See *Manninen*, footnote 33 above, paragraph 48.

44 — See my Opinion in *Test Claimants in the ACT Group Litigation*, footnote 2 above, point 43 onwards.

45 — Ibid., see also the Opinion of Advocate General Kokott in *Manninen*, footnote 33 above, point 74.

47. The present question, however, asks whether Article 43 EC permits a Member State to apply an exemption system for domestic-source dividends and a credit system for foreign-source dividends. The answer to this question depends on whether this distinction has the effect that the UK treats foreign-source dividends less favourably than domestic-source dividends.

48. In this regard, the UK and the Commission argue that, in a domestic context, the effect of exemption and credit systems of economic double taxation relief would be precisely the same. The adoption of a credit system for domestic-source income, however, would mean pointless extra administration costs, while an exemption system, which leads to the same results, is far simpler and less costly to run. Similarly, the effect of the regime for domestic-source dividends (exemption) and foreign-source dividends (credit) is the same: in each case, economic double taxation is relieved.

49. The Test Claimants dispute this conclusion. They argue that a difference exists between the exemption and credit systems in cases where the UK distributing subsidiary has, pursuant to particular UK corporation tax exemptions and benefits (e.g., for investment or Research & Development), in fact paid a lower net rate of corporation tax than the standard UK rate. Under an exemption system, this is 'passed on' to the recipient parent company — i.e., the dividends distributed will ultimately thus have borne a tax rate lower than the standard UK corporation tax rate. Under a credit system applied in a domestic context, however, in a case where a lower effective corporation tax rate had been originally borne by the profits pursuant to exemptions and allowances, this rate would always be 'topped up' to the standard UK corporation rate upon distribution to the parent company.[46] Similarly, in the case of foreign-source dividends, the effect of a credit system is that the UK in all cases tops up the effective foreign corporation tax paid to the standard UK rate, without taking account of underlying corporation tax allowances granted at subsidiary level.

50. It would seem, therefore, that the application of a credit system by the UK for the relief of double economic taxation on foreign-source dividends can in certain cases have less favourable effects than the pure exemption system applied to domestic-source dividends. While, under an exemption system, the benefits of underlying corporation tax exemptions and allowances may be passed on to the parent company

46 — See, by analogy, how the Finnish imputation credit system worked in the domestic context to top up the effective tax paid on the profits distributed to 29%, the standard Finnish corporation tax rate (the difference being charged to the distributing company): *Manninen*, footnote 33 above, paragraph 11.

receiving the dividends, under a credit system these benefits cannot be passed on as the tax borne by the dividends is topped up to the standard UK corporation tax rate. In such cases, the effect of this could be seen as the application by the UK of a different (lower) tax rate to domestic-source dividends than to foreign-source dividends.

51. A further question arises as to whether such discriminatory treatment can be justified. On this point, the UK argues in its submissions that any restriction can be justified on the grounds of fiscal cohesion. It argues, relying on *Manninen*, that the effect of the UK's system is to relieve economic double taxation for foreign-source and domestic-source dividends. Cohesion is maintained in cross-border situations because the recipient parent company receives credit for all of the foreign tax paid on the profits from which the dividend arose. While the UK's arguments certainly show that, as I observed above, in principle the application of a credit system can be perfectly in accordance with Article 43 EC, they do not go towards justification of the possible difference in treatment, discussed above, between foreign- and domestic-source income as regards the potential ability to pass on the benefit of underlying tax allowances to recipient parent companies.

52. In the absence of a mechanism enabling such tax allowances to be taken into account in a similar way for foreign-source dividends as for domestic-source dividends, therefore — the presence of which has not been contended in the present case — it is my view that the UK taxation rules for non-portfolio dividends infringe Article 43 EC.

53. As regards foreign portfolio holdings, for which credit was given only for the foreign withholding tax levied on the foreign dividends, the UK's provisions seem clearly discriminatory. While UK corporation tax was not chargeable on dividends received by UK companies by virtue of a portfolio holding in another UK company, UK corporation tax was chargeable on dividends received from such a holding in a company resident in another Member State, subject only to credit for foreign withholding tax (and not for underlying foreign corporation tax). Put otherwise, the UK had chosen, in

the exercise of its competence, fully to relieve double economic taxation of dividends coming from a portfolio holding in a UK company, without doing so for dividends coming from a foreign portfolio holding. This evidently represents less favourable treatment of foreign-source income falling within its tax jurisdiction than of equivalent domestic-source income.

54. In its written and oral submissions, the UK attempted to justify this on the ground that it would be disproportionately expensive and complex to administer and supervise the grant of tax credits for foreign underlying tax in respect of smaller shareholdings, which complexity would result in delay and legal uncertainty for taxpayers.

55. I am not convinced by this argument. While it is true that affording tax credits for dividends for foreign-source portfolio holdings would place an extra administrative burden on the UK authorities, this burden is in my view not disproportionate to the benefit of relieving economic double taxation for relevant UK corporate shareholders. I would refer on this point to the Court's judgment in *Manninen* where, in holding that Article 56 EC obliged Finland to extend its imputation tax credit to account for corporation tax levied on dividends incoming from Sweden, the Court rejected arguments based on potential difficulties for the taxpayer or the tax administration to obtain the necessary information on the corporation tax paid in another Member State. [47] Although, as the Court observed, the calculation of a tax credit granted to a Finnish-resident shareholder receiving dividends from a company established in another Member State must take account of the tax actually paid by that company, and that such tax would arise from the general rules on calculating the basis of assessment and from the rate of corporation tax in that latter Member State, 'possible difficulties in determining the tax actually paid cannot, in any event, justify an obstacle to the free movement of capital such as that which arises from the legislation at issue in the main proceedings'. [48] Precisely the same considerations apply in the present case. I note that the option of exempting such dividend income from UK corporation tax (as happens for UK-source dividend income from portfolio holdings) would in any event be available to the UK, should it prefer to avoid additional administrative burdens.

56. For these reasons, the response to the first question should be that it is contrary to

47 — For reference to these arguments, see point 77 of the Opinion of Advocate General Kokott in *Manninen*, footnote 33 above.

48 — *Manninen*, footnote 33 above, paragraph 54.

Articles 43 and 56 EC for a Member State to keep in force and apply measures such as those at issue in the present case, which exempt from corporation tax dividends received by a company resident in that Member State from other resident companies and which subject dividends received by the resident company from companies resident in other Member States to corporation tax, after giving double taxation relief for any withholding tax payable on the dividend and, under certain conditions, for the underlying tax paid by the non-resident companies on their profits in their country of residence.

C — *Questions 2 and 3*

57. By its second question, the national court asks whether, where a Member State has a system which in certain circumstances imposes ACT on the payment of dividends by a resident company to its shareholders and grants a tax credit to shareholders resident in that Member State in respect of those dividends, it is contrary to Article 43 or 56 EC or Article 4(1) or 6 of Directive 90/435 for the Member State to keep in force and apply measures which provide for the resident company to pay dividends to its shareholders without being liable to pay ACT to the extent that it has received dividends from companies resident in that Member State (either directly or indirectly through other companies resident in that Member State) and which do not provide for the resident company to pay dividends to its shareholders without being liable to pay ACT to the extent that it has received dividends from non-resident companies.

58. By its third question, the national court asks whether it is contrary to these provisions of Community law for the Member State to keep in force and apply measures which provide for the ACT liability to be set against the liability of the dividend-paying company, and that of other companies in the group resident in that Member State, to corporation tax in that Member State upon their profits, but which

(1) do not provide for any form of set off of the ACT liability or some equivalent relief (such as the refund of ACT) in respect of profits earned, whether in that State or in other Member States, by companies in the group which are not residents in that Member State; and/or

(2) provide that any double tax relief which a company resident in that Member State enjoys reduces the liability to corporation tax against which the ACT liability can be set.

59. The second question thus concerns the feature of the UK system at issue whereby

(1) UK corporate shareholders receiving dividends from UK companies, which had paid ACT upon the distribution of these dividends, received a tax credit equal to the ACT paid by the distributing company, meaning that ACT was paid only once in respect of dividends passed up through UK-resident members of groups of companies; and

(2) UK corporate shareholders receiving dividends from non-UK companies did not receive such a tax credit, and were as a result liable to pay ACT on the full amount of profit distributions made. The third question concerns the feature that foreign corporation tax paid on incoming dividends could not be set off against ACT, but only against UK MCT. As ACT paid could in turn only be set off against UK MCT, however, this meant that companies with substantial foreign-source income could have unrelieved ACT (i.e., ACT paid which could not be set off against a company's MCT liability in that accounting period: so-called 'surplus ACT'). While there were possibilities ultimately to relieve such surplus ACT (e.g., by carrying it back or forward for set-off against MCT of other periods, or by surrendering it to UK-resident subsidiaries), not all companies could avail of such provisions.

60. As these two questions deal with what, in the domestic context, are complementary features of the UK system, the full effect of the system can, in my view, best be appreciated by considering them together.

1. Compatibility with Article 43 (and Article 56) EC

61. As I observed above, Article 43 EC prohibits the UK, insofar as it has divided its tax base to include foreign-source income, from discriminating between foreign-source and domestic income.[49] The Court has consistently held that discrimina-

49 — See my Opinion in *Test Claimants in the ACT Group Litigation*, point 58.

tion consists in the application of different rules to comparable situations or in the application of the same rule to different situations. [50]

62. The question here is whether, by granting a tax credit to UK corporate shareholders where UK ACT has been paid upstream on distributed profits, and by providing that ACT can only be set off against UK MCT, the UK is treating companies which are in comparable situations differently.

63. The alleged difference in treatment contrasts UK corporate shareholders receiving dividends upon which ACT has been paid (entitlement to corporate tax credit for ACT already paid on profits, ability to set off ACT paid against MCT liability), and those receiving dividends upon which only foreign corporation tax has been paid (no entitlement to corporate tax credit as no ACT has been paid on profits, no ability to set off ACT paid against foreign corporation tax liability). The first issue is therefore whether these two sets of companies are in comparable situations.

64. The UK argues that this is not the case. As regards the corporate tax credit, the UK notes that this is granted only with respect to distributed profits upon which ACT has already been paid, and not with respect to distributed profits upon which no ACT has been paid. Companies receiving profits on which ACT has been paid and companies receiving profits on which no ACT has been paid are not in comparable situations. It is true that, as non-UK companies never pay ACT on distribution of profits, dividends that they distribute never qualify for this corporate tax credit. However, there is as such no condition of UK 'nationality' of the distributing company for grant of the credit: the sole condition is that ACT should already have been paid on the distributed profits. Further, as regards the rule that ACT can only be set off against UK MCT, the UK argues that this does not discriminate against companies receiving foreign-source profits: in all cases, UK corporate shareholders may set ACT off against MCT in exactly the same manner.

65. A response to this argument requires consideration of the relationship between

50 — See, for example, Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, paragraph 26, and cases cited therein.

foreign corporation tax paid on profits of non-UK companies, normal UK corporation tax ('MCT') paid on UK-source profits, and ACT paid on distributed profits of UK companies.

66. In this regard, it is instructive to recall the judgment of the Court in *Metallgesellschaft,* [51] which concerned the compatibility of the UK regime whereby UK-resident companies had the possibility to pay dividends to their parent company without having to pay ACT where their parent company was UK-resident, but not where their parent company was resident in another Member State (the 'group exemption' scheme). In arguing that the denial of such a benefit to non-UK-parented companies was justified, the UK Government argued, inter alia, that the situation of resident subsidiaries of resident parent companies was not comparable to that of resident subsidiaries of non-resident parent companies. In particular, while in the former case, payment of ACT was merely deferred by grant of the group exemption (i.e., the UK-resident parent company was itself be required to pay ACT when making distributions), in the latter case, granting a group exemption would mean that no ACT at all would be paid. [52]

67. In rejecting this argument, the Court held that,

'First, in so far as ACT is in no sense a tax on dividends but rather an advance payment of corporation tax, it is incorrect to suppose that affording resident subsidiaries of non-resident parent companies the possibility of making a group income election would allow the subsidiary to avoid paying any tax in the United Kingdom on profits distributed by way of dividends.

The proportion of corporation tax which a resident subsidiary need not pay in advance when distributing dividends to its parent company under the group income election regime is in principle paid when the subsidiary's MCT liability falls due. It should be remembered that a resident subsidiary of a company resident in another Member State is liable to MCT in the United Kingdom in respect of its profits in the same way as a resident subsidiary of a resident parent company.

51 — See footnote 12.

52 — *Metallgesellschaft,* footnote 12 above, paragraphs 46 to 48. ...

Second, the fact that a non-resident parent company will, unlike a resident parent company, not be subject to ACT when it in turn pays out dividends cannot justify denying the resident subsidiary of the non-resident parent the possibility of exemption from payment of ACT when paying dividends to the parent.

The fact that a non-resident parent company is not liable to ACT is attributable to its not being liable to corporation tax in the United Kingdom, since it is subject to that tax in its State of establishment. Logic therefore requires that a company should not have to make advance payment of a tax to which it will never be liable.' [53]

68. It is clear from these observations, with which I agree, that ACT should be considered for the purposes of the present case as an advance payment of UK corporation tax. It is true that, as the UK points out, ACT exhibits certain features which differ from 'mainstream' corporation tax. In particular, ACT is paid when and if a company distributes dividends, is measured by the size of the distribution, and is not susceptible to exemptions applicable to MCT. These differences, however, seem to me to follow logically from the fact that ACT is, by its nature and as its name indicates, levied in advance of 'normal' UK corporation tax (MCT). Thus, in the UK's system, the ACT paid upon distribution of dividends could subsequently be set off against a company's MCT on its profits for the relevant accounting period, albeit subject to a certain limit.

69. As a result, UK corporate shareholders receiving dividends upon which ACT has been paid and those receiving dividends upon which only foreign corporation tax has been paid are in principle in comparable situations. This follows from the fact that, just as the (upstream) UK-resident distributing companies are in principle subject to UK corporation tax liability — including, upon relevant distributions, ACT — non-UK-resident distributing companies are in principle subject to corporation tax liability in their State of residence.

70. The next question is whether the UK legislation at issue had the effect of treating corporate shareholders receiving distributed profits from non-UK-resident companies less

53 — *Metallgesellschaft*, footnote 12 above, paragraphs 52, 53, 55 and 56.

favourably than those receiving distributed profits from UK-resident companies.

71. While the former were liable to ACT upon re-distribution of the profits received, the latter were effectively exempt (via grant of a tax credit) from ACT liability to the extent that ACT had already been paid on the upstream distribution. Further, the ACT paid in each case could only be set off against UK MCT, and not foreign corporation tax, paid on the profits contained in the distribution.

72. In my view, this clearly amounts to less favourable treatment of foreign-source dividends.

73. The aim and effect of the UK system, applied in a domestic context, was to ensure that double economic taxation of distributed profits was fully relieved at the corporate level. Due to the grant of the corporate tax credit, ACT only had to be paid once in the 'chain' of distribution. Further, ACT paid during an accounting period could, subject to a certain limit, be set off against MCT. ACT that could not be relieved in that accounting period (so-called 'surplus' ACT) could potentially be relieved by certain other methods, for example by carrying it back or forward for set-off against UK MCT of other periods, or by surrendering it to UK-resident subsidiaries.

74. In contrast, however, the UK system did not ensure full relief at the corporate level of double economic taxation for foreign-source dividends. This could occur as a result of the combined effect of the fact that

(1) ACT was charged in full on re-distributed foreign-source profits (as referred to Question 2 of the order for reference); but

(2) ACT liability could not be set off against foreign corporation tax paid (as referred to in Question 3(i) of the order for reference); and

(3) double tax relief for foreign corporation tax already paid, where granted (i.e., non-portfolio holdings), reduced the liability to corporation tax against which this ACT could be set (as referred to in Question 3(ii) of the order for reference).

75. To the extent that double economic taxation was not fully relieved in the case of foreign-source dividends in an equivalent manner to domestic dividends, therefore, the UK's system was discriminatory, unless the UK can prove that such a difference in treatment was justified and proportionate. The Court has held that, insofar as it chooses to relieve economic double taxation on its residents' dividends, a home State must provide the same relief for incoming foreign-source dividends as for domestic dividends, and must take foreign corporation tax paid into account for this purpose. [54]

76. I note that the fact that the economic double taxation is the result of a combination of rules means that an appreciation of how full relief from double economic taxation for foreign-source dividends should have been effectively achieved may be complex. This question arises more specifically in Questions 6 to 9 below. As I discuss there, it is for the national court to assess how breach of the UK's obligation of non-discrimination should be remedied in practice, subject to the requirement that such remedy should be adequate and effective in restoring the equal treatment guaranteed by Articles 43 and 56 EC.

77. However, I would add that, as long as it were possible to give equivalent full double economic taxation relief for foreign-source and domestic-source dividends, the UK would in principle be entitled to require any remaining UK 'corporation tax' liability on foreign-source profits to be paid in advance upon distribution of profits (i.e., as ACT). This follows, as I see it, from the fact that the UK is at liberty to choose the manner in which it organises its own tax system, as long as it applies this system in a non-discriminatory manner to domestic- and foreign-source income. In the same way as the UK obliged UK 'corporation tax' liability to be paid in advance for domestic-source distributed profits, therefore, so it may in principle require such liability as exists after full double economic taxation relief to be paid in advance for foreign-source distributed profits.

78. This position is not changed by the UK's argument that surplus, unrelieved, ACT may

54 — See my opinion in *Test Claimants in the ACT Group Litigation*, footnote 2 above, paragraph 58, and judgments cited therein (notably, *Manninen*, footnote 33 above, *Verkooijen*, footnote 33 above, and Case C-315/02 *Lenz* [2004] ECR I-7063).

also conceivably arise in domestic situations, namely where the ACT paid by a UK shareholder exceeds that shareholder's UK MCT liability (for example, where a UK company has benefited from considerable exemptions and allowances from UK MCT liability). In such a situation, the UK's system still maintains its aim of fully relieving economic double taxation for domestic dividends.

79. Nor can I accept the UK Government's argument that any difference in treatment between shareholders receiving foreign- and domestic-source dividends is justified on the basis of the need for fiscal cohesion of the UK tax system. The UK Government contends that this justification is made out because there is a direct link between the tax advantage granted to the UK corporate shareholder (the benefit of the tax credit for ACT already paid on distributed profits) and an offsetting tax liability (the distributing company's liability to ACT on the distribution). As noted, however, non-UK-resident distributing companies are, albeit not liable to UK ACT, liable to pay foreign corporation tax on the profits comprised in the distribution. Just as economic double taxation is relieved on UK-source distributed profits, therefore, it should be relieved on foreign-source distributed profits. For this reason, this argument should be rejected. [55]

2. Compatibility with the Parent-Subsidiary Directive

80. The national court also asks whether the provisions restricting grant of the tax credit to corporate shareholders receiving dividends upon which ACT has already been paid, and restricting the possibility of set-off of ACT to set-off against UK MCT, contravene Article 4(1) or 6 of the Parent-Subsidiary Directive, the text of which articles I have set out in full above.

55 — I would note as an ancillary point that, in cases where the UK system had resulted in surplus ACT, one possibility of 'using' this ACT was by surrendering the surplus ACT credit to UK-resident subsidiaries (which could set it off against their own UK MCT liability). As observed by the Commission, the per se restriction of such a set off possibility to UK-resident subsidiaries would seem discriminatory: to the extent that non-UK-resident subsidiaries had UK MCT liability, I see no reason why they should not equally have been entitled to 'use' their parent company's surplus ACT. As the compatibility of this provision with Community law has not explicitly been raised by the national court in its order for reference, however, it is unnecessary to discuss this point further here.

81. As a preliminary point, I note that this question only applies to distributions falling within the material and temporal scope of the Parent-Subsidiary Directive, namely, distributions between a subsidiary and a parent company as defined in that directive and made after 1 January 1992.

82. Article 4(1) of the Parent-Subsidiary essentially provides that, where a parent company receives distributed profits from a subsidiary resident in another Member State, the parent company's State shall either exempt such profits from taxation, or grant a credit for corporation (and, if appropriate, withholding) tax already paid on the profits in the subsidiary's State.

83. To my mind, analysis for compatibility of the UK legislation with this provision raises, as regards distributions falling under the material scope of the Parent-Subsidiary Directive, [56] broadly similar issues to those I have just dealt with as regards Articles 43 and 56 EC. I note, however, that the obligation imposed on the UK by Article 4(1) is narrower than that imposed by Articles 43 and 56 EC: while the latter impose an obligation not to discriminate between foreign-source and domestic-source income, the former requires merely that a parent company State should credit corporation tax already paid on distributed dividends, up to the limit of the amount of the corresponding domestic tax, or exempt such dividends from taxation.

84. As, in the present case, the UK chose the credit method of double taxation relief, it is obliged by Article 4(1) to grant credit, up to the limit of the amount of the corresponding domestic tax, for foreign corporation tax paid by a non-UK subsidiary on profits distributed to its UK parent. As, for the reasons I gave above, ACT should be considered for present purposes as an advance payment of UK corporation tax (albeit levied upon and in the case of distribution of profits), it should be considered together with UK MCT liability to constitute the UK domestic tax 'corresponding' to foreign corporation tax paid, within the meaning of Article 4(1) of the Parent-Subsidiary Directive. In my view, the essence of the obligation contained in this article is to ensure that no double economic taxation occurs in a parent company's State following the levying of corporation tax and, where relevant, withholding tax on profits distributed by a subsidiary in that subsidiary's State. As such, the obligation imposed on the UK by this article is, as with Articles 43 and 56

56 — Namely, parent companies with a minimum holding of 25% in the capital of a company of another Member State, with both companies fulfilling the conditions set out in Article 2 of the directive (see Article 3 of the directive).

EC, to ensure that double economic taxation of such distributed profits is relieved. Such an interpretation is in line with the aim of the directive, which is to introduce 'tax rules which are neutral from the point of view of competition' with regard to company groups. [57]

85. In rebuttal of this position, the UK Government argues that Article 4(1) refers only to taxes levied upon the receipt of distributed profits by a parent company from its subsidiary, and not to a tax such as ACT, which is imposed only if and when a distribution of profits is made and thus cannot be said to be a tax on profits distributed by the subsidiary. I cannot accept this argument, motivated once again by the aim of Article 4(1), which is to avoid double taxation in the parent company home State. The restrictive interpretation of the article espoused by the UK Government would, applied to the present situation, compromise the achievement of this aim.

86. For this reason, insofar as the UK system did not allow credit to be given for foreign corporation tax already paid on incoming dividends received from foreign subsidiaries as against not only UK MCT but also ACT paid, it infringed Article 4(1) of the Parent-Subsidiary Directive.

87. The national court also raises the issue of compatibility with Article 6 of the Parent-Subsidiary Directive, which prohibits a parent company's State of residence from charging withholding tax on the profits which such a company receives from a subsidiary.

88. In order to consider this issue, it is necessary to recall the definition of the term 'withholding tax' in the Parent-Subsidiary Directive. In this regard, the Court has held that this term is not limited to certain specific types of national taxation: 'the nature of a tax, duty or charge must be determined by the Court, under Community law, according to the objective characteristics by which it is levied, irrespective of its classification under national law'. [58] In the context of Article 5(1) of the Parent-Subsidiary Directive (prohibition on withholding tax in the subsidiary's State upon distribution of profits to parents in another Member State), the Court has held that: 'Any tax on income received in the State in which dividends are

57 — See the preamble to the Parent-Subsidiary Directive.

58 — Case C-58/01 *Océ van der Grinten* [2003] ECR I-9089, paragraph 46, Case C-375/98 *Epson Europe* [2000] ECR I-4243, paragraph 22, Case C-294/99 *Athinaiki Zithopiia* [2001] ECR I-6797, paragraphs 26 and 27.

distributed is a withholding tax on distributed profits for the purposes of Article 5(1) of the Directive where the chargeable event for the tax is the payment of dividends or of any other income from shares, the taxable amount is the income from those shares and the taxable person is the holder of the shares.' [59]

89. Transferring these criteria to Article 6 of the Parent-Subsidiary Directive (i.e., concerning the obligations of the parent company State), a tax imposed by a parent company State should be considered to be a withholding tax if

(1) the chargeable event for the tax is the receipt of dividends or of any other income from shares;

(2) the taxable amount is the income from those shares; and

(3) the taxable person is the holder of the shares.

59 — *Océ van der Grinten*, footnote 58 above, paragraph 47, *Epson Europe*, footnote 58 above, paragraph 23, *Athinaiki Zithopiia*, footnote 58 above, paragraphs 28 and 29.

90. Applying these criteria to the levying of ACT, it seems to me that ACT cannot be considered to be a withholding tax in the sense of Article 6 of the Parent-Subsidiary Directive. As pointed out by the UK Government in its submissions, ACT is not levied upon the receipt of subsidiary dividends by a parent company, but rather on the re-distribution of such dividends by the parent company to its own shareholders, i.e., the payment of dividends at a discrete 'downstream' level. The chargeable event for the levying of ACT is thus not such as to enable it to fall within the definition of withholding tax. [60]

91. For this reason, the UK provisions at issue do not in my view infringe Article 6 of the Parent-Subsidiary Directive.

3. Conclusion on Questions 2 and 3

92. For the above reasons, it is my view that, insofar as the UK system described in Questions 2 and 3 ensured full relief for

60 — I note that the present situation does not fall within the principles set out in Article 7(1) of the Parent-Subsidiary Directive, which states that the term 'withholding tax' does not cover an advance payment or prepayment of corporation tax to the Member State of the subsidiary which is made in connection with a distribution of profits to its parent company. Clearly, ACT is a tax levied by the Member State of the parent company, not the subsidiary.

double economic taxation at the corporate level on domestic-source dividends distributed to UK corporate shareholders, but failed to ensure full double economic taxation relief on dividends distributed by companies resident in other Member States, it is discriminatory and contrary to Articles 43 and 56 EC and, as regards distributions falling within its scope, Article 4(1) of the Parent-Subsidiary Directive. The system is not, however, in breach of Article 6 of this directive.

(2) not to provide for the shareholders of the resident companies to receive a tax credit which they would have received on a dividend from a resident company which had not itself received dividends from non-resident companies.

D — *Question 4*

93. By its fourth question, the national court asks whether, where the UK measures provide in certain circumstances for resident companies, if they so elect, to recover the ACT paid on distributions to their shareholders to the extent that distributions are received by the resident companies from non-resident companies (including for this purpose companies resident in third countries), it is contrary to Article 43 or 56 EC or Article 4(1) or 6 of Directive 90/435 for those measures

(1) to oblige the resident companies to pay ACT and to reclaim it subsequently; and

94. This question concerns the compatibility with the abovementioned Community law provisions of the so-called Foreign Income Dividend ('FID') Scheme introduced in the UK with effect from 1 July 1994. As I explained above, under this system a UK-resident company could, prior to payment of a cash dividend to its shareholders, elect that this dividend was a foreign income dividend. ACT payment was payable on this FID but, if the company could match the FID with foreign profits, a claim for repayment could be made for surplus ACT arising in respect of the FID. Such surplus ACT was repaid at the same time as MCT became payable, i.e., 9 months after the end of the accounting period, and after set off against any MCT liability for the period. The shareholder receiving the FID was not entitled to a tax credit under section 231(1) TA, but an individual receiving a FID was treated as receiving income which had borne tax at the lower rate for the year of assessment. However, no repayment was made to such

shareholders of income tax treated as having been paid, nor could a tax-exempt shareholder reclaim a tax credit similar to that which would have been payable on a non-FID qualifying distribution.

95. The obligation imposed on the UK by Articles 43 and 56 in implementing the FID was precisely the same as I described in the context of Questions 2 and 3 above: namely, an obligation to ensure equivalent full relief of double economic taxation for foreign-source dividends as for domestic-source dividends.

96. As regards the feature of the FID system raised in the first part of Question 4, therefore – the obligation for resident companies receiving foreign dividends to pay ACT on re-distribution and to reclaim this subsequently — this obligation infringed Articles 43 and 56 EC insofar as such ACT resulted in double economic taxation of these foreign-source profits. The fact that resident companies could subsequently reclaim the ACT paid is clearly no defence here: by analogy with the Court's observations in *Metallgesellschaft*,[61] the cash-flow disadvantage for such companies in the interim period prior to reclaim qualifies, for the purposes of the non-discrimination principle, as less favourable treatment.[62]

97. The second part of Question 4 concerns the feature of the FID system whereby, to the extent that UK-resident companies had received dividends from non-resident companies, (downstream) shareholders of these UK companies did not receive the tax credit which they would have received on a dividend from a UK-resident company which had not itself received dividends from non-resident companies.

98. In this regard, to the extent that the UK chose to relieve double economic taxation by grant of an imputation tax credit for domestic-source dividends, it is obliged by Articles 43 and 56 EC to relieve double taxation in an equivalent way for foreign-source dividends.[63]

61 — See footnote 12.

62 — See *Metallgesellschaft*, footnote 12 above, paragraph 44.

63 — See *Manninen*, footnote 33 above.

99. As regards the UK Government's argument that, under its FID system, shareholders of UK companies receiving FIDs could in fact avoid double taxation because they were treated as if they had received income which had borne tax at the lower rate for the year of assessment, I would observe that it is for the national court to assess, in a particular case, whether such treatment actually had the effect that double economic taxation was relieved in an equivalent manner as for domestic-source dividends.

100. Insofar as the FID system did not result in equivalent double economic taxation relief for UK companies' shareholders receiving FIDs as for those receiving domestic-source profits, it breaches Articles 43 and 56 EC unless justified.

101. In its defence, the UK Government argues first of all that the fact that the FID system was a wholly elective regime means that it could not amount to a restriction on any party's freedom of establishment or freedom to move capital: the underlying UK tax provisions (dealt with in Questions 2 and 3 above) remained in place at all material times. To the extent that these underlying tax provisions were also discriminatory and in breach of Articles 43 and 56, however, this argument is clearly fallacious. It was in neither case possible for UK companies with foreign shareholders to receive non-discriminatory treatment of their foreign-source income in comparison with domestic-source income.

102. Second, the UK Government argues that a non-resident subsidiary that has not been obliged to pay ACT upon distribution is in any event in a position to pay a larger dividend to its UK parent company than a resident subsidiary, which must pay ACT upon its distributions, would be able to pay. Again, this argument fails to recognise that, while the non-resident subsidiary has not been obliged to pay ACT, it has none the less been subject to foreign corporation tax which, as I observed above, places parent companies receiving foreign- and domestic-source dividends in a comparable position.

103. Finally, the UK Government raises the argument that the FID system is justified by the need to preserve the fiscal cohesion of the UK tax system, as it argued as regards Question 2 above, and to ensure the effectiveness of fiscal supervision, in particular as concerns third countries. As regards intra-Community restrictions, to the extent that these arguments are substantiated, they repeat those dealt with under Question 2

and should be dismissed for the same reasons. The question whether such arguments may carry greater force concerning 'third country' restrictions has been raised under Question 5 and I will deal with it briefly there.

104. A separate issue is whether the only potential claimants of loss caused by such a breach should be the shareholders themselves, and not the UK distributing company. On this point, the Test Claimants contend that parents paying distributions from foreign-source income were caused by the FID system to enhance dividends for shareholders to distribute an equivalent amount as parents paying distributions from domestic-source income. I deal with this point under Question 6, which concerns appropriate remedies for breach.

105. The national court also raises the compatibility of the two features it identified in the FID system — liability of UK companies re-distributing foreign dividends to pay ACT (Question 4(i)) and failure to give imputation tax credits to their downstream shareholders (Question 4(ii)) — with Articles 4(1) and 6 of the Parent-Subsidiary Directive. As regards Article 4(1), as I explained above in relation to Questions 2 and 3, this imposes an obligation fully to relieve double economic taxation at the level of the receiving corporate shareholder on distributions falling within its material and temporal scope. As such, the analysis under Question 4(i) (liability to ACT) is the same as for Articles 43 and 56. In the case of Question 4(ii) (grant of imputation tax credit), however, this concerns a difference in treatment at the level not of the receiving company itself, but of that company's shareholders. For this reason, such a restriction would not seem to me to fall within the scope of Article 4(1) of the Parent-Subsidiary Directive. Likewise, for analogous reasons as I explained above in the context of Questions 2 and 3, neither of the features raised in Question 4 constitutes, in my view, a breach of Article 6 of the Parent-Subsidiary Directive.

106. The answer to the fourth question should therefore be that, where the UK measures provide in certain circumstances for resident companies, if they so elect, to recover the ACT paid on distributions to their shareholders to the extent that distributions are received by the resident companies from non-resident companies (including for this purpose companies resident in third countries), (1) it is contrary to Articles 43 and 56 EC, as well as Article 4(1) of the Parent-Subsidiary Directive, to oblige the resident companies to pay ACT and to

reclaim it subsequently, to the extent that this does not ensure equivalent full relief from double economic taxation to that provided for domestic-source dividends; and (2) it is contrary to Articles 43 and 56 EC not to provide for the shareholders of the resident companies to receive equivalent relief from double economic taxation which they would have received on a dividend from a resident company which had not itself received dividends from non-resident companies.

E — *Question 5*

107. By its fifth question, the national court asks whether where, prior to 31 December 1993, a Member State adopted the measures outlined in Questions 1 and 2, and after that date it adopted the further measures outlined in Question 4, and if the latter measures constitute a restriction prohibited by Article 56 of the EC Treaty, that restriction is to be taken to be a new restriction not already existing on 31 December 1993.

108. The national court raises this question in the context of Article 57(1) EC, which provides that the Article 56 EC prohibition of restrictions of free movement of capital shall be 'without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Community law adopted in respect of the movement of capital to or from third countries involving direct investment — including in real estate — establishment, the provision of financial services or the admission of securities to capital markets'. The question essentially asks therefore whether, to the extent that the measures outlined in Question 4 fall within the Article 56 EC prohibition, this prohibition includes restrictions on free movement of capital between Member States, and third countries. [64]

109. The first question is whether the FID rules, which took effect from 1 July 1994, can be considered to form part of restrictions which 'existed' on 31 December 1993.

110. On this point, both the Test Claimants and the UK Government rightly refer to the

64 — I note that Questions 1 to 3 explicitly concern only intra-Community restrictions as formulated by the national court, because they concern restrictions that already existed on 31 December 1993 within the meaning of Article 57(1) EC.

Court's judgment in *Konle*.[65] That case concerned the interpretation of a derogating clause for Austria in the Act of Accession of the Republic of Austria, the Republic of Finland and the Kingdom of Sweden and the adjustments to the treaties on which the European Union is founded[66], which allows it to maintain for a certain period its existing legislation regarding (prior authorisation of) secondary residences. The Court first observed that, while it was for the Austrian courts to determine the content of the national legislation existing at the date of Austria's accession, it was for the Court to supply guidance on the Community concept of 'existing legislation'.[67] The Court continued,

'Any measure adopted after the date of accession is not, by that fact alone, automatically excluded from the derogation laid down in [the derogating article of the Act of Accession]. Thus, if it is, in substance, identical to the previous legislation or if it is limited to reducing or eliminating an obstacle to the exercise of Community rights and freedoms in the earlier legislation, it will be covered by the derogation.

On the other hand, legislation based on an approach which differs from that of the previous law and establishes new procedures cannot be treated as legislation existing at the time of accession.'[68]

111. As I observed in my Opinion in *Ospelt*, it also follows from Article 57(1) EC that Member States are empowered to adapt existing legislation without altering the existing legal situation.[69]

112. In the context of the present case, on the basis of the description provided in the order for reference, it seems to me that the object and effect of the introduction of the FID regime was indeed to reduce (although not eliminate) the existing obstacle to exercise of the freedoms provided by Articles 43 and 56 EC — namely the failure fully to relieve double economic taxation on foreign-source dividends. Indeed, the existing ACT regime was not removed for foreign-source dividends upon the introduction of the FID changes, which remained optional for companies falling under their scope. I would add that this manner of interpreting Article 57(1)

65 — Case C-302/97 [1999] ECR I-3099.

66 — OJ 1994 C 241, p. 21.

67 — Ibid., paragraph 27.

68 — Ibid., paragraphs 52 and 53. See also, Case C-300/01 *Salzmann* [2003] ECR I-4899 and my Opinion in Case C-452/01 *Ospelt* [2003] ECR I-9743, point 52.

69 — *Ospelt*, footnote 68 above, paragraph 53.

EC, to include legislation aimed at lessening existing restrictions, is wholly logical: in the absence of such an interpretation, Member States would have an incentive to maintain existing restrictions rather than attempt to reduce such restrictions partially or fully.

113. As a result, while final assessment of the content, purpose and effect of the FID system is for the national court, on the basis of the details provided it is my view that the system forms part of restrictions that existed on 31 December 1993 within the meaning of Article 57(1) EC.

114. The second question is whether the FID regime falls within the material scope of Article 57(1) EC.

115. The Test Claimants argue that the regime falls outwith the material scope of Article 57(1) EC, which is limited to movement of capital to or from third countries involving 'direct investment — including in real estate — establishment, the provision of financial services or the admission of securities to capital markets'.

116. The Test Claimants argue that the term 'investment' should be interpreted strictly, and does not extend to payments flowing from such an investment. I do not agree. As the Court has held, as discrimination in the tax treatment of domestic- and foreign-source dividends may render investment in the shares established in other Member States less attractive, it should be considered to be a restriction on the free movement of capital. [70]

117. The Test Claimants further argue that the phrase 'direct investment' in this regard should not extend to smaller participations (e.g., portfolio holdings) held by UK companies abroad. In this regard, it is true that, as an exception to Article 56 EC, Article 57(1) EC should be construed strictly. [71] It is my view that the concept of direct investment should be interpreted in accordance with the guidance given in Annex I to Directive 88/361, which outlines the nomenclature for capital movements referred to in Article 1 of that directive. Heading 1 of the Annex deals with 'Direct Investment' and the most relevant inclusion for present purposes within this category is subheading 2: 'Participation in new or existing undertaking with a view to establishing or maintaining lasting economic links.' The Explanatory Memorandum to the directive sheds further light on what is meant by 'direct investment',

70 — See *Manninen*, footnote 33 above, paragraphs 22 to 24, and the Opinion of Advocate General Kokott in that case at points 27 to 33.

71 — See my Opinion in *Ospelt*, footnote 68 above.

namely, 'Investments of all kinds by natural persons or commercial, industrial or financial undertakings, and which serve to establish or to maintain lasting and direct links between the person providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity. This concept must therefore be understood in its widest sense.'

118. The Explanatory Memorandum continues, 'As regards those undertakings mentioned under I-2 of the Nomenclature which have the status of companies limited by shares, there is participation in the nature of direct investment where the block of shares held by a natural person of another undertaking or any other holder enables the shareholder, either pursuant to the provisions of national laws relating to companies limited by shares or otherwise, to participate effectively in the management of the company or in its control.'

119. It is for the national court to decide whether, in a given case, the investment that a UK company holds in a company resident in a third country serves to establish or maintain 'lasting and direct links' with the latter company, allowing the UK company to 'participate effectively in the management of the company or in its control'. I would observe, however, that this is clearly a lower threshold than the 'decisive influence' test to which I referred in the context of distinguishing between the scope of application of Articles 43 and 56 EC under Title IV(A) above.

120. Only in the event that a UK company's holding in a third country company was not such as to allow effective participation, therefore, would the Article 56 EC prohibition apply.

121. This raises in turn the issue whether the same considerations apply to the analysis of Article 56 EC as regards intra-Community capital movements as opposed to capital movements between Member States and third countries. In this regard, it is evident from the wording of Article 56(1) EC that restrictions on free movement of capital between Member States and third countries are, in principle, prohibited. Nonetheless, it is my view that, in analysing whether such restrictions are justified (whether under Article 58(1) EC or under the discrimination analysis of Article 56 EC), different considerations may apply than is the case with purely intra-Community restrictions. As I have already observed in my Opinion in

Ospelt, the particular context of intra-Community freedom of capital is that it must be regarded as a constituent element of economic and monetary union. [72] As I stated there, the fact that monetary policy is, following completion of economic and monetary union, set by the European Central Bank, presupposes complete unity in terms of the movement of money and capital. This context does not obtain in the case of movement of capital between Member States and third countries, although the movement of capital has been to a large extent liberalised worldwide. [73] As a result, I will not exclude that a Member State may be able to prove that a restriction of capital movements with third countries is justified on a given ground, in circumstances where this ground would not amount to a valid justification of a restriction on purely intra-Community capital movements.

122. In the present case, however, as I observed above, the UK Government has not put forward any substantiated arguments as to why specific considerations apply to justify the restrictions comprised in the FID scheme in the case of third countries. Its arguments as to justification of the scheme are primarily based on fiscal cohesion, and it argues that the 'drain of revenue' out of the Community in the case of third country movements is of greater concern than in intra-Community situations. This abstract argument is, however, in my view not sufficient to prove that the restrictions of the FID scheme as regards third country-source dividends were, in that particular case, justified.

123. In any event, due my answer on the scope of Article 57(1) EC in this case, it is in my view not necessary to give a definite response on this issue.

124. The answer to the fifth question should therefore in my opinion be that, where prior to 31 December 1993 a Member State adopted the measures outlined in Questions 1 and 2, and after that date it adopted the further measures outlined in Question 4, and if the latter measures constitute a restriction prohibited by Article 56 EC, that restriction forms part of provisions that already existed on the 31 December 1993, within the meaning of Article 57(1) EC.

72 — See *Ospelt*, footnote 68 above, points 35 to 40.

73 — *Ospelt*, footnote 68 above, points 41 and 42.

F — *Questions 6 to 9*

125. Questions 6 to 9 of the order for reference raise questions relating to the nature of remedies that should be available to affected UK-resident companies or other companies in the same group in the event of any of the measures set out in Questions 1 to 5 being in breach of any of the Community provisions referred to in those questions.

126. In this regard, the Court has consistently held that that the right to a refund of charges levied in a Member State in breach of rules of Community law is the consequence and complement of the rights conferred on individuals by Community provisions as interpreted by the Court.[74] The Member State is therefore required in principle to repay charges levied in breach of Community law.[75]

127. In the absence of Community rules on the recovery of sums unduly paid, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive from Community law, provided, first, that such rules are not less favourable than those governing similar domestic actions (principle of equivalence) and, second, that they do not render practically impossible or excessively difficult the exercise of rights conferred by Community law (principle of effectiveness).[76]

128. The question raised in the present case is whether the plaintiffs' claims should be characterised as claims in restitution, damages or for an amount representing a benefit unduly denied.

129. On this point also, the Court's judgment in *Metallgesellschaft* is relevant. In that case, the second question posed by the national court concerned the appropriate remedy that should be available where a UK subsidiary and non-UK parent had been deprived of the benefit of the group exemp-

74 — *Metallgesellschaft*, footnote 12 above, paragraph 84. See also, judgments in Case 199/82 *San Giorgio* [1983] ECR 3595, paragraph 12; Case 309/85 *Barra* [1988] ECR 355, paragraph 17; Case C-62/93 *BP Supergas* [1995] ECR I-1883, paragraph 40; Case C-343/96 *Dilexport* [1999] ECR I-579, paragraph 23; Joined Cases C-441/98 and C-442/98 *Michailidis* [2000] ECR I-7145, paragraph 30.

75 — *Metallgesellschaft*, footnote 12 above, paragraph 84. See also, Case C-62/00 *Marks & Spencer* [2002] ECR I-6325, paragraph 34; Case C-129/00 *Commission* v *Italy* [2003] ECR I-14637, paragraph 25; Joined Cases C-192/95 to C-218/95 *Comateb and Others* [1997] ECR I-165, paragraph 20; *Dilexport*, footnote 74 above, paragraph 23; and *Michailidis*, footnote 74 above, paragraph 30.

76 — *Metallgesellschaft*, paragraph 85. See also, *Marks & Spencer I*, footnote 75 above, paragraph 39; Case C-231/96 *Edis* [1998] ECR I-4951, paragraphs 19 and 34; Case C-260/96 *Spac* [1998] ECR I-4997, paragraph 18; Case C-228/96 *Aprile* [1998] ECR I-7141, paragraph 18; and *Dilexport*, footnote 74 above, paragraph 25. See similarly, Case C-453/99 *Courage* v *Crehan* [2001] ECR I-6297.

tion scheme contrary to Article 43 EC. In particular, the question was whether Article 43 EC entitled that subsidiary and/or its parent company to obtain a sum equal to the interest accrued on the advance payments made by the subsidiary from the date of those payments until the date on which the tax became chargeable, even when national law prohibited the payment of interest on a principal sum which was not due. The Court emphasised that it was not its task to assign a legal classification (under English law) to the actions brought by the plaintiffs before the national court, but was for the affected companies to specify the nature and basis of their actions — whether for restitution or for compensation in damages — subject to the supervision of the national court. [77]

130. On this basis, the Court went on to consider issues arising on both of the hypotheses put forward by the national court: first, the hypothesis that the actions were to be treated as claims in restitution, and second, the hypothesis that they were to be treated as claims in damages. [78] It concluded that, in any event, Article 43 EC required that the plaintiffs should have an effective legal remedy in order to obtain reimbursement or reparation of the financial loss which they had sustained and from which the authorities of the Member State concerned had benefited as a result of the advance payment of tax. [79] The mere fact that the sole object of such an action would be the payment of interest did not constitute a ground for dismissing such an action. [80]

131. I note that, in that case, no questions had been referred by the national court in respect of the interpretation of the *Brasserie du Pêcheur* general conditions for State liability for a breach of Community law, and the Court did not consider whether these conditions were made out. [81] Advocate General Fennelly considered the issue briefly, although only in the alternative as his view was that it was 'more correct and more logical to treat the plaintiffs' claim as restitutionary rather than as a compensatory claim for damages'. [82]

77 — *Metallgesellschaft*, footnote 12 above, paragraph 81.

78 — Ibid., paragraphs 82 to 95.

79 — Ibid., paragraph 96.

80 — Ibid., paragraph 96.

81 — Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur and Factortame* [1996] ECR I-1029.

82 — Opinion of Advocate General Fennelly in *Metallgesellschaft*, footnote 12 above, point 52.

132. In the present case, it seems to me that, with one exception, the claims described in the national court's sixth question should be considered equivalent to claims for recovery of sums unduly paid, that is to say, claims for recovery of charges unlawfully levied within the meaning of the Court's case-law, which the UK is in principle obliged to repay. The underlying principle should be that the UK should not profit and companies (or groups of companies) which have been required to pay the unlawful charge must not suffer loss as a result of the imposition of the charge. [83] As such, in order that the remedy provided to the Test Claimants should be effective in obtaining reimbursement or reparation of the financial loss which they had sustained and from which the authorities of the Member State concerned had benefited, this relief should in my view extend to all direct consequences of the unlawful levying of tax. This includes to my mind:

(1) repayment of unlawfully levied corporation tax (Questions 6(i), (iii) and (vii));

(2) the restoration of any relief applied against such unlawfully levied corporation tax (Question 6(ii));

(3) the restoration of reliefs foregone in order to set off unlawfully levied corporation tax (Question 6(v));

(4) loss of use of money insofar as corporation tax was, due to the breach of Community law, paid earlier than it would otherwise have been (Questions 6(iv), (vi), and (viii)). [84] In each case, it would be for the national court to satisfy itself that the relief claimed was a direct consequence of the unlawful levy charged.

133. On this point, I am not convinced that the head of claim outlined in Question 6(ix) should qualify as equivalent to a claim for repayment of charges unlawfully levied. The Test Claimants essentially argue that the UK's discriminatory failure to grant equivalent imputation credits to shareholders of UK companies receiving FIDs caused those companies to enhance their distributions to compensate these shareholders. However, it does not seem to me that such actions on the part of the distributing company to increase the amount of distributions should be considered to be a direct consequence of the UK's unlawful failure to grant an equivalent credit to the shareholders. Rather,

83 — See, Opinion of Advocate General Fennelly in *Metallgesellschaft*, footnote 12 above, point 45.

84 — See, in this regard, the Court's response to the second question in *Metallgesellschaft*, footnote 12 above.

the direct consequence of this failure is simply the extra tax levied on those shareholders than would have been the case had the UK complied with its Community law obligations — which loss is suffered by the shareholders, and not the distributing companies. In contrast, any increase by these companies in the amount of dividend distributed to its shareholders does not seem to me to follow inevitably from the denial of tax credit, nor it is possible without more to conclude that the distribution of an increased dividend necessarily qualifies as a loss incurred for the distributing companies.

134. In principle, it is for the national court to decide how the various claims brought should be characterised under national law. However, as I observed above, this is subject to the condition that the characterisation should allow the Test Claimants an effective remedy in order to obtain reimbursement or reparation of the financial loss which they had sustained and from which the authorities of the Member State concerned had benefited as a result of the advance payment of tax. [85] This obligation requires the national court, in characterising claims under national law, to take into account the fact that the conditions for damages as set out in *Brasserie du Pêcheur* may not be made out in a given case and, in such a situation, ensure that an effective remedy is nonetheless provided.

135. In the present case, for example, I am not convinced that the *Brasserie du Pêcheur* conditions would be satisfied for all the aspects of the UK system raised in the present reference that, in my opinion, breach Community law. Clearly, the first condition (breach of a rule of law intended to confer rights on individuals) is fulfilled, as each of the Community law provisions raised is directly effective. The same would seem true by and large for the third condition (existence of a direct causal link between the breach of an obligation resting on the State and damage sustained by injured parties), with the potential exception of the claim outlined in Question 6(ix) for the reasons I have mentioned above.

136. However, I have considerable doubts whether the second condition — the existence of a 'sufficiently serious' breach of Community law — is fulfilled for all aspects of the system which, in my view, breach

85 — *Metallgesellschaft*, footnote 12 above, paragraph 96.

Community law. As observed by the Court in *Brasserie du Pêcheur*,

'... the decisive test for finding that a breach of Community law is sufficiently serious is whether the Member State or the Community institution concerned manifestly and gravely disregarded the limits on its discretion.

The factors which the competent court may take into consideration include the clarity and precision of the rule breached, the measure of discretion left by that rule to the national or Community authorities, whether the infringement and the damage caused was intentional or involuntary, whether any error of law was excusable or inexcusable, the fact that the position taken by a Community institution may have contributed towards the omission, and the adoption or retention of national measures or practices contrary to Community law.

On any view, a breach of Community law will clearly be sufficiently serious if it has persisted despite a judgment finding the infringement in question to be established, or a preliminary ruling or settled case-law of the Court on the matter from which it is clear that the conduct in question constituted an infringement.' [86]

137. In *Metallgesellschaft*, the Court, as I observed above, did not consider this matter, nor was the question raised by the national court in that case. Advocate General Fennelly, who as I have noted was of the opinion that the plaintiffs remedy in that case was restitutionary in nature, none the less made some comments in the alternative on the question of whether the *Brasserie du Pêcheur* conditions were satisfied. He remarked that, 'The issue is whether the clarity and precision of Article [43] of the EC Treaty were such that the breach may be regarded as sufficiently serious. This has to be viewed in the light of the widespread use of residence as a criterion for direct taxation purposes coupled with the state of development of the relevant case-law at the material time. This will concern the limits which affect the use by Member States of that criterion where it is detrimental to the interests of residents from other Member States. In short, was the refusal to allow the group income election, viewed objectively, excusable or inexcusable?' [87] He went on to opine that, as what was in issue was indirect discrimination, this,

86 — *Brasserie du Pêcheur*, footnote 81 above, paragraphs 55 to 58.

87 — Opinion of Advocate General Fennelly in *Metallgesellschaft*, footnote 12 above, point 55.

'should, in general, be considered sufficiently serious ... To classify a breach of Article 52 of the Treaty such as that involved in the present case as excusable, the national court must be satisfied not only that the United Kingdom authorities genuinely believed that refusing to extend the benefit of the group exemption in question to groups whose parent company was non-resident was strictly necessary, but also, viewed objectively in the light of *Bachmann* [88] and the principle of strict interpretation of exceptions to fundamental Treaty rules like the freedom of establishment, that this belief was reasonable'. [89]

138. I agree with Advocate General Fennelly that the crucial question in deciding whether a breach such as the UK's in that case is sufficiently serious is the question whether the error of law was, viewed objectively, excusable or inexcusable. I would also agree that, in most areas of Community law, indirect discrimination is likely to satisfy this test. However, as I have observed in my Opinion in *Test Claimants in the ACT Group Litigation*, [90] certain of the Court's case-law setting out the boundaries of the application of the Treaty free movement provisions in the field of direct taxation is extremely complex and, in parts, in the process of development. For example, it was not in my opinion wholly clear until the recent *Verkooijen* [91] and *Manninen* [92] judgments that Member States acting in a home State capacity are obliged by Articles 43 and 56 EC to grant equivalent relief from double economic taxation to resident shareholders receiving foreign-source income as for resident shareholders receiving domestic-source income. Such areas may be contrasted, however, with obligations that clearly follow from secondary legislation such as the Parent-Subsidiary Directive, or that follow clearly from jurisprudence of the Court which existed at the time that the relevant measures were in force. In sum, it follows in my view that breaches occurring at what were at that time the boundaries of the development of the Court's case-law in this field should not be considered as a manifest and grave disregard of the limits or a Member State's discretion within the meaning of the Court's case-law. It is for the national court to make the final assessment of this issue on the facts of the present case. [93]

139. The response to Questions 6 to 9 should therefore in my view be that, in the

88 — Case C-204/90 [1992] ECR I-249.

89 — Ibid., paragraph 56.

90 — See footnote 2.

91 — See footnote 33.

92 — See footnote 33.

93 — See, for example, *Brasserie du Pêcheur*, footnote 81 above, paragraph 58.

absence of Community rules on the recovery of taxes unduly paid, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which taxpayers derive from Community law, including the characterisation of actions brought by the claimants before the national court. However, in exercising such jurisdiction, national courts are obliged to ensure that the claimants have an effective legal remedy in order to obtain reimbursement or reparation of the financial loss which they have sustained as a direct result of tax levied in breach of Community law.

V — Temporal limitation

140. In its oral submissions, the UK government requested that, in the event that the Court should find that it has breached Community law in the present case, the Court should consider limiting the temporal effects of its judgment. It requests the Court, should the issue arise, to re-open the procedure following its judgment in *Banco Popolare di Cremona*. [94] The UK government notes that the legislation at issue in this case was, prior to the Court's judgment in *Metallgesellschaft* [95], which concerned a different aspect of the legislation to that raised in the present case, never attacked before the Court. Further, the legislation remained substantially the same between 1973 and its abolition in 1999, at which time imputation systems were the method preferred by the Commission in relieving double taxation. Finally, the UK government states that the potential value of claims at issue could amount to £7 billion, which costs would be exacerbated by the complexity involved in having to settle claims dating back to 1974.

141. In rebuttal, the Test Claimants argue that the potential financial consequences of the present case are much smaller than the estimate of the UK government — rather, they contend that the figure at stake is in the region of £100 million and £2 billion, depending on the outcome of an action pending before the English national courts concerning limitation. In addition, they submit that, even if the UK rules were not explicitly attacked by claims under Articles 43 and 56 EC in the UK national courts until relatively recently, the measures — and in particular their cross border application — were nonetheless otherwise contested prior to this. Finally, the Test Claimants request that, in the event that the Court were minded

94 — Case C-475/03 *Banca Popolare di Cremona*, Opinion of Advocate General Jacobs of 17 March 2005.

95 — See footnote 12

to limit the effects of its judgment in time, the oral procedure should be re-opened in order to allow for further submissions on this issue.

142. To begin by recalling the applicable principles to a plea of temporal limitation, the Court has consistently held that the interpretation it gives to a provision of Community law clarifies and defines the meaning and scope of that provision as it should have been understood and applied from the time of its entry into force. Very exceptionally, having regard to the need for legal certainty, the Court has, in application of the general principle of legal certainty inherent in the Community legal order, chosen to restrict the possibility for any person concerned of relying on a provision it has interpreted with a view to calling in question legal relationships established in good faith. The Court has taken that step only in quite specific circumstances, where there was (1) a risk of serious economic repercussions owing in particular to the large number of legal relationships entered into in good faith on the basis of rules considered to be validly in force and (2) where it appeared that both individuals and national authorities had been led into adopting practices which did not comply with Community legislation by reason of objective, significant uncertainty regarding the implications of Community provisions, to which the conduct of other Member States or the Commission may even have contributed. [96]

143. Turning now to respond to the UK government's argument in the present case, my first observation would be that, where a party raises a plea in a procedure before the Court, it is for that party to ensure that its arguments have been sufficiently enunciated, and that the Court has before it sufficient information to allow it to come to a judgment on the issue. This is a fundamental principle of the Court's procedure and is necessary in order to avoid the Court's giving judgment on purely hypothetical issues, or on the basis of mere assumptions that could prove to be inaccurate. Further, in principle parties' written submissions should cover all pleas upon which they rely. [97] This is in the interest not only of allowing other parties to the case sufficient opportunity of reply, but also of aiding the Court in taking initial

96 — See Case C-209/03 *Bidar* [2005] ECR I-2119, paragraphs 66 to 69; the Opinion of Advocate General Jacobs in *Banco Populare di Cremona*, footnote 94 above, points 74 and 75; and the Opinion of Advocate General Tizzano of 10 November 2005 in Case C-292/04 *Meilicke*, not yet reported in the ECR.

97 — See, in the case of direct actions, Articles 38 and 42(2) of the Rules of Procedure of the Court of Justice. Article 38 requires applications to contain a 'summary of the pleas in law upon which the action is based'. Article 42(2) provides that, 'No new plea in law may be introduced in the course of proceedings unless it is based on matters of law or of fact which come to light in the course of the procedure. If in the course of the procedure one of the parties puts forward a new plea in law which is so based, the President may, even after the expiry of the normal procedural time limits, acting on a report of the Judge Rapporteur and after hearing the Advocate General, allow the other party time to answer that plea. The decision on the admissibility of the plea shall be reserved for the final judgment'.

decisions such as, for example, assignment of cases to particular formations or preparatory enquires that could be necessary.

144. In the present case, the plea of limitation of temporal effects was not raised by the UK government in its written submissions. Rather, it raised this plea at the oral hearing, without providing detailed substantive arguments or evidence on either of the two elements of which, by the consistent case law I set out above, the Court needs to be satisfied in order to limit the temporal effect of a judgment. As regards the first element — risk of serious financial repercussions owing to the large number of legal relationships entered into in good faith on the basis of rules considered to be validly in force — while the UK estimated the potential figure at stake as £ 7 billion, it gave no indication of how it arrived at this figure, or of the number of affected legal relationships upon which it was based. The UK government did not offer any more clarification on the issue in response to the Test Claimants' counter-argument that the true amount at stake would be between £ 100 million and £ 2 billion. As regards the second element — the requirement that individuals and national authorities should have been 'led into adopting practices which did not comply with Community legislation by reason of objective, significant uncertainty regarding the implications of Community provisions', the UK government confined itself to stating that its ACT system had never been attacked under EU law prior to Metallgesellschaft, and that imputation systems were at the time the Commission's preferred method of economic double taxation relief. It gave no argument as to which of the Court's case law on Articles 43 and/or 56 EC were relevant to the case in point, or as to the 'cut off' point that it considered the Court should adopt if it chose to limit the effect of its judgment. [98]

145. For these reasons, I am of the view that the Court should reject the UK government's plea of temporal limitation without more, on the basis of insufficient substantiation. I note that the UK government has not attempted to provide any justification for its failure to raise the temporal limitation plea in its written submissions, or for its failure to provide substantial argument on the issue during the procedure before the Court as a whole. True, the UK government has asked the Court to re open the procedure following the *Banco Populare di Cremona* judgment. However, the principal features of the Court's case law setting out the two basic conditions for temporal limitation of its judgments, which I outlined above, have been long settled. The further aspect of this line of jurisprudence at issue in the re-opened *Banco Populare di Cremona* procedure following the Opinion of Advocate General

98 — In contrast, for example, in *Banco Populare di Cremona*, footnote 94 above, and *Meilicke*, footnote 96 above, the Italian and German governments included substantial argument on the temporal limitation issue in their original written submissions.

Jacobs in that case — that is, the possibility of fixing a cut-off point for the effects of a judgment that lies in the future — has not been raised in the present case.

146. Should the Court be of the view that the UK's failure to substantiate its plea does not of itself suffice to dismiss the issue of temporal limitation, however, while I am reluctant for the above reasons to express a view on the merits without having heard substantial argument, I would make the following observations. Although as I noted above, the boundaries of the scope of the application of the Treaty free movement provisions in the direct taxation sphere have not always been obvious, it seems to me that the UK ought to have been aware that there was a risk that a system which treated foreign source income less favourably than domestic-source income could be viewed as discriminatory and contrary to Community law. The potential application of the basic non discrimination prohibition to direct tax measures should have at least been clear to the UK with the Court's judgment in *Avoir Fiscal*, if not before, albeit that that case concerned a different type of discrimination via such measures. [99] Further, I cannot agree with the UK's implicit suggestion that the Commission's alleged preference at the relevant time for imputation methods of economic double taxation relief caused them to believe that their system was consistent with Community law: even if the Commission had condoned imputation methods in general, it did not condone the specific discriminatory features of the UK's imputation system at issue in the present case. There is thus no reason to believe that the UK was 'led into' maintaining its system by reason of objective, significant uncertainty regarding the implications of Community law, or that the Commission contributed to any such uncertainty, within the meaning of the second element of the test set out in the Court's case-law described above.

147. For the above reasons, I am of the view that the Court should dismiss the UK government's plea that the effects of its judgment should be limited in time.

99 — Case 270/83 *Commission* v *France* [1986] ECR 273.

VI — Conclusion

140. For these reasons, I am of the view that the Court should give the following response to the questions referred by the High Court of Justice of England and Wales, Chancery Division:

— It is contrary to Articles 43 and 56 EC for a Member State to keep in force and apply measures such as those at issue in the present case, which exempt from corporation tax dividends received by a company resident in that Member State from other resident companies and which subject dividends received by the resident company from companies resident in other Member States to corporation tax, after giving double taxation relief for any withholding tax payable on the dividend and, under certain conditions, for the underlying tax paid by the non-resident companies on their profits in their country of residence.

— Insofar as the UK system described in Questions 2 and 3 of the order for reference ensured full relief for double economic taxation at the corporate level on domestic-source dividends distributed to UK corporate shareholders, but failed to ensure full double economic taxation relief on dividends distributed by companies resident in other Member States, it is discriminatory and contrary to Articles 43 and 56 EC and, as regards distributions falling within its scope, Article 4(1) of Council Directive 90/435/EEC. The system is not, however, in breach of Article 6 of this directive.

— Where the UK measures provide in certain circumstances for resident companies, if they so elect, to recover the ACT paid on distributions to their shareholders to the extent that distributions are received by the resident companies from non-resident companies (including for this purpose companies resident in third countries), (1) it is contrary to Articles 43 and 56 EC, as well as Article 4(1) of Directive 90/435, to oblige the resident companies to pay ACT and to reclaim it subsequently, to the extent that this does not ensure equivalent full relief from double economic taxation to that provided for domestic-source dividends; and (2) it is contrary to Articles 43 and 56 EC not to provide for the shareholders of the resident companies to receive equivalent relief from double economic taxation which they would have received on a dividend from a resident company which had not itself received dividends from non-resident companies.

— Where prior to 31 December 1993 a Member State adopted the measures outlined in Questions 1 and 2 of the order for reference, and after that date it adopted the further measures outlined in Question 4 of the order for reference, and if the latter measures constitute a restriction prohibited by Article 56 EC, that restriction forms part of provisions that already existed on 31 December 1993, within the meaning of Article 57(1) EC.

— In the absence of Community rules on the recovery of taxes unduly paid, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which taxpayers derive from Community law, including the characterisation of actions brought by the claimants before the national court. However, in exercising such jurisdiction, national courts are obliged to ensure that the claimants have an effective legal remedy in order to obtain reimbursement or reparation of the financial loss which they have sustained as a direct result of tax levied in breach of Community law.