# OPINION OF ADVOCATE GENERAL GEELHOED

delivered on 23 February 2006 [1]

## I — Introduction

1. The principal question raised by the present case, a preliminary reference from the High Court of Justice of England and Wales, Chancery Division, is the compatibility with Articles 43 or 56 EC of the United Kingdom's denial of tax credits to non-UK-resident companies receiving dividends from UK-resident subsidiaries, when it grants such credit to resident companies and to companies resident in certain other Member States pursuant to double taxation conventions ('DTCs'). Put otherwise, in what (if any) circumstances do Article 43 and 56 EC oblige Member States to grant tax credits to recipients of outgoing dividends? [2]

2. The legislative context of this case is the same as that before the Court in a previous case, *Metallgesellschaft*; namely, the United Kingdom's regime of Advance Corporation Tax ('ACT') in force between 1973 and 1999. Although the principal issue in the present case was also raised in that case, the Court expressly found it unnecessary to deal with this issue in view of its answer to the other questions raised. [3]

3. The question whether the Treaty requires Member States in the UK's position to grant tax credits for outgoing dividends is a novel one. As such, it is the latest in a line — the most recent example of which is the important *Marks & Spencer* judgment [4] — enjoining the Court to explore the boundaries of the application of the Treaty free movement provisions in the field of corporate direct taxation, which remains a predominantly Member State competence. This is an area in which the Court, faced with increasingly complicated factual and legisla-

1 — Original language: English.

2 — The inverse situation — the granting of tax credits to recipients of incoming dividends, which was the subject of the Court's recent judgment in Case C-319/02 *Manninen* [2004] ECR I-7477 — is at issue in the parallel case, Case C-446/04 *Test Claimants in the FII Group Litigation* (OJ 2005 C 6, p. 26).

3 — See Joined Cases C-397/98 and C-410/98 *Metallgesellschaft* [2001] ECR I-1727, paragraph 97.

4 — Case C-446/03 *Marks & Spencer* [2005] ECR I-10837.

tive contexts and arguments seeking to test the limits of the Treaty, has developed a substantial body of rather complex case-law. It is also an area where predictability and legal certainty are crucially important, so that Member States can plan their budget and design their corporate tax systems on the basis of relatively reliable revenue predictions. As a result, a truly sound and satisfactory answer to the above question requires consideration of the fundamental framework for analysis of the application of the free movement rules in the direct taxation sphere.

## II — Legal and economic background to the case

### A — *Overview of the context of dividend taxation*

4. Prior to setting out the relevant provisions of the United Kingdom tax regime at issue, it is important to outline the broader framework for taxation of distributed company profits (dividends) within the European Union, 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. [5]

5. 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,

5 — 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).

a shareholder suffers first withholding tax and then income tax, levied by different States, on the same profits.

6. 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.

7. 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 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.[6] 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 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.

8. At the time relevant to the present case, the United Kingdom used an imputation system of dividend taxation.

B — *Relevant UK legislation*

9. 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

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

aim of removing discrimination against distributed profits.[7] As described by the Court in *Metallgesellschaft*, this system essentially functioned as follows.

1. ACT: Liability and set-off

10. Companies resident in the United Kingdom which made certain qualifying distributions, including the payment of dividends to their shareholders, were liable to pay ACT calculated on an amount equal to the amount or value of the distribution made.[8] The sum of the amount of the distribution and the ACT was called a 'franked payment'.[9]

11. The ACT paid could be set off against a company's normal or 'mainstream' corporation tax liability on its profits for the relevant accounting period, subject to a certain limit. Unrelieved ACT, known as 'surplus' ACT, could be carried back or forward to be set off against mainstream corporation tax from other accounting periods.[10] Alternatively, the company could transfer ('surrender') this ACT to its subsidiaries, which could set it off against their own corporation tax liability. The payment of ACT gave rise in certain circumstances to a tax credit in the hands of companies and individual shareholders receiving the distribution.

2. Tax credits: Corporate shareholders

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.[11] Further, the company was entitled to a tax credit equal to the ACT paid by the subsidiary.[12] Together, the dividend and tax credit constituted what was termed 'franked

7 — 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).

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

9 — Section 238(1) TA.

10 — Section 239 TA.

11 — Section 208 TA.

12 — Section 231(1) TA.

investment income'.[13] 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. Such 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.[14] These arrangements were the subject of the Court's judgment in *Metallgesellschaft.*[15]

13. In the case of a non-UK-resident corporate shareholder, such companies were not subject to UK corporation tax, but were in principle chargeable to UK income tax in relation to UK-source income.[16] However, a non-resident company receiving a dividend from a UK-resident company in respect of which it was not entitled to a tax credit was effectively not liable to any UK income tax on the distribution.[17] As under UK legislation a non-resident company was not entitled to a tax credit[18] (in the absence of a DTC providing otherwise), this meant that such a company was not assessable to income tax.

3. Tax credits: Individual shareholders

14. 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.[19] This 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.[20] Non-UK-resident individual shareholders were effectively not liable to pay UK income tax.[21]

13 — Section 238(1) TA.

14 — Section 247 TA.

15 — See footnote 3.

16 — Section 20 TA.

17 — By section 233(1) TA, a non-resident company receiving a dividend from a UK resident company in respect of which it was not entitled to a tax credit was not assessable to UK income tax at the lower rate on the distribution, which was the only rate at which tax was charged. By section 231(1) TA, a non-resident company was not entitled to a tax credit, meaning that, unless it was entitled to a tax credit under a DTC, it was not assessable to UK income tax at the lower rate (the only rate at which tax was charged).

18 — Section 231(1) TA.

19 — Section 231(1) TA

20 — Section 231(1)(3) TA.

21 — Non-resident individual shareholders were not entitled to tax credits, save where the contrary was provided for in the UK's DTC with the relevant country. However, a non-resident individual who was not entitled to a tax credit was treated as having paid UK income tax at the 'lower rate' on the distribution (section 233(1) TA). This had the effect that, unless the individual was entitled to a tax credit under a DTC, no net payment of UK income tax was required.

4. The position under Double Taxation Conventions

15. Certain DTCs concluded between the United Kingdom and other countries conferred, at the relevant time, entitlement to tax credit on non-resident individuals and companies, the terms of which entitlement varied per DTC.

16. An example is the UK-Netherlands DTC, which, in the case of a corporate shareholder resident in the Netherlands, conferred entitlement to a partial tax credit on such a shareholder receiving dividends from a UK subsidiary, if that shareholder either alone or together with one or more associated companies controlled directly or indirectly 10% or more of the voting power in the UK company.[22] In such a case, the dividend was subject to a limited rate of UK income tax. In the case of Netherlands-resident individual or corporate 'portfolio' investors, defined by that DTC as a direct or indirect holding of less than 10%, such investors were entitled to a full tax credit in respect of the UK-source dividend.[23] These investors were also liable to UK income tax, but at a limited rate as stipulated in the convention.

17. In contrast, for example, the United Kingdom-France DTC conferred an entitlement to a tax credit only if the dividend recipient held less than 10% of the voting power in the relevant subsidiary. Other DTCs, such as that concluded between the United Kingdom and Germany, conferred no entitlement to a tax credit.

18. In addition, certain DTCs, such as that concluded between the UK and the Netherlands,[24] contained a so-called 'limitation of benefit' clause, which removed entitlement to tax credit (that would otherwise exist) if a non-resident shareholder were itself owned by a company resident in a country whose DTC with the United Kingdom did not confer a tax credit on companies receiving UK-source dividends. Thus, for example,

22 — Article 10(3)(c) of the UK-Netherlands DTC.

23 — Article 10(3)(b) of the UK-Netherlands DTC.

24 — Article 10(3)(d) of the UK-Netherlands DTC.

Article 10(3)(d)(i) of the UK-Netherlands DTC, in the form relevant to the present case, provided that,

'no tax credit shall be payable where the beneficial owner of the dividends is a company, other than a company whose shares are officially quoted on a Netherlands stock exchange ... unless the company shows that it is not controlled by a person or two or more associated or connected persons together, who or any of whom would not have been entitled to a tax credit if he had been the beneficial owner of the dividends.'

5. 1999 changes

19. For distributions made on or after 6 April 1999, the ACT system was abolished, meaning that companies no longer had to pay or account for ACT on qualifying distributions. [25]

C — *Relevant secondary Community law*

20. 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. [26] Article 5 of the Parent-Subsidiary Directive provides that, where a parent company holds 25% or more of the capital of a subsidiary, profits distributed by that subsidiary to the parent shall be exempt from withholding tax. However, Article 7 specifies that,

'1. The term "withholding tax" as used in this Directive shall not cover an advance payment or prepayment (précompte) of corporation tax to the Member State of the subsidiary which is made in connection with a distribution of profits to its parent company.

2. This Directive shall not affect the application of domestic or agreement-based provisions designed to eliminate or lessen economic double taxation of dividends, in particular provisions relating to the payment of tax credits to the recipients of dividends.'

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

26 — See footnote 5.

## III — Factual background and questions referred

21. The ACT group litigation concerns claims for compensation and/or restitution brought by a number of companies in the High Court of Justice of England and Wales following the Court's judgment in *Metallgesellschaft*, in which the Court held that it was contrary to Article 43 EC for the tax legislation of a Member State (in that case, the UK) to afford a subsidiary resident in that Member State the opportunity to make dividend distributions without having to pay ACT where its parent company was also resident in that Member State ('group income election'), but not where its parent company was resident in another Member State.

22. The ACT group litigation comprises four separate classes of claim and is defined by a Group Litigation Order, which sets out the issues for determination common to the claims. The present case relates to Class IV of the ACT group litigation, to which at the time of reference claimants from 28 company groups were party. Under the supervision of the High Court of Justice, the parties selected five 'test cases' for consideration in this class of the group litigation, four of which are relevant to the present preliminary reference. These test cases concern: (1) Dividends distributed between January 1974 and May 1989 by Pirelli UK PLC, a UK-resident company, to Pirelli & C SpA, an Italian-resident company. Throughout this period, Pirelli SpA owned at least 10% of the issued ordinary shares of Pirelli UK plc; (2) Dividends distributed between September 1979 and December 1998 by UK-resident Essilor Limited to Essilor International SA, resident in France. Essilor Limited was a wholly owned subsidiary of Essilor International SA at the relevant time; (3) Dividends distributed between 1993 and 1994 by BMW (GB) Limited, a UK-resident company, to the Dutch-resident BMW Holding BV. BMW (GB) Limited was at the relevant time wholly owned by BMW Holding BV, which in turn was a direct wholly-owned subsidiary of BMW AG, a German company. BMW Holding BV had, at the relevant time, no shares quoted on the Netherlands Stock Exchange; and (4) Dividends distributed between 1995 and 1998 by the UK-resident Sony United Kingdom Limited to the Netherlands resident Sony Europe Holdings BV, of which Sony United Kingdom Limited was a wholly-owned subsidiary. Sony Europe Holdings BV was ultimately owned by a Japanese-resident company.

23. Following a hearing on June 9, 2004, and with the consent of the Claimants and the Inland Revenue, the High Court of Justice of England and Wales (Chancery Division) decided to stay the proceedings and refer

the following questions to the Court under Article 234 EC:

'(1) Is it contrary to Article 43 EC or 56 EC (having regard to Articles 57 EC and 58 EC) (or their predecessor provisions):

(a) For Member State A (such as the United Kingdom)

(i) to enact and keep in force legislation which confers an entitlement to a full tax credit in respect of dividends paid by companies resident in Member State A ("relevant dividends") to individual shareholders resident in Member State A;

(ii) to give effect to a provision in double taxation conventions concluded with certain other Member States and third countries which confers an entitlement to a full tax credit (less tax as provided for in those conventions) in respect of relevant dividends to individual shareholders resident in those other Member States and third countries; but not to confer an entitlement to any tax credit (whether full or partial) in respect of relevant dividends when paid by a subsidiary resident in Member State A (such as the United Kingdom) to a parent company resident in Member State B (such as Germany) either under domestic provisions or under the terms of the double taxation convention between those States;

(b) For Member State A (such as the United Kingdom) to give effect to a provision in the applicable double taxation convention conferring an entitlement to a partial tax credit in respect of relevant dividends on a parent company resident in Member State C (such as the Netherlands), but not to confer such an entitlement on a parent company resident in Member State B (such as Germany), where there is no provision for a partial tax credit in the double taxation convention between Member State A and Member State B;

(c) For Member State A (such as the United Kingdom) not to confer an entitlement to a partial tax credit in respect of relevant dividends on a company resident in Member State C (such as the Netherlands) which is controlled by a company resident in Member State B (such as Germany) when Member State A gives effect to provisions in double taxation conventions which confer such an entitlement:

(1) on companies resident in Member State C which are controlled by residents of Member State C;

(2) on companies resident in Member State C which are controlled by residents of Member State D (such as Italy) where there is a provision conferring entitlement to a partial tax credit in respect of relevant dividends in the double taxation convention between Member State A and Member State D;

(3) on companies resident in Member State D irrespective of who controls those companies?

(d) Does it make any difference to the answer to Question 1(c) that the company resident in Member State C is controlled not by a company resident in Member State B, but by a company resident in a third country?

(2) If the answer to all or any part of Question 1a) to (c) is in the affirmative, what principles does Community law lay down with regard to the Community rights and remedies available in the circumstances set out in those questions? In particular:

(a) Is Member State A obliged to pay:

(i) The full tax credit or an amount equivalent thereto; or

(ii) The partial tax credit or an amount equivalent thereto; or

(iii) The full or partial tax credit, or an amount equivalent thereto:

1. net of any extra income tax payable or which would have

been payable if the dividend paid to the relevant claimant had attracted a tax credit;

2. net of such tax calculated on some other basis?

(b) To whom should such payment be made:

(i) The relevant parent company in Member State B or Member State C; or

(ii) The relevant subsidiary in Member State A?

(c) Is the right to such payment:

(i) A right to reimbursement of sums unduly levied such that repayment is a consequence of, and an adjunct to, the right conferred by Articles 43 and/or 56; and/or

(ii) A right to compensation or damages such that the conditions for recovery laid down in Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur and Factortame* must be satisfied; and/or

(iii) A right to recover a benefit unduly denied and, if so:

1. is such a right a consequence of, and an adjunct to, the right conferred by Articles 43 and/or 56; or

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

3. must some other conditions be met?

(d) Does it make any difference for the purposes of Question 2(c) above whether as a matter of the domestic law of State A the claims are brought as restitutionary claims or are brought or have to be brought as claims for damages?

(e) In order to recover, is it necessary for the company making the claim to establish that it, or its parent, would have claimed a tax credit (full or partial as the case may be) if it had known that under Community law it was entitled to do so?

(f) Does it make any difference to the answer to Question 2(a) that in accordance with the ruling of the Court of Justice in Joined Cases C-397/98 and C-410/98 *Hoechst and Metallgesellschaft* the relevant subsidiary in Member State A may have been reimbursed or may be entitled in principle to reimbursement of, or in respect of, advance corporation tax in relation to the dividend paid to the relevant parent company in Member State B or Member State C?

(g) What guidance, if any, does the Court of Justice think it appropriate to provide in the present cases 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 Pecheur and Factortame*, in particular as to whether, given the state of the case law on the interpretation of the relevant Community law provisions, the breach was excusable?'

24. In accordance with Article 103(4) of the Rules of Procedure, written submissions were lodged by the Test Claimants, the United Kingdom Government and the Inland Revenue, Ireland and the Commission, as well as by the Finnish, German, the Netherlands, and Italian Governments. An oral hearing was held on 22 November 2005, in which submissions were made by the Test Claimants, the United Kingdom Government and the Inland Revenue, the Commission, Ireland, and the German, French and the Netherlands Governments.

## IV — Analysis

### A — *Question 1(a)*

25. By Question 1(a), the national court essentially asks whether, where a country

such as the United Kingdom grants a full tax credit for dividends paid by UK-resident companies to individual shareholders resident in the UK and, where provided by DTC and subject to tax as provided for in that DTC, in third countries and other Member States, Articles 43 or 56 EC require the UK to extend a full or partial tax credit to outgoing dividends paid by a UK-resident subsidiary to a non-UK-resident parent company.

1. Application of Article 43 EC and/or Article 56 EC

26. As the national court has raised both Articles 43 and 56 EC in its first question, the first issue to be dealt with is which of these Articles applies in the present case. In principle, this is important for two reasons. First, while Article 43 EC applies only to restrictions on the exercise of freedom of establishment between Member States, Article 56 EC also prohibits restrictions on the movement of capital between Member States and third countries. Second, the temporal scope of Article 56 EC is different to that of Article 43 EC: in particular, Article 56 EC entered into force and became directly effective on 1 January 1994, and is subject to a 'standstill' provision (Article 57 EC) as regards third states (although the principle of free movement of capital had already been established by Council Directive 88/361). [27]

27. In my view, the UK legislation at issue in principle may fall within the ambit of either Article 43 or 56 EC, depending on the quality of holding that a given claimant possesses in the relevant UK-resident company. 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. [28] As a result, in the case of non-UK-resident companies whose holdings in UK companies satisfy this criterion, therefore, it is the compatibility of the UK legislation with Article 43 EC that should be assessed.

28. Although the application of this criterion is a matter for the national courts after

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

28 — 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'.

analysis of the circumstances of the claimant company, it is evident from the order for reference that certain of the test cases fall into this category.[29] It bears mention that, although the exercise of this freedom by such companies will also inevitably involve the movement of capital into the UK insofar as this is necessary to establish a subsidiary, in my view this is a purely indirect consequence of the exercise of freedom of establishment. I would refer in this regard to 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'.[30] As a result, Article 43 EC takes priority of application for such companies.

29. In the case of non-UK-resident companies holding an investment in a 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'. 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.[31]

30. 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 would be necessary to consider the compatibility of the UK legislation at issue with both Articles 43 and 56 EC. None the less, in this case the application of each article leads to the same result, and raises similar issues. As a result, although I only expressly consider below the application of Article 43 EC, the same reasoning applies when applying Article 56 EC.

2. Compatibility with Article 43 EC

31. As I observed earlier, this case raises the novel question whether, on the basis of the above national legislative framework, Article 43 EC obliges the UK to grant tax credits for

29 — In particular, test cases (2) to (4). On the basis for the order for reference alone, it is unclear whether one of the test cases — that of Pirelli — satisfies this criterion

30 — Cited in footnote 28 above, paragraph 26. See also, my opinion in Joined Cases C-515/99 and C-527/99 to C-540/99 *Reisch* [2002] ECR I-2157, paragraph 59.

31 — Case C-35/98 *Verkooijen* [2000] ECR I-4071. See also *Manninen*, footnote 2 above, where the point was not explicitly discussed.

outgoing dividends. In my view, this question should be answered in the negative. A clear and comprehensive explanation of why this is so requires a return to the principles underlying the application of the free movement rules in the field of direct taxation.

(a) Application of Article 43 EC to direct tax rules: Introduction

32. The starting point in analysing the scope of Article 43 EC here is to recall that direct taxation is in principle an area of Member State competence. As is well known harmonisation within the sphere is possible only by means of legislation on the basis of Article 94 EC, requiring unanimity of voting in the Council for legislation to be passed,[32] and to date little Community legislation exists in the field.[33]

33. Notwithstanding this, in the classic formulation of the Court, 'although direct taxation falls within their competence, Member States must none the less exercise that competence consistently with Community law'.[34] Evidently, 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. By Article 43(2) EC, freedom of establishment includes the right to set up and manage undertakings in a Member State under the conditions laid down by that State for its own nationals. Pursuant to Article 48 EC, freedom of establishment encompasses the right of companies or firms formed in accordance with the laws of a Member State and having their registered office, central administration or principal place of business within the Community to pursue their activities in the Member State concerned through a subsidiary, branch or agency.[35]

34. The Court has consistently held this prohibition to mean that national tax measures that restrict, or form obstacles to, the exercise of the freedom of establishment infringe Article 43 EC unless that restriction pursues a legitimate objective compatible with the Treaty and is justified by imperative

32 — Article 95(2) EC specifies that Article 95 EC does not apply to fiscal provisions. This Article provides for approximation of laws by the co-decision procedure of Article 251 EC, where qualified majority voting applies.

33 — That which exists does not form, or attempt to form, the basis of any positive coherent Community tax system, but is confined to circumscribed discrete areas of particular relevance to cross-border situations. This is, of course, in stark contrast with indirect taxation, where the Community has constructed a common taxation system based on the 'standing harmonisation order' of Article 93 EC.

34 — See, for example, *Marks & Spencer*, footnote 4 above, paragraph 29, and cases cited therein.

35 — See *Marks & Spencer*, footnote 4 above, paragraph 30, and Case C-307/97 *Saint Gobain* [1999] ECR I-6161, paragraph 34.

reasons in the public interest. In addition, the application of the restriction must be appropriate to ensuring the attainment of the objective pursued and must not go beyond what is necessary to attain it.[36]

35. The Court also frequently uses the language of discrimination in the context of Article 43 EC applied to direct taxation measures. It has consistently held Article 43 EC to prohibit discrimination, whether direct discrimination (i.e., measures differentiating overtly on nationality grounds) and indirect or 'covert' discrimination (i.e., measures equally applicable in law but with a discriminatory effect in fact).[37] In this regard, it has defined the concept of discrimination as the 'application of different rules to comparable situations or ... the application of the same rule to different situations'.[38]

36. Upon rigorous analysis, it is my view that, in the direct taxation sphere, there is no practical difference between these two manners of formulation i.e., 'restriction' and 'discrimination'. What is essential, however, is to distinguish between two senses of the term 'restriction' when dealing with direct taxation rules.

37. The first refers to restrictions resulting inevitably from the co-existence of national tax systems. In accordance with Member State competence for the area in the present state of Community law, direct tax within the EU is governed by co-existing discrete and varied national tax systems. Certain disadvantages for companies active in cross-border situations result directly and inevitably from this juxtaposition of systems, and in particular from: (1) the existence of cumulative administrative compliance burdens for companies active cross-border; (2) the existence of disparities between national tax systems; and (3) the necessity to divide tax jurisdiction, meaning dislocation of tax base. I discuss these in more detail below.

38. It is true that, in a general sense, these consequences may 'restrict' cross-border activity. However, use of the term 'restriction' – although employed in the Court's case-law — is in this context misleading. In reality, at issue here are distortions of economic activity resulting from the fact that different legal systems must exist side-by-side. In certain cases, these distortions provide disadvantages for economic actors; in other cases, advantages. While in the first case they are 'restrictive', in the second case

36 — See, for example, *Marks & Spencer*, footnote 4 above, paragraph 35, *Baars*, footnote 28 above, *Saint Gobain*, footnote 35 above, Case C-264/96 *ICI* [1998] ECR I-4695 and Case C-250/95 *Futura* [1997] ECR I-2471.

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

38 — See *Royal Bank of Scotland*, footnote 37 above, paragraph 26, and cases cited therein.

they stimulate cross-border establishment activity. Although the Court is as a rule faced with what can be termed the 'quasi-restrictions' flowing from these distortions, one should not forget that there is a second side to the coin — that is, where particular advantages arise for cross-border establishment. In the latter case, the taxable subject concerned does not generally invoke Community law.

39. The causes and character of these quasi-restrictions mean that they may only be eliminated through the intervention of the Community legislator, by putting in place a cohesive solution on an EU-wide scale, that is, an EU-wide tax system. In the absence of an EU-wide tax solution, therefore, such quasi-restrictions should be held to fall outside the scope of Article 43 EC. I would add that judicial intervention is, by its nature, casuistic and fragmented. As a result, the Court should be cautious in giving an answer to questions arising before it raising issues of a systematic nature. The legislator is better placed to deal with such questions, in particular when they raise issues of inherent fiscal-economic policy considerations.

40. In contrast, the second sense of restriction refers to what may be termed 'true' restrictions: that is to say, restrictions that go beyond those flowing inevitably from the co-existence of national tax systems, which fall within the scope of Article 43 EC. Indeed, the fact that, as I explain below, the criteria determining direct tax jurisdiction are residence- or source-based means that essentially all 'truly' restrictive national direct tax measures will also, in practice, qualify as directly or indirectly discriminatory measures. [39]

41. I turn now to explore in more detail the distinction between quasi-restrictive and discriminatory measures (subsections (b) and (c) below, respectively).

(b) Inevitable restrictive consequences of the co-existence of national tax systems (Quasi-restrictions)

(i) Greater administrative compliance burden

42. A first consequence of the juxtaposition of separate national tax systems is that each

39 — See further, my analysis of the situations raised in the Court's case-law, section IV(A)(2)(c) below.

system has, from a purely administrative perspective, its own tax authority, its own procedure for submission of tax returns and its own subsequent investigations (where necessary) of those tax returns. As a result, economic operators active in cross-border situations will from the outset be subject to a greater compliance burden than operators active only in one Member State.[40]

(ii) Existence of disparities

43. A second consequence of the co-existence of discrete national tax systems is that disparities, or variations, will exist between these systems. That these disparities are inevitable is evident when one considers that national tax systems are tailored to the specific macroeconomic circumstances existing in that Member State at any given time. In the present state of integration of national economies, these circumstances vary considerably between Member States. For example, a number of important factors of production differ greatly between Member States (e.g., the structure and size of Member States' labour and capital markets). Member States with a large labour force relative to capital may, for instance, choose to place a greater tax burden on labour than capital.

44. Likewise, choices of economic policy may differ substantially between Member States. These choices are reflected in, for example, tax rates: Member States may choose to levy relatively higher tax in order to provide more and better public services, or because they wish to redistribute more income to lower levels of society. Each of these choices is a policy decision central to Member States' direct tax competence. In turn, these choices may be a factor contributing to other differences between national tax systems, such as the approach to relief of economic double taxation — for example, States with relatively lower tax rates may opt for a classical system of double tax relief, while States with higher tax rates may prefer an imputation system.

45. As a result, unless greater integration of national economies occurs within the EU, it is logical that the structure and content of

40 — See the Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, '*Towards an internal market without tax obstacles*', which identifies a large number of tax hindrances to cross-border economic activity in the internal market, concluding that, 'Most of these problems stem from the fact that companies in the EU need to comply with up to [at that time] 15 different sets of rules ...The multiplicity of tax laws, conventions and practices entails substantial compliance costs and represents in itself a barrier to cross-border economic activity.' (COM(2001) 583 final, p. 11).

Member States' direct tax systems, as well as tax rates, will vary greatly.

46. The existence of these disparities has inevitable distortive effects on investment, employment and, in the case of companies and self-employed persons, establishment decisions. Clearly, differences between Member States in levels of effective business taxation, of administrative tax burdens, and in the structure of national tax regimes influence the location of economic activity. However, as the Court has recently confirmed in *Schempp*, and as I emphasised in my Opinion in that case, possible distortions resulting from mere disparities between tax systems do not fall within the scope of the free movement provisions of the Treaty. In that case, which concerned a claim under the citizenship provisions of the Treaty, the Court recalled that, 'the Court has already held that the Treaty offers no guarantee to a citizen of the Union that transferring his activities to a Member State other than that in which he previously resided will be neutral as regards taxation. Given the disparities in the tax legislation of the Member States, such a transfer may be to the citizen's advantage in terms of indirect taxation or not, according to circumstances.'[41] Precisely the same principle applies to claims under Article 43 EC. Thus, obstacles to freedom of establishment resulting from disparities or differences between the tax systems of two or more Member States fall outside the scope of Article 43 EC. These may be contrasted with obstacles resulting from discrimination, which occurs as a result of the rules of just one tax jurisdiction.[42]

47. It bears mention that, although restrictions resulting from disparities do not fall within the scope of the Treaty free movement rules, that is not to say that they fall in principle outwith the scope of the Treaty. Rather, Member States' competence in the direct tax field is subject, in the first place, to harmonisation measures taken under Article 94 EC, and in the second place, to measures taken by the Commission under Article 96 or 97 EC to counteract distortions in the conditions of competition.[43]

41 — Case C-403/03 *Schempp*, judgment of 12 July 2005, paragraph 45. See also point 33 of my Opinion in that case and Case C-365/02 *Lindfors* [2004] ECR I-7183, paragraph 34.

42 — An apt analogy can be made here with social security, a field also based on what are essentially discrete co-existent national systems. While Council Regulation (EEC) No 1408/71 of 14 June 1971 on the application of social security schemes to employed persons and their families moving within the Community, OJ *English Special Edition: Series I Chapter 1971(II) p. 416 (as amended)*, links these systems to a certain extent, it is not the case, as Community law presently stands, that individuals can move between Member States without any repercussions for their social security status.

43 — Indeed, in itself, the existence of disparities may well have a positive effect on Member States' economies and benefit the internal market. With the exception of certain extreme cases — for example, the cases of 'harmful tax competition' — there is a powerful argument that transparent regulatory competition in tax regimes, as in other spheres, gives Member States an incentive to be as efficient as possible in the administration and structure of their tax systems and in the use of their direct tax receipts.

(iii) Division of tax jurisdiction (dislocation of tax base)

48. A third restrictive consequence of the fact that direct tax systems are national is the necessity to divide tax jurisdiction over the income of cross-border economic operators (dislocation of tax base). As with disparities, these restrictions should be distinguished from discrimination, as they result not from the rules of just one tax jurisdiction, but from the co-existence of two separate tax jurisdictions (i.e., no one tax jurisdiction is to blame for the tax disadvantage). However, unlike disparities, they would continue to exist even if national tax systems were exactly the same in design and content.

49. The nature of this type of restriction can be explained quite simply. Clearly, the co-existence of national tax systems means that, in order to deal with cross-border economic operators, it is necessary to decide how these systems interact. In particular, a State must choose a criterion by which it decides which part of an economic operator's income falls within their tax jurisdiction. In the present state of international tax law, one of the most important methods of dividing tax jurisdiction is based on the distinction between 'home State' (taxation of residents) and 'source State' (taxation of non-residents) taxation. [44]

50. In the case of home State taxation, the State of residence of the taxpayer has in principle tax jurisdiction over its total income ('worldwide' taxation). A principal rationale behind this is that the place where the taxpayer uses most facilities (e.g., public services, social security, infrastructure etc.) is his State of residence. In contrast, in the case of source State taxation, the State of the non-resident has tax jurisdiction only over that part of the non-resident's income that is earned within the source State's territory ('territoriality' taxation). A principal rationale for this is that it is the source State which provides the 'economic opportunity' to earn this income.

51. As a consequence of this way of dividing tax jurisdiction, an economic operator earning foreign-source income may, in the absence of priority rules between the relevant States, be subject to juridical double taxation. Under international tax law, the generally accepted rule of taxation priority is that of 'source country entitlement': that is, priority of taxation right over source country income lies with the source State. Insofar as juridical double taxation is to be relieved,

44 — See the OECD Model Double Taxation Convention on Income and on Capital, with Commentaries to the Articles, OECD, Paris, 1977, as revised.

therefore, this is in principle a matter for the home State, which can choose whether and how it wishes to provide such relief.[45] For example, a State may choose to relieve juridical double taxation unilaterally or by DTC; and using an exemption or credit method.[46] Clearly, therefore, the distinction between residents (home State, worldwide taxation) and non-residents (source State, territorial taxation) is crucial to the current division of tax jurisdiction between States, as reflected in international tax law.

52. Under Community law, the power to choose criteria of, and allocate, tax jurisdiction lies purely with Member States (as governed by international tax law). At present, there are no alternative criteria to be found in Community law, and no basis for laying down any such criteria. The Court has recognised this on a number of occasions. For example, in *Gilly*, after observing that allocating fiscal jurisdiction on the basis of nationality cannot as such be regarded as constituting discrimination, the Court stated that this, 'flows, in the absence of any unifying or harmonising measures adopted in the Community context under, in particular, the second indent of Article [293] of the Treaty, from the contracting parties' competence to define the criteria for allocating their powers of taxation as between themselves, with a view to eliminating double taxation. Nor, in the allocation of fiscal jurisdiction, is it unreasonable for the Member States to base their agreements on international practice and the model convention drawn up by the OECD ...'[47] Similarly, the Court has in numerous cases expressly accepted the compatibility with Community law of the basic distinction between home State (worldwide) and source State (territorial) jurisdiction.[48]

45 — See the OECD Model Double Taxation Convention, footnote 44.

46 — In the case of the exemption method, the taxpayer's state of residence exempts the foreign-source income of its residents, on the basis that this income has already been taxed in the 'source' State (i.e., the State in which the income was earned). In the case of the credit method of avoidance of double taxation, however, taxpayers earning foreign-source income are taxed in their State of residence on their worldwide income, including foreign-source income, but may credit the tax paid in the source State against the home State tax attributable to this foreign-source income.

47 — Case C-336/96 *Gilly* [1998] ECR I-2793, paragraphs 30 and 31. See also, paragraph 24: 'The Member States are competent to determine the criteria for taxation on income and wealth with a view to eliminating double taxation — by means, inter alia, of international agreements — and have concluded many bilateral conventions based, in particular, on the model conventions on income and wealth tax drawn up by the [OECD].'

48 — See, for example, Case C-234/01 *Gerritse* [2003] ECR I-5933, paragraph 45, where the Court recognised that, 'for tax purposes, residence is the connecting factor on which international tax law, in particular the Model Convention of the Organisation for Economic Cooperation and Development (OECD) ..., is as a rule founded for the purpose of allocating powers of taxation between States in situations involving extraneous elements.' See also Case C-376/03 *D* [2005] ECR I-5821, paragraph 28; Case C-385/00 *De Groot* [2000] ECR I-11819, paragraph 93; *Saint-Gobain*, footnote 35 above; *Futura*, footnote 36 above, paragraphs 20 and 21; and Case C-279/93 *Schumacker* [1995] ECR I-225, paragraph 57, in which the Court stated, 'The fact that a Member State does not grant a non resident certain benefits which it grants a resident is not, as a rule, discriminatory, since those two categories of taxpayers are not in a comparable situation'.

53. Notwithstanding this, the Court has held that the distinction between residents and non-residents is not always a sufficient basis for treating taxpayers differently. In *Marks & Spencer*, the Court summarised its position on this point, noting that: '... in tax law, the taxpayers' residence may constitute a factor that might justify national rules involving different treatment for resident and non-resident taxpayers. However, residence is not always a proper factor for distinction. In effect, acceptance of the proposition that the Member State in which a company seeks to establish itself may freely apply to it a different treatment solely by reason of the fact that its registered office is situated in another Member State would deprive Article 43 EC of all meaning ... In each specific situation, it is necessary to consider whether the fact that a tax advantage is available solely to resident taxpayers is based on relevant objective elements apt to justify the difference in treatment ...'.[49]

54. The Court's reasoning in this case shows that, where differences in treatment exist, it will look closely to see if objective reasons exist to justify such different treatment. Put otherwise: 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 this regard, it is important to note that economic actors who make use of their right to freedom of movement are, in principle, familiar with the disparities between the national tax rules that are relevant to them, as well as the relevant attribution of tax jurisdiction on the basis of DTCs. In the light of the above, the question is: To what obligations are Member States subjected by Article 43 EC?

(c) Restrictions falling under Article 43 EC

55. To repeat, where a restriction on freedom of establishment results purely from the co-existence of national tax administrations, disparities between national tax systems, or the division of tax jurisdiction between two tax systems (a quasi-restriction), this should not fall within the scope of Article 43 EC. In contrast, 'true' restrictions, that is to say, restrictions to free movement of establishment going beyond those resulting inevitably from the existence of national tax systems, fall under the Article 43 EC prohibition unless justified. In the terminology used

49 — *Marks & Spencer*, footnote 4 above, paragraphs 37 and 38.

above, in order to fall under Article 43 EC, disadvantageous tax treatment should follow from discrimination resulting from the rules of one jurisdiction, not disparity or division of tax jurisdiction between (two or more) Member States' tax systems.

56. As I recalled above, the Court has held that discrimination consists in the 'application of different rules to comparable situations or in the application of the same rule to different situations'.[50]

57. In my view, it follows as a consequence of the method of dividing tax jurisdiction adopted by Member States — that is, the distinction between worldwide (home State) and territorial (source State) tax jurisdiction — that the concept of discrimination applies in different ways to States acting in home State and source State capacity. Quite simply, as the nature of the tax jurisdiction being exercised in each case differs fundamentally, an economic operator subject to home State jurisdiction cannot per se be considered to be in a comparable situation to an economic operator subject to source State jurisdiction, and vice versa. As a result, Article 43 EC imposes two different categories of obligation on a State, depending upon the jurisdictional capacity in which it is acting in a particular case.

(i) Article 43 EC home state obligations

58. The central obligation imposed on States exercising home State jurisdiction is, in essence, to 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. This principle has been illustrated in the Court's case-law. Thus, in the case of corporate income taxation for example, the Court has held that:

— Insofar as it chooses to relieve economic double taxation on its residents' dividends, a home State, with tax jurisdiction over the worldwide income of its residents, must provide the same relief for incoming foreign-source dividends as for domestic dividends, and must

50 — *Royal Bank of Scotland*, footnote 37 above, paragraph 26, and cases cited therein.

take foreign corporation tax paid into account for this purpose. [51]

— Similarly, where a home State offers the possibility to offset domestic losses against domestic prior or future profits, this possibility cannot be denied on the sole ground that the relevant company also earns foreign-source income. [52]

— In addition, where a State makes group income relief from the obligation to pay ACT available to domestic subsidiaries distributing profits to domestic parents, it must extend this possibility to domestic subsidiaries distributing profits to foreign parents, which subsidiaries would otherwise be subject to ACT. [53]

59. Conversely, in *Marks & Spencer*, the Court held that, in principle, insofar as a Member State does not exercise tax jurisdiction over a non-resident subsidiary of a resident parent company, then it does not have to give loss relief. [54] Put otherwise, if a home State has divided its tax base so that it does not exercise tax jurisdiction over a foreign subsidiary of one of its corporate residents, it is in principle consistent for that State to refuse to take into account deductions relating to that foreign-source income in assessing its resident's tax.

60. As regards individual income taxation, the Court's case-law has in principle recognised the international tax law rule that it is for home States, in accordance with their worldwide tax jurisdiction, to take full account of the personal circumstances of a worker or entrepreneur, [55] unless and to the

51 — See *Manninen*, footnote 2 above (tax credit granted for domestic dividends must also be given for foreign-source dividends); *Verkooijen*, footnote 31 above (home State must grant same exemption from individual income tax on foreign-source dividends as grants to domestic dividends), Case C-315/02 *Lenz* [2004] ECR I-7063 (option for income tax treatment available for domestic dividends must be extended to foreign-source dividends). See also C-334/02 *Commission* v *France* (fixed levy) [2004] ECR I-2229 (benefit of low rate final withholding tax was restricted to proceeds from debt claims paid by resident debtors only; a similar benefit should be granted to beneficiaries of payments by foreign debtors) and the Opinion of Advocate General Tizzano of 10 November 2005 in Case C-292/04 *Meilicke*, pending before the Court.

52 — Case C-141/99 *AMIB* [2000] ECR I-11619, Case C-431/01 *Mertens* [2002] ECR I-7073 (domestic company required to offset domestic losses against foreign profits); *ICI*, footnote 36 above (domestic loss relief conditional on question whether domestic company had foreign subsidiaries).

53 — *Metallgesellschaft*, footnote 3 above.

54 — *Marks & Spencer*, footnote 4 above, paragraph 46. The Court justified this on the basis, inter alia, that companies cannot have an option to choose tax jurisdiction from free movement provisions, as this would jeopardise a balanced allocation of tax jurisdiction.

55 — For example, tax-free basic amounts, splitting income options for married couples, or deduction of maintenance payments.

extent that the source State has taken these into account (e.g., under the provisions of a DTC).[56] Further, investment incentives accorded to residents investing domestically must also be accorded for cross-border investments.[57]

61. Finally, although a home State may validly require taxpayers seeking permanently to leave its jurisdiction to settle their tax position (exit taxation, levied for example, on unrealised capital gains), it cannot impose such exit taxes in a manner that is disproportionate to the necessity of securing fiscal coherence or avoiding abuse.[58]

62. As regards home State obligations in the field of corporate income taxation, I should like to add a brief comment on the Court's judgment in *Bosal*.[59] In that case, the Court held contrary to Article 43 EC a Dutch rule by which Dutch-resident parent companies could only deduct costs relating to a subsidiary if that subsidiary was taxable in the Netherlands, or if its costs were indirectly instrumental in the making of profits taxable in the Netherlands. The Court used an essentially three-step reasoning in reaching this conclusion. First, after concluding that the Dutch limitation on deductibility of costs was in principle compatible with the Parent-Subsidiary Directive,[60] the Court observed that such a limitation 'might dissuade' a (Dutch) parent company from carrying on its activities via a subsidiary established in another Member State, and so constituted a hindrance to the establishment of subsidiaries within the meaning of Article 43 EC. Second, the Court rejected the possibility that the rule could be justified on so-called 'fiscal cohesion' grounds (i.e., the need to preserve the coherence of the Dutch tax system). It reasoned that no 'direct link' existed in the present case between the granting of a tax advantage — the right of a parent company to deduct costs connected with holdings in the capital of their subsidiaries — and the liability to tax of its subsidiary. In this regard, the Court cited its judgment in *Baars*[61] that no direct link could be found to exist when dealing with different taxes or the tax treatment of different taxpayers. Third, the Court dismissed the argument that, because of the territoriality principle, the situations of a Dutch parent company with Dutch-taxable subsidiaries, and a Dutch parent company with non-Dutch taxable subsidiaries, could not be considered 'comparable' for Article 43 EC purposes. On this point, the Court confined itself to citing its judgment in

56 — See, for example, *De Groot*, footnote 48 above, paragraphs 99 and 100, Case C-391/97 *Gschwind* [1999] ECR I-5451, paragraph 22; and Case C-107/94 *Asscher* [1996] ECR I-3089, paragraph 44. The generally accepted reason for this is that the home State, which taxes worldwide income, is in a better position to obtain information on these circumstances. See also the so-called *Schumacker* exception to this principle, discussed below.

57 — Case C-484/93 *Svensson* [1995] ECR I-3955, and *Verkooijen*, footnote 31 above.

58 — Case C-9/02 *De Lasteyrie de Saillant* [2004] ECR I-2409.

59 — Case C-168/01 *Bosal* [2003] ECR I-9409.

60 — By virtue of Article 4(2) of the Parent-Subsidiary Directive.

61 — See footnote 28 above.

*Metallgesellschaft*[62] and observing that, while the application of the territoriality principle in its *Futura*[63] judgment concerned the taxation of a single company (active in another Member State via a branch), the present case concerned the taxation of parent and subsidiary (i.e., two legal persons, taxable separately).

63. With respect, this judgment did not, in my view, accord sufficient recognition to the Member States' division of tax jurisdiction in that case. I refer in particular to the Court's finding that the comparability criterion was satisfied. It is in my view crucial to the analysis that the Netherlands exempt from taxation all profits coming 'inward' from non-domestic subsidiaries. That is to say, the division of tax jurisdiction between the Netherlands and the Member States of residence of the subsidiaries was such that jurisdiction to tax the foreign subsidiaries' profit fell solely to the latter — the source State. As a result, it would seem to me to be wholly consistent with this division of jurisdiction for the Netherlands to allocate those charges paid by the Dutch parent which were attributable to the exempted profits of the foreign subsidiaries, to the Member State of the subsidiaries. In other terms, it would seem clear that the position of a domestic parent company with a subsidiary whose profits are taxable in that Member State, on the one hand, and such a parent company with a subsidiary whose profits are not taxable (exempt) in that Member State, on the other hand, are not comparable. In sum, this would appear to be a classic example of a difference in treatment resulting directly from dislocation of tax base. It seems to me that the result of the Court's judgment was to override the Member States' choice of division of tax jurisdiction and priority of taxation — which choice, as I observed above, lies solely within Member States' competence.

64. I would add that, in principle, the result of the *Bosal* judgment also means that the (same) charges could equally be deducted in the Member State of the subsidiary. While it can be presumed that the Court would not have intended to allow 'double relief', its judgment gives no indication which of the two States — that of the parent company or the subsidiary — should have priority of taxation in this cost deduction. Indeed, this was the second question referred by the Hoge Raad in that case, to which the Court did not explicitly respond. Suffice to say, as I observed above, that Community law does

62 — See footnote 3 above.

63 — See footnote 36 above.

not contain any basis for allocating such jurisdiction and priority.[64]

65. As a separate point, it is important to note that in *Marks & Spencer*, the Court added a caveat — as regards corporate income taxation — to the principle that home States are obliged to treat foreign-source income of their residents consistently with the way they have divided their tax base. The Court held that, in exceptional circumstances, where there is absolutely no possibility for subsidiaries resident in another Member State to set off their losses, a home State must extend domestic group relief to such losses, despite the fact that the home State does not otherwise exercise any tax jurisdiction over those subsidiaries.[65] It explained this caveat on the basis that to deny group loss relief in such circumstances, would go 'beyond what is necessary to attain the essential part' of the objective of achieving a balanced allocation of tax jurisdiction.[66] Whatever the ratio decidendi of the caveat may be, I submit that it should be applied extremely restrictively. It functions asymmetrically by, on the one hand, offering relief in cases where applying a source State's tax regulations results in losses for subsidiaries while, on the other hand, leaving extraordinary profits earned by subsidiaries operating in a more advantageous tax regime untaxed in the home State. The final result may be that, by virtue of this caveat, the Court has introduced an additional disparity in the interrelation between national tax systems, thereby further distorting the exercise of the freedom of establishment and free movement of capital within the Community. To put it somewhat differently, I see no reason why companies which decide to relocate their activities to another Member State, in full knowledge of the local tax legislation, should be awarded highly selective and distortional tax relief in the home State in the circumstance where their source State activities incur losses that cannot be offset in the latter State.

(ii) Article 43 EC source State obligations

66. As source States have tax jurisdiction only over the income that is earned by the non-resident within the source State's jurisdiction, they are subject to a more limited obligation under Article 43 EC. In essence,

64 — I would add that I find it difficult to see the relevance of the *Metallgesellschaft* judgment (footnote 3 above) to the situation in *Bosal* (footnote 59 above). In that case, the Court essentially held that groups of companies with a foreign parent company cannot be denied the benefit of a group income election scheme available to groups of companies with a domestic parent company, under which scheme UK subsidiaries did not have to pay otherwise applicable ACT on the dividends they pay to their parent companies. In that case, jurisdiction to tax the profits of UK subsidiaries fell in principle to the UK, and thus the UK was obliged in exercising this jurisdiction to grant the same benefits to all UK-resident subsidiaries, irrespective of location of their parent companies. In that sense, the case could be seen as the inverse of the situation in *Bosal*, where the Netherlands, as parent company home State, had chosen to exercise no tax jurisdiction over non-resident subsidiaries' profits.

65 — See footnote 4 above, paragraphs 55 and 56.

66 — Ibid.

this can be expressed as an obligation to treat all non-residents in a comparable way to residents (non-discrimination), insofar as these non-residents fall within their tax jurisdiction — i.e., subject to the difference in the extent of their tax jurisdiction over residents and non-residents.

67. In the case of corporate income taxation, this obligation has been applied to mean, for example, that:

— Tax benefits accorded to resident companies — including those granted pursuant to DTCs [67] — must be accorded in the same way to branches (permanent establishments) of non-resident companies if these branches are otherwise subject to corporation tax in the same way as resident companies. [68] Thus, for example, branches of non-resident companies are entitled to the same imputation credits for dividends received if they are taxed on these dividends in the same way as resident companies. [69]

— In addition, insofar as a source State exercises tax jurisdiction over a foreign branch, it cannot impose a higher corporate tax rate on this branch than applied to its own resident companies. [70]

— Nor can a source State subject only outgoing interest repayments on a loan to a resident subsidiary from a controlling non-resident shareholder to, e.g., minimum capitalisation requirements (thin capitalisation rules), while not subjecting domestic repayments to any such requirement, unless such a requirement is justified. [71]

— Conversely, the Court has held that the fact that, for the purpose of calculating the basis of assessment to tax for non-resident taxpayers, a source State only takes into account profits and losses arising from their activities in that State — and not, for example, losses arising in their home State — is in no way prohibited by the Treaty. [72]

67 — *Saint Gobain*, footnote 35 above.

68 — Case C-270/83 *Commission* v *France* ('Avoir Fiscal') [1986] ECR 273, Case C-330/91 *Commerzbank* [1993] ECR I-4017 (branch of non-resident company entitled to same interest on repayment of overpaid taxes), *Futura*, footnote 36 above (branch of non-resident company entitled to same loss carry-over possibilities).

69 — *Avoir Fiscal*, footnote 68 above.

70 — *Royal Bank of Scotland*, footnote 37 above.

71 — Case C-324/00 *Lankhorst-Hohorst* [2002] ECR I-11779, and see the pending reference in Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* (OJ 2005 C 57, p. 20).

72 — *Futura*, footnote 36 above, paragraph 21.

— Further, source States should not impose disproportionately heavy administrative or accounting requirements on foreign companies active within their territory (i.e., requirements that go beyond what results from the fact that tax administrations are national), including where compliance with these requirements is necessary to avail of a tax benefit relating to source State income. [73]

68. In the case of individual income taxation, this principle means that, for example,

— Source States may not distinguish between residents and non-residents in the case of income-related deductions from individual income tax — that is to say, deductions that are 'directly linked' [74] to the activity that generated the taxable income in the source State (e.g., business expenses). [75] In this regard, the effect of the different rules, and not their form, is decisive. [76] This includes, as the Court has recently held in *Bouanich*, the effect of any relevant DTCs on the situation in point. [77] In contrast, source States may in principle refuse to grant non-residents person-related benefits granted to residents as, under international tax law, it is for the home State to take personal circumstances into account in individual income taxation. [78]

— The Court has, however, laid down an exception to this principle, namely, a source State may be required to 'act' as a home State in taking personal circumstances into account, where over 90% of an individual's income is earned and subject to tax in the source State. [79] The reason for this exception is to avoid a situation where, in cases where a taxpayer earns insufficient income in his home State for it to take account of his personal circumstances, these circumstances are not taken into account anywhere. Whatever the appropriate percentage threshold may be for applic-

73 — Case C-118/96 *Safir* [1998] ECR I-1897; *Futura*, footnote 36 above.

74 — *Gerritse*, footnote 48 above, paragraph 27.

75 — *Gerritse*, footnote 48 above; *Schumacker*, footnote 48 above. See also, *Asscher*, footnote 52 above (no higher tax scale for non-residents) and Case C-80/94 *Wielockx* [1995] ECR I-2493 (source States must allow deduction of pension contributions by non-residents from income earned within their territory in the same way as residents, unless the fiscal cohesion defence applies).

76 — *Gerritse*, footnote 48 above, paragraph 54.

77 — Case C-265/04 *Bouanich* [2006] ECR I-923, paragraphs 51 to 55.

78 — See, for example, *D*, footnote 48 above, paragraph 38 (as regards wealth tax).

79 — *Schumacker*, footnote 48 above; *D*, footnote 48 above, paragraph 30; Case C-169/03 *Wallentin* [2004] ECR I-6443; *Wielockx*, footnote 75 above, paragraph 22; and *Gschwind*, footnote 56 above.

ability of the exception, it is in my view decisive that the taxpayer's personal circumstances could not otherwise be taken into account. [80]

69. A further application of the source State non-discrimination obligation is that, insofar as a source State chooses to relieve domestic economic double taxation for its residents (for example, in taxation of dividends), it must extend this relief to non-residents to the extent that similar domestic double economic taxation results from the exercise of its tax jurisdiction over these non-residents (for example, where the source State subjects company profits first to corporation tax and then to income tax upon distribution). This follows from the principle that tax benefits granted by the source State to non-residents should equal those granted to residents insofar as the source State otherwise exercises equal tax jurisdiction over both groups. [81]

70. It is none the less in my view open to a Member State to ensure the fulfilment of its obligations under the Treaty free movement provisions by means of provisions contained in a DTC. Thus, taking the example of a source State imposing domestic economic double taxation on its non-residents in the same way as on its residents, it is in my view open to that source State to ensure that its non-residents receive the same double taxation relief as its residents by virtue of a DTC. In such a situation, however, the extent of double taxation relief granted to non-residents must be equivalent to that granted to residents. In this regard, I would concur with the approach taken by the Court in its judgment in *Bouanich* holding that, in a case where a State exercised the same tax jurisdiction over its non-resident shareholders as over its resident shareholders, it was for the national court to assess whether, taking the applicable DTC into account, residents were treated more favourably than non-residents. [82]

71. Appreciation of Member States' compliance with the Treaty free movement obligations should, in my opinion, take into account the effect of DTCs for two reasons. First, as I observed above, the Member States are free to apportion between themselves not

80 — See, for example, *Gschwind*, footnote 56 above, paragraph 29; *de Groot*, footnote 48 above, paragraph 101. The exceptional obligation for the source State to take personal circumstances into account also applies as regards wealth tax, as another direct tax based on the taxpayer's ability to pay: *D*, footnote 48 above, paragraphs 31-34. See also, Advocate General Léger's Opinion of 1 March 2005 in Case C-152/03 *Ritter-Coulais* [2006] ECR I-1711, which advocates extending this exception beyond 'typical' person-related benefits, to the right to deduct rental income losses made in the home State.

81 — See cases cited in footnotes 67 and 68 above.

82 — See footnote 77 above, paragraph 51.

only tax jurisdiction but also priority to taxation. Thus, in the example given above, it is open to the source State which imposes double economic taxation on dividends to ensure, by DTC, that this will be relieved by the home State. Second, if the effect of the DTC in an individual case were not taken into account, this would ignore the economic reality of that taxable subject's activity and incentives in a cross-border context. Put otherwise, it could distort the real effect on that taxpayer of the combination of home and source State obligations. I would emphasise that, in such a scenario, it would form part of the source State's Treaty obligations to ensure that this result has been achieved. It would be no defence, for example, to argue that the home State had been in breach of its DTC obligations by failing to relieve the relevant economic double taxation. [83]

72. As a more general point, in my view the combination of home State and source State obligations under the free movement provisions should properly be seen as a whole, or as achieving a type of equilibrium. Examination of the situation of an individual economic operator in the framework of just one of these States — without taking into account the Article 43 EC obligations of the other State — may give an unbalanced and misleading impression, and may fail to capture the economic reality in which that operator is acting.

73. I would add as a final point that, of course, even if a Member State's tax rule falls in principle within the scope of the Article 43 EC prohibition (i.e., amounts to discrimination or a 'true' restriction), it is subject to potential justification on grounds, for example, of the need to ensure fiscal cohesion of national tax systems [84] and the need to prevent abuse of law. [85]

83 — I note on this point that a different approach was taken by the EFTA Court in its Fokus Bank judgment (Case E-1/04 *Fokus Bank* v *The Norwegian State*, judgment of 23 November 2004). That case raised, inter alia, the compatibility with the free movement of capital (Article 40 of the EEA Agreement, equivalent to Article 56 EC) of Norwegian rules whereby Norway subjected company profits first to corporation tax and upon distribution (1) in the case of residents, income tax. However, a full imputation tax credit was granted to resident shareholders to relieve economic double taxation of dividends; (2) in the case of non-residents, 15% withholding tax. However, by the relevant DTC in that case, this 15% was credited against tax imposed in the home State. In holding this rule to infringe the principle of free movement of capital, the EFTA Court equated taxation of outbound dividends (source State taxation) with inbound dividends (home State taxation), relying on the Court's judgments in *Lenz* and *Manninen* (paragraph 30), and reasoned that that a source State could in principle not rely on the provisions of a DTC to remedy economic double taxation caused by that source State (paragraph 37). For the reasons explained above, I do not concur with this analysis.

84 — Case C-204/90 *Bachmann* [1992] ECR I-249.

85 — See, for example, *Lankhorst-Hohorst*, footnote 71 above; *ICI*, footnote 36 above.

(d) Application of these principles to the present case

74. The present question asks whether the fact that the UK granted no imputation tax credit for 'outgoing' dividends paid by a UK-resident subsidiary to a non-UK-resident parent company, restricts the latter's freedom to establish a subsidiary in the UK, given that the UK granted a full tax credit for dividends paid by UK-resident companies to individual shareholders resident in the UK and, where provided by DTC (subject to tax as provided for in that DTC), to third countries and other Member States.

75. In order to respond to this question, it is necessary in the first place to make a clarification. The issue to be decided here is not whether the UK ought to have given the same tax credit as it granted to UK parent companies of UK subsidiaries, to non-UK parent companies of UK subsidiaries. That is to say, it does not concern the grant to a UK corporate shareholder of a tax credit equal to the ACT paid by its UK subsidiary (i.e., the first 'level' of economic double taxation relief in the UK system). Rather, the Test Claimants argue that the individual shareholders of non-UK parent companies should have received the same imputation tax credit as the individual shareholders of UK parent companies. The question thus concerns the grant to an individual shareholder of a UK company of an imputation credit for corporation tax already paid on the dividend, which could be set off against their UK income tax liability or paid to them in cash if the credit exceeded this liability (i.e., the second 'level' of economic double taxation relief in the UK system).

76. Put otherwise, the Test Claimants argue that individual shareholders of a non-UK-resident parent company — who received no UK imputation credit (save under certain DTCs) — should be entitled to the same tax credit for UK corporation tax paid on profits earned by UK subsidiaries, as individual shareholders of a UK-resident parent company — who received a UK imputation credit

effectively neutralising their liability to UK income tax. As such, the argument is based on a comparison of resident and non-resident parent companies by reference to the UK tax treatment of their individual shareholders.

77. The Test Claimants contend that this difference in treatment of individual shareholders places non-UK parent companies with a UK subsidiary at a disadvantage in comparison to UK parent companies with a UK subsidiary. They argue that, while the UK system ensures a lower aggregate tax burden on profits distributed via a UK parent company through the elimination or reduction of economic double taxation, it offers no such assurance to (UK-source) profits distributed via a non-UK parent company. In their contention, this could make investing in a UK parent company more attractive than in a non-UK parent company, in the absence of 'enhancement' of the dividend by the parent company to compensate for a higher overall tax burden in the latter case. This disadvantage for non-UK parent companies could in turn, they argue, deter a non-UK parent company from establishing a subsidiary in the UK.

78. It is true that, depending on the tax system of the country of residence of the non-UK parent company, [86] it is conceivable that the aggregate tax burden on profits distributed from a UK subsidiary via a non-UK parent company could potentially be greater than the aggregate tax burden on profits distributed from a UK subsidiary via a UK parent company.

79. The relevant question for the present analysis is, however, whether this potential disadvantage for non-UK parent companies is caused by UK rules amounting to a true restriction of freedom of establishment within the meaning of Article 43 EC.

80. It is to my eyes clear that this is not the case. Such a disadvantage, in cases where it arose, would be a consummate example of what I have termed above a quasi-restriction, resulting from disparities and the division of tax jurisdiction between national tax systems. It would not result from any discriminatory application by the UK of its own tax rules to tax subjects falling within its jurisdiction. On the one hand, in the case of profits distributed from a UK subsidiary

86 — For example, if the State had chosen not (fully) to relieve economic double taxation of dividends, then the overall tax burden on distributed profits from a UK subsidiary to its non-UK parent company would be greater than the burden on distributed profits from a UK subsidiary to a UK parent company.

via a UK parent company to UK-resident individual shareholders, the UK exercises home State (worldwide) tax jurisdiction at each of these three stages. In exercise of this jurisdiction, the UK has, as I already described, chosen to relieve double economic taxation on the distribution of subsidiary profits by (a) granting a tax credit to the UK parent company to ensure that ACT is only paid once on these profits and (b) granting an imputation tax credit to the UK-resident shareholder that relieves all or part of his liability to UK income tax. On the other hand, in the case of profits distributed by a UK subsidiary via a non-UK parent company to an individual shareholder, the UK in principle exercised source State (territorial) jurisdiction.

81. This difference in quality of tax jurisdiction results from the manner in which States have chosen to allocate (divide) taxation power, in the exercise of their competence and as accepted by international tax law.

82. In the latter case, the UK in fact levied tax only once on the UK-source profits: that is, in the form of ACT levied on the UK subsidiary upon the distribution of profits. The effect of the UK system was that outgoing dividends were not, unless they gave rise to a UK tax credit, subject to a second level of UK taxation in the form of income tax.

83. As a result, insofar as they came within the UK's tax jurisdiction, outgoing dividends were treated in precisely the same way as domestic dividends. In the first place, the payment of each gave rise to ACT liability. In the case of domestic dividends, UK income tax was in principle levied in the hands of the shareholder. An imputation credit was granted by the UK, which extinguished all or part of this income tax liability. In the case of outgoing dividends, however, in the absence of a DTC providing otherwise, no UK income tax was levied. There was therefore no UK income tax liability to extinguish with an imputation credit.

84. In sum, the extent of the UK's tax jurisdiction over such dividends was jurisdiction to levy ACT, which jurisdiction it exercised in a non-discriminatory manner and thus in conformity with its obligations under Article 43 EC.

85. True, it is possible that such UK-source profits could be subject to taxation once again in the State of residence of the non-UK

parent company (double economic taxation), and in the State of residence of the individual shareholder (triple economic taxation). As discussed above, however, the rules of taxation priority accepted in international tax law hold that, in principle, the UK enjoys taxation priority over UK-source profits.

86. In contrast, it is, for example, open to the State of residence of the non-UK parent company to relieve economic double taxation on these UK-source profits if it so wishes. In exercising this home State jurisdiction, this State is, as I have observed, under an Article 43 EC obligation not to discriminate between this foreign-source income and domestic income. Likewise, at the individual shareholder level, it is, in accordance with the Court's judgment in *Manninen*,[87] for the State of residence of the shareholder to relieve, if it so chooses, economic double (or triple) taxation of dividends received. As observed, in exercising this jurisdiction, this State is obliged by Article 43 EC not to discriminate between foreign- and domestic-source income. Insofar as any individual shareholders of the non-UK parent companies in the present case are resident in the UK, the UK is of course, in accordance with *Manninen*, subject to this non-discrimination obligation. This has not been disputed and is not the subject of the present reference.

87. None the less, in the case of outgoing dividends governed by a DTC, it is clear from the information before the Court in the present case that in certain cases the UK retained under its DTCs a right to subject these dividends to (limited) UK income tax. Similarly, in certain cases, the individual shareholder recipient was entitled to a full or partial tax credit. In the UK's submission, a direct link exists between the UK income tax rate imposed on such dividends and the (extent of) entitlement to tax credit.

88. In this regard, I would repeat that, as I explained above, the nature of the UK's obligation, acting as source State as regards outgoing dividends, is, insofar as it exercises tax jurisdiction over non-residents' income, to treat it in a comparable way to residents' income. In other terms, to the extent that the UK exercises jurisdiction to levy UK income tax on dividends distributed to non-residents, it must ensure that these non-residents receive equivalent treatment — including tax benefits — as residents subject to the same UK income tax jurisdiction

87 — See footnote 2 above.

would receive. Put otherwise, the extent of the UK's obligation should respect the division of jurisdiction and tax base arrived at in the applicable bilateral DTC. As held by the Court in *Bouanich*, it is for the national court to decide, in each case and depending on the terms of the relevant DTC, whether this obligation has been complied with. [88]

89. I would add that where the UK can show that the relevant DTC itself provides that it is for the State of residence of the corporate or individual shareholder to relieve the economic double taxation resulting from the imposition of ACT and UK income tax, this is in my view sufficient to discharge its Article 43 EC obligations. Again, as I observed above, this follows from Member States' freedom to apportion tax jurisdiction and priority between themselves, as well as the need to take account of the cross-border economic reality in which the taxpayer is operating. As I have already stated, it would form part of the UK's Article 43 EC obligation to ensure that this result has been achieved, and would be no defence to argue that the home State had been in breach of its DTC obligations by failing to relieve the relevant economic double taxation.

90. As noted, this reasoning applies equally, and leads to the same conclusion, in analysing the UK legislation at issue for compatibility with Article 56 EC.

91. For these reasons, the answer to Question 1(a) should be that where, under legislation such as that at issue in the present case, the UK grants a full tax credit for dividends paid by UK-resident companies to UK-resident individual shareholders, it is not required by Article 43 or 56 EC to extend a full or partial tax credit to outgoing dividends paid by a UK-resident subsidiary to a non-UK-resident parent company where these dividends are not subject to UK income tax. However, to the extent that, pursuant to a DTC, the UK exercises jurisdiction to levy UK income tax on dividends distributed to non-residents, it must ensure that these non-residents receive equivalent treatment — including tax bene-

88 — See *Bouanich*, footnote 77 above, paragraphs 54 and 55.

fits — as residents subject to the same UK income tax jurisdiction would receive.

B — *Question 1(b)*

92. By Question 1(b), the national court asks whether it is contrary to Article 43 or 56 EC for a Member State such as the United Kingdom to give effect to a provision in a DTC conferring an entitlement to a partial tax credit in respect of relevant dividends on a parent company resident in a particular Member State (such as the Netherlands), but not to confer such an entitlement on a parent company resident in another Member State (such as Germany), where there is no provision for a partial tax credit in the DTC between the UK and Germany.

93. This question essentially raises the issue whether the Treaty free movement provisions, and in particular the principle of non-discrimination, oblige Member States to extend benefits granted to residents of one Member State under a DTC, to residents of other Member States: that is to say, whether a State in the UK's position is obliged to extend 'Most Favoured Nation' treatment to residents of other Member States.

94. The issue has most recently been dealt with by the Court in its judgment in the *D* case.[89] That case concerned a German resident — Mr D — 10% of whose wealth consisted of real property situated in the Netherlands. The Netherlands subjected this 10% to wealth tax, but refused to grant Mr D the wealth tax allowance to which Dutch residents and, pursuant to the Belgium-Netherlands DTC, Belgian residents were entitled. Mr D argued, inter alia, that the fact that the Netherlands treated Belgian and German residents differently in this regard amounted to unlawful discrimination contrary to Article 56 EC, and that on this basis the Netherlands should award him a similar allowance. In rejecting this argument, the Court held that the situation of non-residents covered by a DTC, and those not covered by that DTC, are not comparable. Thus there could be no question of discrimination between these two groups of taxpayers. In reaching this conclusion, the Court made three principal observations. First, the Belgium-Netherlands DTC represented an allocation of powers of taxation between these two Member States.[90] Second, it was an 'an inherent consequence of bilateral double taxation conventions' that the 'reciprocal rights and obligations' contained in these DTCs applied only to persons resident in one of the two Contracting

89 — See footnote 48 above.

90 — *D*, footnote 48 above, paragraph 60.

Member States. Third, a reciprocal rule such as, in that case, the provision granting the Netherlands wealth tax allowance to Belgian residents, could not be regarded as a benefit separable from the remainder of the Belgium-Netherlands DTC, but formed 'an integral part thereof' and contributed to its 'overall balance'.

95. This reasoning, with which I respectfully concur, applies with equal force to the situation raised in the present question. In the example posited by the national court, the position of a Netherlands parent company receiving a partial tax credit from the UK under the Netherlands-UK DTC cannot properly be compared with that of a German parent company, which receives no tax credit. I would emphasise, as the Court did in *D*, that each DTC contains a specific allocation of tax jurisdiction and priority of taxation between the Contracting States.[91] This allocation represents an overall balance negotiated as a whole, and on a reciprocal footing, on the basis of the particular features of the two national tax systems and economies at issue, pursuant to Member States' competence and as expressly provided for by Article 293 EC. The differences in equilibrium arrived at in such bilateral negotiations reflect the diversity of national tax systems and economic circumstances — including, as I noted above, within the EU. It follows that non-residents subject to different balances of tax jurisdiction and priority rules arrived at in different DTCs, cannot be considered to be in comparable situations. As I discussed above, differences in treatments flowing purely from Member States' division of tax jurisdiction or choice of priority rules do not fall within the scope of Article 43 or 56 EC. Rather, the extent of a source State's obligations as regards non-residents is, insofar as it exercises tax jurisdiction, to treat them in a comparable manner to residents.

96. For this reason, the answer to Question 1(b) should in my opinion be that it is not contrary to Article 43 or 56 EC for a Member State such as the United Kingdom to give effect to a provision in a DTC conferring an entitlement to a partial tax credit in respect of relevant dividends on a parent company resident in a particular Member State (such

91 — See by analogy, the comment of Advocate General Ruiz-Jarabo Colomer in *Gilly*, footnote 47 above, 'The object of a bilateral double taxation convention is to prevent income which is taxed in one State from being taxed again in the other. The object is not, therefore, to ensure that the tax paid by the taxpayer in one State is not more than would be payable in the other, regardless of where the income was received and whatever its specific source' (point 66).

as the Netherlands), but not to confer such an entitlement on a parent company resident in another Member State (such as Germany), where there is no provision for a partial tax credit in the DTC between the UK and Germany.

C — *Questions 1(c) and (d)*

97. By Question 1(c), the national court asks whether it is contrary to Article 43 or 56 EC for the United Kingdom, in giving effect to its DTCs, to grant no partial tax credit to Netherlands-resident companies if controlled by a German resident, but to confer entitlement to a partial tax credit in respect of relevant dividends on (i) a Netherlands-resident company if controlled by another Dutch resident, (ii) a Netherlands-resident company if controlled by a resident of a Member State such as Italy, where there is provision for a partial tax credit in the Italy-Netherlands DTC, or (iii) Italian-resident companies, regardless of who controls them. By Question 1(d), the national court asks if the answer to Question 1(c) would be different if it referred to a Netherlands-resident company controlled not by a German resident, but by a resident of a third country.

98. In essence, the issue raised by these questions is the compatibility with Article 43 EC of so-called 'limitation of benefit' clauses in Member States' DTCs, by which entitlement to tax benefits of corporate residents of the Contracting States is limited according to the place of residence of those controlling these companies. In the present scenario, for example, the benefit of a UK partial tax credit is denied to Netherlands-resident companies if in turn controlled by a resident of a Member State such as Germany, where the German-UK DTC contains no provision for a UK partial tax credit.

99. The answer to these questions, in my view, follows from similar reasoning as I set out for Question 1(b).

100. As explained above, it is not possible to compare the situation of non-residents covered by a DTC and those not covered by that DTC, because each DTC represents a particular balance of tax jurisdiction and priority achieved between the Contracting States. A difference in treatment between these non-residents does not amount to discrimination because they are in different positions. The question here is whether it is

permissible to distinguish between non-residents which are resident in the same Member State and thus covered by the same DTC, depending on whether the non-resident is controlled by a resident of a Member State (or third country) whose DTC with the UK does not make provision for partial tax credits. Are these non-residents comparable for the purposes of the non-discrimination principle?

101. The answer to this question must in my view be in the negative. The distinction in a DTC between non-residents on the basis of the country of residence (and thus applicable DTC) of their controlling shareholder, forms a part of the equilibrium of jurisdiction and priority reached by the Contracting States in the exercise of their competence, to which I have already referred. As a result, enquiry into the reasons and justifications for this choice of equilibrium — which may only be appreciated in the light of the broader balance reached in the extensive network of bilateral DTCs that exists at present — does not fall within the proper scope of the Treaty free movement provisions.

102. The answer to Questions 1(c) and (d) should therefore be that it is not contrary to Article 43 or 56 EC for the United Kingdom, in giving effect to its DTCs, to grant no partial tax credit to Netherlands-resident companies if controlled by a German or third-country resident, but to confer entitlement to a partial tax credit in respect of relevant dividends on (i) a Netherlands-resident company if controlled by another Dutch resident, (ii) a Netherlands-resident company if controlled by a resident of a Member State such as Italy, where there is provision for a partial tax credit in the Italy-Netherlands DTC, or (iii) Italian-resident companies, regardless of who controls them.

D — *Question 2*

103. This question raises the issue of the Community law rights and remedies available in the event of a breach of Article 43 or 56 EC in the circumstances set out in Question 1. As will be clear from the above, however, it is my view that the responses to Question 1(a) to (c) must so clearly be in the negative that I do not find it useful or necessary to reply on this point. I would note, however, that similar questions concerning remedies have been posed in the preliminary reference in the parallel case, *Test Claimants in the FII Litigation.*[92]

92 — See footnote 2 above.

## V — Conclusion

104. 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:

— Where, under legislation such as that at issue in the present case, the United Kingdom grants a full tax credit for dividends paid by UK-resident companies to UK-resident individual shareholders, it is not required by Article 43 or 56 EC to extend a full or partial tax credit to outgoing dividends paid by a UK-resident subsidiary to a non-UK-resident parent company where these dividends are not subject to UK income tax. However, to the extent that, pursuant to a double taxation convention, the UK exercises jurisdiction to levy UK income tax on dividends distributed to non-residents, it must ensure that these non-residents receive equivalent treatment — including tax benefits — as residents subject to the same UK income tax jurisdiction would receive.

— It is not contrary to Article 43 or 56 EC for the United Kingdom to give effect to a provision in a DTC conferring an entitlement to a partial tax credit in respect of relevant dividends on a parent company resident in a particular Member State (such as the Netherlands), but not to confer such an entitlement on a parent company resident in another Member State (such as Germany), where there is no provision for a partial tax credit in the DTC between the UK and Germany.

— It is not contrary to Article 43 or 56 EC for the United Kingdom, in giving effect to its DTCs, to grant no partial tax credit to Netherlands-resident companies if controlled by a German or third-country resident, but to confer entitlement to a partial tax credit in respect of relevant dividends on (i) a Netherlands-resident company if controlled by another Dutch resident, (ii) a Netherlands-resident company if controlled by a resident of a Member State such as Italy, where there is provision for a partial tax credit in the Italy-Netherlands DTC, or (iii) Italian-resident companies, regardless of who controls them.