OPINION OF ADVOCATE GENERAL LÉGER

delivered on 2 May 2006 [1]

1. The purpose of these preliminary ruling proceedings is to assess the compatibility with Community law of national legislation such as the legislation of the United Kingdom of Great Britain and Northern Ireland on 'controlled foreign companies'. [2]

2. The purpose of that legislation is to counteract tax avoidance. It is designed to counter the practice whereby a United Kingdom resident company transfers it taxable profits to a company it controls established in another State which applies a much lower rate of taxation than that in effect in the United Kingdom.

3. The legislation in question is therefore designed to apply when the profits made by a CFC of a company which is resident in the United Kingdom for tax purposes is subject to much lower taxation than that in effect in that Member State. That legislation provides that, in derogation from the ordinary legal rules and unless one of the exceptions referred to is applicable, those profits are included in the parent company's tax base as they arise.

4. As the many Member States which intervened in these proceedings have stated, several of them have adopted this type of legislation. The adoption of such legislation was recommended by the OECD (Organisation for Economic Cooperation and Development) with a view, in particular, to counteracting harmful tax competition. [3] According to a study published by the OECD in 1996, although the content of the legislation on CFCs in force in the States which are members of that organisation varies, a characteristic common to all is the taxation of resident shareholders of at least a portion of the undistributed profits of CFCs. [4]

5. This is the first time that the Court has been called upon to examine the compatibility of such legislation with Community law.

1 — Original language: French.

2 — 'CFCs'

3 — *Harmful Tax Competition. An Emerging Global Issue*, OECD, Paris, 1998, p. 44

4 — *Controlled Foreign Company Legislation*, OECD, Paris, 1996, p. 19.

6. I do not think that secondary legislation contains provisions relevant to this examination. As regards, first, counteraction of tax avoidance, action taken at Community level in that regard remains very limited. In so far as direct taxation continues to fall within the competence of the Member States and, consequently, systems of taxation vary within the European Union, it seems logical that measures to counteract tax evasion or avoidance also be specific to each State. Although the Council of the European Union stated, in its resolution of 10 February 1975, [5] its intention to combat tax evasion and avoidance, it restricted action contemplated at Community level to the improvement of cooperation between the authorities of the different Member States to enable the correct assessment of tax. [6]

7. So far as concerns, second, the provisions 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, [7] they are not relevant in this case since they are designed solely to set up a common system as regards the taxation of profits distributed by a subsidiary. Those provisions do not relate to a system such as that provided for by the United Kingdom legislation on CFCs, which attributes to the parent company the profits of its foreign subsidiary as they arise.

8. Accordingly, it is the rules of the EC Treaty on the rights of free movement with which the Special Commissioners ask the Court to examine the compatibility of the legislation in question. They wish to know whether that legislation constitutes discrimination or a restriction on that freedom of movement and, as the case may be, if it can be justified in terms of counteraction of tax avoidance.

9. Before proceeding to that analysis, it is necessary to set out the content of the national legislation in question and the facts of the main proceedings.

I — National legislation

10. United Kingdom tax legislation provides that a company resident in that Member State within the meaning of that legislation, that is to say a company governed by United Kingdom law or the central organs of management or control of which are situated in that Member State, is subject to corpora-

5 — Resolution on the measures to be taken by the Community in order to combat international tax evasion and avoidance (OJ 1975 C 35 p. 1).

6 — That cooperation was set up by Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (OJ 1977 L 336, p. 15).

7 — OJ 1990 L 225, p. 6.

tion tax on its worldwide profits. It is thus taxed on profits made outside the United Kingdom through a permanent establishment, such as a branch or agency. It is also taxed on dividends distributed to it by a foreign company in which it owns a holding.

11. In order to prevent those profits originating abroad from being subject to double taxation, the United Kingdom tax legislation provides for the grant of a tax credit to the resident company up to the amount of the foreign tax which was paid.

12. A United Kingdom resident parent company is not taxed on the profits of its subsidiaries as they arise. So far as concerns profits made by a subsidiary established in the United Kingdom, nor are they taxed when they are distributed in the form of dividends to the parent company resident in that State.

13. The United Kingdom legislation on CFCs provides for an exception to the rule that a United Kingdom resident parent company is not taxed on the profits made by a subsidiary established abroad as they arise.

14. That legislation is contained in sections 747 to 756 and Schedules 24 to 26 of the Income and Corporation Taxes Act 1988. Under that legislation, a foreign subsidiary in which, under the version applicable at the material time, the parent company owns a holding of more than 50 per cent is treated as a transparent entity. Accordingly, the profits made by that subsidiary are attributed to the parent company in the United Kingdom and included in the parent company's tax base, although they were not received by that company. They are taxed by means of a tax credit for the tax paid by the subsidiary in the State of establishment. If those same profits are then paid in the form of dividends to the parent company, the tax paid by the latter in the United Kingdom on the profits of its subsidiary is treated as additional tax paid by the subsidiary to the State of establishment and gives rise to a tax credit payable in respect of the dividends.

15. The legislation on CFCs is designed to apply when the subsidiary established in a State other than the United Kingdom is subject in that other State to a 'lower level of taxation'. There is a 'lower level of taxation' in respect of any accounting period in which the tax paid by the foreign subsidiary is less than three quarters of the amount of tax which would have been paid in the United Kingdom if the profits of the subsidiary had been taxed there.

16. Legislation on CFCs provides, however, for a number of exceptions which have changed over time. According to the version of that legislation applicable at the time of

the facts in the main proceedings, it did not apply if one of the following conditions was fulfilled:

(1) The foreign subsidiary pursues an 'acceptable distribution policy'. That means that a specified percentage (90% in 1996) of the profits of the subsidiary are distributed within 18 months and taxed in the hands of a United Kingdom resident company.

(2) The foreign subsidiary is engaged in 'exempt activities'. These are activities referred to in the legislation, such as certain trading activities carried out from a business establishment.

(3) The foreign subsidiary satisfies the 'public quotation condition'. That means that 35 per cent of the voting rights are held by the public, the subsidiary is quoted and its securities are dealt in on a recognised stock exchange.

(4) The company's chargeable profits do not exceed GBP 50 000.

(5) The establishment and operation of the foreign subsidiary satisfies 'the motive test'. That test contains two limbs and the taxpayer must show that it complies with each of them.

— The first element relates to transactions routed between the CFC and the parent company. Thus, if the transactions reflected in the profits of the subsidiary for the accounting period in question produce a reduction in United Kingdom taxation (that is, a reduction compared to the tax which would have been due in the United Kingdom if those transactions had not been carried out) and that exceeds a minimum amount, the taxpayer must show that the reduction in United Kingdom tax was not the main purpose, or one of the main purposes, of those transactions.

— The second element regards the setting up of the CFC. The taxpayer must show that it was not the main reason, or one of the main reasons, for the subsidiary's existence in that accounting period to achieve a reduction in United Kingdom tax by means of the diversion of profits. According to the legislation, there is a diversion of profits if it is reasonable to suppose that, had the subsidiary or any related non-United Kingdom resident company not existed, their receipts would have been received by, and been taxable in the hands of, a United Kingdom resident.

17. The national court states that, if none of the first four conditions apply, the motive test allows the tax authorities to consider the particular circumstances of the taxpayer against the purpose of the CFC legislation, which is to tax profits that are either accumulated abroad or diverted abroad from the United Kingdom.

18. It also states that, to that end, in 1996 the tax authority published a list of countries within which, subject to specified conditions, a subsidiary could be established and be regarded as meeting the requirements for exemption from application of the legislation on CFCs.

II — Facts in the main proceedings

19. These proceedings arise from the dispute between Cadbury Schweppes plc [8] and Cadbury Schweppes Overseas Limited [9] on the one hand and the Commissioners of Inland Revenue on the other hand, concerning the taxation of CSO by the United Kingdom tax authorities in respect of profits made by one of the Cadbury group subsidiaries in Ireland.

20. Cadbury is a United Kingdom resident company. It is the parent company of a group of companies consisting of subsidiaries established in that State, in other Member States and in third countries, at the head of which is CSO. The group thus includes two subsidiaries wholly owned indirectly by Cadbury, Cadbury Schweppes Treasury Services [10] and Cadbury Schweppes Treasury International, [11] which were established in the International Financial Services Centre in Dublin, Ireland.

21. At the material time, those two subsidiaries were subject to a tax rate of 10%.

22. The business of CSTS and CSTI is to raise finance and to provide that finance to subsidiaries in the Cadbury group.

8 — 'Cadbury'

9 — 'CSO'

10 — 'CSTS'

11 — 'CSTI'

23. According to the order for reference, Cadbury established CSTS, which replaced an earlier structure involving a company established in Jersey, for three purposes. First, to remedy a Canadian tax problem for Canadian resident preference shareholders of Cadbury, secondly, to avoid the need to obtain consents from the United Kingdom Treasury for overseas lending and, thirdly, to reduce the withholding tax on dividends paid within the group by benefiting from Directive 90/435. The national court states that all those purposes would have been achieved if CSTS had been established in the United Kingdom.

24. It also states that Cadbury incorporated CSTS and CSTI as tax resident indirect subsidiaries in Ireland solely in order that intra-group lending treasury activities could benefit from the regime of the International Financial Services Centre for group treasury companies in Ireland and would not be taxed in the United Kingdom.

25. Given the rate of tax applicable to companies incorporated in the Centre, the profits of CSTS and CSTI are subject to 'a lower level of taxation' within the meaning of the legislation on CFCs. The United Kingdom tax authorities also took the view that, for the 1996 financial year, none of the conditions for exemption from that legislation applied. It claimed from CSO, the first United Kingdom resident company in the group chain, corporation tax in the sum of GBP 638 633.54 on the profits of CSTI for the financial year ending 28 December 1996. The tax notice related only to the profits of CSTI because, in the financial year concerned, CSTS made a loss.

26. Cadbury and CSO appealed against that tax notice to the Special Commissioners, the appeal body in respect of decisions of the tax administration. Before that body, they contended that the United Kingdom legislation on CFCs was contrary to freedom of establishment laid down in Article 43 EC, freedom to provide services in Article 49 EC and free movement of capital in Article 56 EC.

III — The question referred for a preliminary ruling

27. The national court states that it is faced with the following uncertainties:

'Whether [Cadbury], in establishing and capitalising companies in another Member State solely because of a more favourable tax regime available in that Member State (as compared to the United Kingdom's tax regime), is exercising the fundamental freedoms, or whether it is an abuse of such freedoms.

If [Cadbury] is exercising the fundamental freedoms, whether the correct approach in the circumstances of this case is to consider whether the United Kingdom's [CFC] legislation may be viewed as a restriction on the exercise of those freedoms, or whether it involves discrimination.

In relation to whether the legislation should be viewed as a restriction, whether the fact that [Cadbury] may pay no more tax than what CSTS and CSTI would have paid if they had been established in the United Kingdom means that there is no such restriction; and whether it is relevant that

(a) the rules for calculating the tax liability in respect of CSTS and CSTI's income differ in some respects from the ordinary rules applicable to United Kingdom subsidiaries of [Cadbury] and

(b) there is no relief for losses of one subsidiary against the profits of the other or against the profits of [Cadbury] and its United Kingdom subsidiaries (such relief for losses would have been available if CSTS and CSTI had been established in the United Kingdom rather than Ireland).

In relation to whether the legislation should be viewed as involving discrimination, what comparison should be made and whether any comparison is possible; in particular, whether the facts should be compared to [Cadbury] establishing subsidiaries in the United Kingdom (accepting that [Cadbury]'s profits cannot include the profits of its United Kingdom subsidiaries) or in a Member State which does not charge a lower rate of tax.

If there is either a restriction on establishment or discrimination, whether the legislation can be justified as preventing tax avoidance, given the objective of the legislation to prevent the reduction or diversion of profits liable to United Kingdom tax; and, if it can be so justified, whether the legislation is in fact justified as a proportionate measure achieving that legitimate objective having regard to the scope of the legislation and the exemptions and in particular to the opportunity that the motive test offers for [Cadbury] to demonstrate that it did not have a tax-avoiding purpose by satisfying both limbs of the motive test as described above, which [Cadbury] is unable to do.'

28. It is in the light of those questions that the Special Commissioners decided to stay the proceedings and refer the following question to the Court for a preliminary ruling:

'Do Articles 43 [EC], 49 [EC] and 56 EC preclude national tax legislation such as that in issue in the main proceedings, which provides in specified circumstances for the imposition of a charge upon a company resident in that Member State in respect of the profits of a subsidiary company resident in another Member State and subject to a lower level of taxation?'

IV — Analysis

29. It is settled case-law that, although direct taxes do not fall as such within the competence of the Community, powers retained by the Member States must nevertheless be exercised consistently with Community law. [12] That limitation on the exercise by the Member States of the powers reserved to them also applies to measures designed to prevent tax evasion and avoidance. Although the power of Member States to take such measures is expressly recalled both by the Treaty [13] and acts of secondary legislation, [14] the fact remains that those measures must not infringe the undertakings they have made under the Treaty and, in particular, the rights of freedom of movement instituted by it.

30. The national court wishes to know, in this case, whether the United Kingdom legislation on CFCs is compatible with freedom of establishment, freedom to provide services and free movement of capital.

31. I am of the opinion, like several of the interveners, that it is in the light of freedom of establishment that the compatibility of the legislation in question should be examined.

12 — Case C-246/89 *Commission* v *United Kingdom* [1991] ECR I-4585, paragraph 12, and Case C-9/02 *De Lasteyrie du Saillant* [2004] ECR I-2409, paragraph 44 and the case-law cited.

13 — Article 58(1)(b) EC provides that Article 56 EC on the free movement of capital is to be without prejudice to the right of Member States to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation.

14 — Article 11(1)(a) of Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (OJ 1990 L 225, p. 1) provides that a Member State may refuse to apply all or any part of its provisions where the transaction in question has as its objective tax evasion or tax avoidance. See also Article 1(2) of Directive 90/435, under which that directive is not to preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse, and Article 5(2) of Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (OJ 2003 L 157, p. 49), which provides that Member States may, in the case of transactions for which the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse, withdraw the benefits of that directive or refuse to apply it.

32. According to case-law, when nationals of a Member State have a holding in the capital of a company established in another Member State giving them definite influence over that company's decisions and allowing them to determine its activities, it is the provisions of the Treaty on freedom of establishment which apply and not those relating to the free movement of capital.[15] Further, Article 48 EC extends the rights conferred by Article 43 EC to companies formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community.

33. It may therefore be deduced from those factors that the United Kingdom legislation on CFCs, which sets out the rules applicable to the taxation of profits of a foreign subsidiary with which the resident parent company is linked not only by a mere holding but by control, does not fall within freedom of movement of capital but rather freedom of establishment.

34. The applicants submit that the provisions of the Treaty on freedom to provide services also apply in this case. They claim that the legislation at issue makes the supply of financial services by CSTS and CSTI to their United Kingdom resident parent company more difficult. They cite as examples the judgments in *Safir*[16] and *Eurowings Luftverkehr*.[17]

35. I am not convinced by the applicants' argument. These proceedings concern the compatibility with Community law of legislation of a Member State which attributes to a resident parent company the profits of its subsidiary established in another Member State when that subsidiary is subject to a much lower level of taxation in that State. The nature of the activity carried on by CSTS and CSTI is not specifically referred to by that legislation. The situation is therefore different from that in the *Safir* and *Eurowings Luftverkehr* cases cited above.[18]

36. Admittedly, if the legislation at issue has the result that a resident company is dissuaded from establishing a subsidiary in another Member State, it also has the result that the supply of services by such a subsidiary out of that Member State is prevented. However, that latter restriction is a consequence of the hindrance to establishment. In the present case, it is

15 — Case C-436/00 *X and Y* [2002] ECR I-10829, paragraph 37 and the case-law cited.

16 — Case C-118/96 [1998] ECR I-1897.

17 — Case C-294/97 [1999] ECR I-7447.

18 — In the *Safir* case there was a different tax regime for capital life assurance policies, depending on whether or not they were taken out with companies established in that Member State. In *Eurowings Luftverkehr* the national legislation in question reserved a fiscal advantage, consisting in exemption from making an 'add-back' to the taxable amount of payments for leasing assets, to undertakings which lease those assets from lessors established in the national territory

exactly the freedom to establish a subsidiary in that Member State which is at the core of the proceedings. [19] I do not therefore see the relevance of reliance on the rules on freedom to provide services as well. In any event, I do not believe that examination of the legislation at issue in the light of that freedom, in addition to freedom of establishment, can change the result of my analysis.

37. Consequently, I propose to limit examination of the question referred for a preliminary ruling to whether Articles 43 EC and 48 EC preclude national tax legislation which provides for inclusion in the tax base of a resident parent company profits of a CFC established in another Member State when those profits are subject in that other State to a much lower level of taxation than that in effect in the State of residence of the parent company.

38. The analysis which will make it possible to answer that question will involve examination in turn of the three principal questions with which the national court states it is faced. First, I shall look into whether the establishment by a parent company of a subsidiary in another Member State for the purpose of enjoying a more favourable tax regime than that in effect in the State in which it is established constitutes, in itself, an abuse of freedom of establishment. I shall then analyse, if necessary, whether the United Kingdom legislation on CFCs hinders exercise of that freedom. Finally, I shall examine whether that hindrance may be justified.

A — *Abuse of freedom of establishment*

39. At issue, first, is therefore whether the establishment by a parent company of a subsidiary in another Member State for the purpose of enjoying the more favourable tax regime of that other State constitutes, in itself, an abuse of freedom of establishment. The national court states that it asks that question because Cadbury incorporated CSTS and CSTI as tax resident indirect subsidiaries in Ireland, solely in order that its intra-group lending treasury activities could benefit from the regime of the International Financial Services Centre.

40. I do not believe that the fact that a parent company establishes a subsidiary in another Member State for the avowed purpose of enjoying the more favourable tax regime in that State constitutes, in itself, an abuse of freedom of establishment, which would thereby deprive that company of the opportunity of relying on the rights conferred by Articles 43 EC and 48 EC. I base that analysis on the scope of those provisions, as defined by case-law.

19 — See, to that effect, Case C-36/02 *Omega* [2004] ECR I-9609, paragraph 26.

41. It should be noted, first, that Articles 43 EC and 48 EC expressly grant to a company which meets the requirements set out in the latter article the right to set up an agency, branch or subsidiary in another Member State under the conditions laid down for its own nationals by the law of that State. That fundamental freedom, enshrined by those provisions which have been directly applicable since the transitional period came to an end, [20] is thus intended to enable such a company to set up a secondary establishment in any other Member State. Any company formed in accordance with the law of a Member State may therefore open a subsidiary in the place of its choice within the Community.

42. Next, in this case it seems important to state that 'establishment' allows a Community national to participate, on a stable and continuous basis, in the economic life of a Member State other than his State of origin and to profit therefrom. [21] Freedom of establishment thus concerns the genuine and actual pursuit of an economic activity in the host Member State. [22] As stated by Advocate General Darmon in point 3 of his Opinion in the *Daily Mail and General Trust* case, [23] '[e]stablishment "means integration into a national economy"'. It is therefore the exercise of an economic activity in the host Member State which is the raison d'être of freedom of establishment.

43. Finally, according to case-law, when the objective pursued by freedom of establishment is fulfilled, the reasons for which the Community national or company concerned wished to exercise that freedom cannot call into question the protection they derive from the Treaty.

44. Accordingly, in the judgment in *Centros*, [24] the question to be decided was whether the competent Danish authorities could refuse to register a branch of a limited company formed in accordance with the law of the United Kingdom, on the ground that it did not conduct any business in that Member State and that, ultimately, it sought solely to evade application of the Danish rules on setting up a limited company. [25]

45. At issue was therefore whether the host State could prohibit a company fulfilling the requirements under Article 48 EC from

20 — Case 2/74 *Reyners* [1974] ECR 631, paragraph 25, and Case C-208/00 *Uberseering* [2002] ECR I-9919, paragraph 60.

21 — See, to that effect, *Reyners*, paragraph 21, and Case C-55/94 *Gebhard* [1995] ECR I-4165, paragraph 25.

22 — Case C-221/89 *Factortame and Others* [1991] ECR I-3905, paragraph 20, and *Commission v United Kingdom*, paragraph 21.

23 — Case 81/87 [1988] ECR 5483.

24 — Case C-212/97 [1999] ECR I-1459.

25 — The Danish rules made incorporation of a limited company subject to paying up capital of not less than DKK 200 000, whereas the applicable legislation in the United Kingdom did not make the establishment of that type of company subject to any minimum paid up capital requirement.

setting up a secondary establishment in its territory on the basis of the members' motives for choosing to incorporate their company in another Member State. In other words, could the reasons driving the members prevent them from relying on the rights conferred by Article 43 EC even though reliance on that provision was consistent with its objective, namely to enable companies properly formed under the rules of a Member State to pursue activities on a secondary basis in another Member State?

46. The Court gives precedence to the purpose of the right of establishment conferred by the Treaty. Accordingly, in *Centros*, it stated that the right to form a company in accordance with the law of a Member State and to set up branches in other Member States is inherent in the exercise, in a single market, of the freedom of establishment guaranteed by the Treaty. It held that the fact that a national of a Member State who wishes to set up a company chooses to form it in the Member State whose rules of company law seem to him the least restrictive and to set up branches in other Member States cannot, in itself, constitute an abuse of the right of establishment. [26]

47. That approach, which was adopted by the Court in plenary session, is not an isolated one. It was confirmed in the judgment in *Inspire Art*, [27] in which it was extended to Netherlands legislation which, in comparable circumstances to those in the *Centros* case, did not preclude registration of a branch but made the setting up of that secondary establishment subject to compliance with certain conditions for the incorporation of companies laid down by national law.

48. In the *Inspire Art* case, the Court expressly stated that the reasons for which a company chooses to incorporate in a Member State are, except in the case of fraud, irrelevant with regard to application of the rules on freedom of establishment. [28] It confirmed that the fact that the company relying on Articles 43 EC and 48 EC was formed in a particular Member State for the sole purpose of enjoying the benefit of more favourable legislation does not constitute abuse even if that company conducts its activities entirely or mainly in the State in which it established the secondary establishment. [29]

49. For the purposes of the present case, it can be inferred from that case-law that as long as there is genuine and actual pursuit of an activity by the controlled subsidiary in the Member State in which it was established,

26 — *Centros*, paragraph 27.

27 — Case C-167/01 [2003] ECR I-10155.

28 — *Inspire Art*, paragraph 95.

29 — Ibid., paragraph 96.

the reasons for which the parent company decided to establish the subsidiary in that host State cannot call into question the rights which that company derives from the Treaty.[30]

50. Cadbury's right to rely on the protection conferred by Articles 43 EC and 48 EC therefore depends, in this case, on whether CSTS and CSTI are in fact conducting genuine and actual business in Ireland. It is for the national court to decide that question, which is keenly disputed between the applicants and the United Kingdom. At this stage, however, I think I can state that the fact that Cadbury decided to establish its subsidiaries in Ireland solely so that those subsidiaries are subject to the very favourable tax regime applicable in the International Financial Services Centre does not, in itself, constitute an abuse of the right of establishment.

51. The level of taxation is a factor which a company may legitimately take into account in choosing the host State in which it intends to establish a subsidiary. A company may, without infringing the scope and spirit of Article 43 EC, decide to pursue its secondary activities in another Member State in order to benefit from the more favourable tax regime of that other State in respect of taxable activities in that State.

52. That analysis is borne out by settled case-law, according to which a Member State cannot prevent a company from exercising its freedom of establishment in another Member State on the ground that such an operation entails a reduction in tax revenue as regards the tax which would have been payable on account of future activity if the company had pursued that activity in its Member State of origin.[31]

53. To the same effect, it is also settled case-law that the mere fact that a resident company establishes a secondary establishment in another Member State cannot give rise to a general presumption of tax evasion or avoidance or justify a measure which compromises the exercise of a fundamental

30 — Conversely, when the objectives of freedom of establishment have not been fulfilled, the company cannot rely on the provisions of Article 43 EC. See *Daily Mail and General Trust*. In that case, the company Daily Mail, formed in accordance with the law of the United Kingdom, wished to transfer its central management and control outside that Member State without losing its legal personality or ceasing to be a company incorporated in the United Kingdom, as provided for by the law of that Member State. It disputed, however, that it had to submit to the condition provided for by that legislation requiring consent to be obtained from the Treasury. Daily Mail wished to transfer its central management to the Netherlands in order to be in a position, after establishing its residence for tax purposes in the Netherlands, to sell a significant part of its non-permanent assets and to use the proceeds of that sale to buy a part of its own shares, without having to pay the tax to which such transactions would make it liable under United Kingdom tax law. The Court held that Community law as it then stood did not preclude legislation such as that at issue because it conferred no right on companies incorporated under national law to transfer their central management and control to another Member State while remaining companies of the Member State under the legislation of which they were incorporated.

31 — See, in particular, Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 28, *De Lasteyrie du Saillant*, paragraph 60, and Case C-446/03 *Marks and Spencer* [2005] ECR I-10837, paragraph 44.

freedom guaranteed by the Treaty. [32] As the Court has held on several occasions, the establishment of a company in another Member State does not, of itself, entail tax avoidance, since the company in question will in any event be subject to the legislation of that State. [33]

54. Finally, it may also be inferred from the case-law that a Member State cannot hinder the exercise of the rights of freedom of movement in another Member State by using the pretext of a low level of taxation in that State. [34]

55. In light of those considerations, in the absence of Community harmonisation it must be accepted that there is competition between the tax regimes of the various Member States. That competition, which is reflected in particular by great disparity between the Member States in the rates of taxation of company profits, may have a significant impact on the choice of location made by companies for their activities in the European Union. [35] It may be regrettable that competition operates between the Member States in this field without restriction. That is, however, a political matter.

56. It should be noted, in that respect, that the 'Economic Affairs and Finance' Council ('Ecofin' Council) adopted a code of conduct for business taxation [36] which concerns 'those measures which affect, or may affect, in a significant way the location of business activity in the Community' and under which the Member States committed themselves to the standstill and rollback of such measures. It seems useful to state here that the tax regime applicable in Ireland to companies established in the International Financial Services Centre was cited in the report of the 'Code of Conduct' group, responsible for evaluating national measures which may come within the scope of the code, as being a harmful measure. That tax regime therefore had to be progressively abolished. [37]

32 — See, to that effect, Case C-478/98 *Commission* v *Belgium* [2000] ECR I-7587, paragraph 45. See also Case C-436/00 *X and Y*, paragraph 62.

33 — *ICI*, paragraph 26, Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, paragraph 57, and Case C-324/00 *Lankhorst-Hohorst* [2002] ECR I-11779, paragraph 37.

34 — *Eurowings Luftverkehr*, paragraph 44. See also, to that effect, Case C-422/01 *Skandia and Ramstedt* [2003] ECR I-6817, paragraph 52, and Case C-364/01 *Barbier* [2003] ECR I-15013, paragraph 71.

35 — See, in that respect, the work of the Commission of the European Communities on company taxation within the Union, in particular the Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee — *Towards an Internal Market without tax obstacles* (COM(2001) 582 final), and the Commission Staff Working Paper 'Company Taxation in the Internal Market' (SEC (2001) 1681 final).

36 — Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997, on a code of conduct for business taxation (OJ 1998 C 2, p. 2).

37 — That report is available on the internet at: http://ue.eu.int/ueDocs/cms_Data/docs/pressdata/en/misc/04901.f9.html.

57. Those elements cannot, however, influence the scope of the rights conferred on economic operators by Articles 43 EC and 48 EC. According to its preamble, the code of conduct is a political commitment and does not affect the Member States' rights and obligations or the respective spheres of competence of the Member States and the Community resulting from the Treaty. The adoption of the code of conduct and the reference to the Irish tax system at issue among those tax measures which are harmful to the single market cannot therefore limit nor, a fortiori, retroactively restrict the right conferred by the Treaty on all companies in compliance with Article 48 EC to set up a secondary establishment in the Member State of their choice, including in a State in which a tax system viewed as harmful to the single market is in effect.

58. The fact that that tax system may also be classified as State aid incompatible with the common market [38] does not alter that analysis. As the Commission stated in its observations, the Treaty contains specific provisions, in Articles 87 EC and 88 EC, intended to check the compatibility of such a measure with the common market and to eliminate its harmful effects on that market. The fact that such a tax system does not comply with the rules of the Treaty cannot therefore entitle a Member State to take unilateral measures intended to counter its effects by limiting freedom of movement.

59. Objection might also be made in respect of that analysis that the whole problem remains with regard to the disparity in rates of taxation which are fixed in the laws of the Member States having a general scope. On the one hand, the assessment carried out by the 'Code of Conduct' group of tax measures deemed harmful and scheduled to be abolished, is restricted to individual or specific regimes. On the other hand, under Article 94 EC approximation of national laws regarding applicable rates of taxation always comes within the scope of the rule of unanimity within the Council. To date, no measure to that effect has been taken and none appears likely in the near future, as several Member States stated at the hearing.

60. However, the harmful effects of a total absence of harmonisation of the rates of taxation of company profits call, as we have seen, for a political solution and do not appear to justify, in my opinion, calling into question the scope of the rights conferred by Articles 43 EC and 48 EC, as defined by case-law. I therefore find that the establishment by a company which is resident for tax purposes in a Member State of a subsidiary

38 — According to the Report of the 'Code of Conduct' group, the Commission in 1987 authorised the creation of the International Financial Services Centre, then took the view that the preferential tax rates introduced in that centre constituted operating aid in contravention of the rules of the Treaty, and finally reached an agreement with the Irish authorities to progressively abolish that regime.

in the International Financial Services Centre for the avowed purpose of enjoying the more favourable tax regime applicable there does not, in itself, constitute an abuse of freedom of establishment.

61. I shall now examine whether the United Kingdom legislation on CFCs constitutes a hindrance to freedom of establishment.

B — *Hindrance to freedom of establishment*

62. First, it should be noted that Article 43 EC prohibits not only restrictions on the establishment of a subsidiary in another Member State on the part of the host State, but also those which are attributable to the State of origin. Thus in accordance with settled case-law, even though the provisions of the Treaty on freedom of establishment are, according to their wording, directed mainly at ensuring treatment in the host Member State which is the same as that of nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company formed in accordance with its laws.[39] That prohibition on 'exit restrictions' also applies to tax measures.[40]

63. It is also apparent from the case-law that the restrictions prohibited by Article 43 EC may take different forms. There may be overt discrimination on the basis of nationality or, in the case of a company, its seat. They can also take the form of 'indirect discrimination', namely measures which apply irrespective of the company's seat and are based on conditions which apply without distinction which result essentially in placing nationals from other Member States at a disadvantage, such as the criterion of fiscal residence.[41] Finally, in its more recent case-law, the Court does not inquire into whether the measure in question is to be classified as direct or indirect discrimination. It merely states that there is a difference in tax treatment which creates a disadvantage for economic operators who have exercised the rights conferred by Article 43 EC and could deter them from exercising such rights.[42]

39 — *Daily Mail and General Trust*, paragraph 16, and *Marks and Spencer*, paragraph 31.

40 — The prohibition on exit restrictions through a tax measure was first applied in *ICI*, with regard to United Kingdom legislation making a tax relief available solely to resident companies which controlled, wholly or mainly, subsidiaries whose seat was in the national territory. Since that judgment, it has been illustrated on several occasions (see, in particular, Case C-200/98 *X and Y* [1999] ECR I-8261, *De Lasteyrie du Saillant*, and, for a recent application, Case C-471/04 *Keller Holding* [2006] ECR I-2107).

41 — Case C-330/91 *Commerzbank* [1993] ECR I-4017, paragraphs 14 and 15.

42 — See, inter alia, Case C-141/99 *AMID* [2000] ECR I-11619, paragraphs 22 and 23, Case C-436/00 *X and Y*, paragraphs 36 to 39, *Lankhorst-Hohorst*, paragraphs 27 to 32, Case C-168/01 *Bosal* [2003] ECR I-9409, paragraph 27, *Marks & Spencer*, paragraphs 32 to 34, and *Keller Holding*, paragraphs 31 to 35.

64. The last issue which appears of relevance here in the case-law on the examination of national tax systems in the light of freedom of movement concerns the possible justifications for a restriction. Overt discrimination based on nationality can generally be justified only on a ground referred to in Article 46(1) EC of public policy, public security or public health. Only measures which apply without distinction may also be justified by an overriding reason in the public interest, that is to say by a reason not referred to in that provision, but which is recognised by the case-law as pursuing a legitimate interest. Further, in the context of Articles 43 EC and 48 EC, the seat of companies serves as the connecting factor with the legal system of a Member State, like nationality in the case of natural persons.[43] In tax matters, however, a finding that there is a difference in treatment by reason of company seat does not mean that that unequal treatment cannot be justified for an overriding reason in the public interest.[44]

65. It is in the light of those considerations that I shall examine whether the legislation in question constitutes a hindrance to freedom of establishment. The national court asks, in that regard, if that legislation should be viewed as a restriction on the exercise of freedom of establishment or as discrimination.

66. In the first hypothesis, it asks whether the existence of a restriction is affected by the fact that Cadbury pays no more tax than that which CSTS and CSTI would have paid if they had been established in the United Kingdom, or that there is no tax relief for losses made by its foreign subsidiaries against taxable profits in the United Kingdom, when such relief would have been available if those subsidiaries had been established in that Member State.

67. In the second hypothesis, it asks what comparison should be made in order to show that there is discrimination. Thus it asks whether Cadbury's situation should be compared to that of a resident company which has established a subsidiary in the United Kingdom or to that of a resident company which has set up such a secondary establishment in another Member State in which the rate of taxation is not sufficiently advantageous for the legislation on CFCs to apply.

68. The United Kingdom submits that the legislation at issue does not operate as a discriminatory hindrance to freedom of

43 — *ICI*, paragraph 20 and the case law cited.

44 — See, inter alia, *ICI*, regarding United Kingdom legislation granting tax relief solely to consortium companies which control, wholly or mainly, subsidiaries whose seat is in the national territory (paragraphs 23 and 24), and *Lankhorst Hohorst*, regarding the German system of taxation of interest paid by subsidiaries to their parent companies providing for a difference in treatment according to whether or not the parent company has its seat in Germany

establishment. It claims, first, that Cadbury's situation should be compared only to that of a resident company whose subsidiary is established in the United Kingdom. It goes on to state, supported by the Danish, German, French, Portuguese, Finnish and Swedish Governments, that that legislation is not discriminatory because the tax claimed from Cadbury was no more than the total amount which would have been paid by that company and its subsidiaries if those subsidiaries had been established in the United Kingdom. The economic effect on Cadbury's resources is thus the same in both cases.

69. According to those Member States, the legislation on CFCs thus pursues an objective of fiscal neutrality, by arranging that the overall tax burden on the economic unit consisting of a United Kingdom parent company and its subsidiaries is identical, irrespective of whether the subsidiaries are established in the United Kingdom or in another Member State.

70. Finally, the German Government and the French Government state that the difference in treatment provided for by the legislation in question on the basis of place of establishment of the subsidiaries is objectively justified by the difference in the rates of taxation to which those subsidiaries are subject in their respective State of establishment.

71. I cannot share that view for the following reasons.

72. As we have seen, the legislation in question introduces a special system designed to apply only to resident companies which have established a subsidiary in a Member State providing for a much lower rate of corporation tax than that in effect in the United Kingdom. The legislation on CFCs does not apply, let us recall, if the subsidiary is established in the United Kingdom or if it is established in a Member State with a tax regime which would not result in taxation of the profits of that subsidiary of less than three quarters the amount of tax which would have been paid on those same profits in the United Kingdom.

73. The legislation at issue provides that the profits of the controlled subsidiary may be included in the tax base of the parent company as they arise.

74. It is therefore disadvantageous to the parent company to which it applies compared to, on the one hand, a resident company which has established its subsidiary in the United Kingdom and, on the other, a resident company which has established such a subsidiary in a Member State which does not have a sufficiently favourable tax regime to fall within its scope of application. In the first case, the resident company is never taxed on the profits of its domestic subsidiary. In the second case, the resident company is not taxed on the profits of its foreign subsidiary as they arise. It cannot be taxed until those profits are paid to it in the form of dividends.

75. We have, therefore, differentiated tax treatment which places at a disadvantage companies which, like Cadbury, have established a subsidiary in Ireland, in the International Financial Services Centre, and such treatment is indeed such as to deter a resident company from exercising its right of establishment there.

76. The fact that the tax claimed from Cadbury would be no more than the total amount which would have been paid by the economic unit comprising the parent company and its subsidiaries if those subsidiaries had been established in the United Kingdom does not affect that analysis. That fact does not eliminate the unequal treatment at the level of the parent companies.

77. Even if the legislation at issue were tax-neutral compared to a purely domestic situation, however, that would not call into question the existence of unequal treatment and the disadvantage to Cadbury in comparison with the position of a resident company which has established a subsidiary in another Member State which has a less favourable tax regime than that in effect in the International Financial Services Centre.

78. Unlike the United Kingdom, I do not see why Cadbury's situation should not be compared to that of such a company. I take the view that the assessment of the compatibility with Community law of the legislation in question must examine all the ramifications of that legislation. As we know, 'discrimination' is defined as the application of different rules to comparable situations or the application of the same rule to different situations.[45] The only question to be asked in order to determine whether different treatment of two situations is discriminatory is therefore whether those two situations are comparable. I take the view that that is the case in respect of Cadbury's position and that of a resident company which has established a subsidiary in another Member State having a less favourable tax regime than that in effect in the International Financial Services Centre because, in either case, a United Kingdom resident company has established a subsidiary in another Member State.

79. Against that view, it is submitted that the disparity in the rates of corporation tax in effect within the Union constitutes an objective difference in situation justifying the differentiated treatment laid down by the legislation in question.

80. If that argument were to be followed through, that would be tantamount to conceding that a Member State is entitled, without infringing the rules of the Treaty, to choose the other Member States in which its domestic companies may establish subsidi-

45 — Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, paragraph 26 and the case-law cited.

aries with the benefit of the tax regime applicable in the host State. However, as the applicants and Ireland have submitted, such a situation would manifestly lead to a result contrary to the very notion of 'single market'.

81. The fixing of rates of corporation tax falls, as we have seen, within the unfettered competence of each Member State and Articles 43 EC and 48 EC confer on every company in accordance with Article 48 EC the right to set up a subsidiary in the place of its choice within the Union. A Member State may not, therefore, treat differently its resident companies which establish subsidiaries in other Member States depending on the tax rate applicable in the host State.

82. That interpretation would also run counter to the approach adopted by the Court in *Eurowings Luftverkehr* and *Barbier*, in which it was held that low taxation applicable in a Member State cannot justify unfavourable tax treatment by another Member State [46] and a Community national cannot be deprived of the right to rely on the provisions of the Treaty on the ground that he is profiting from tax advantages which are legally provided by the rules in force in a Member State other than his State of residence. [47]

83. The difference in treatment provided for by the United Kingdom legislation on CFCs depending on the tax rate of the Member State of establishment suffices, in my opinion, for that system to be regarded as constituting a hindrance to freedom of establishment, so that its compatibility with the rules of the Treaty must necessarily be subject to review by the Court.

84. I shall now consider whether that restriction can be justified.

C — *Justification relating to counteraction of tax avoidance*

85. According to the case-file, the United Kingdom legislation on CFCs was adopted to counter a specific type of tax avoidance by means of the artificial diversion of profits made in the United Kingdom. According to that Member State, it is to counter the diversion of the profits of a resident company by establishing a subsidiary in a low-tax country and carrying out intragroup transactions whose primary objective is to transfer those profits to that subsidiary. The referring court asks whether the national legislation in question can be justified by that objective.

46 — *Eurowings Luftverkehr*, paragraph 44.

47 — *Barbier*, paragraph 71.

86. Counteraction of tax avoidance is among the overriding reasons in the public interest which can justify a restriction on the exercise of the fundamental freedoms. The Court has accepted this on several occasions by agreeing to examine whether the restriction on freedom of establishment established by the national legislation concerned could be justified on such a ground. [48] I have also stated that, in *ICI*, it carried out such an examination of the United Kingdom legislation which used the criterion of the seat of controlled subsidiaries to introduce differentiated tax treatment of consortium companies established in that Member State.

87. However, the possibility of actually finding such a justification has been confined within rather strict limits. Thus, according to a phrase habitually used in the case-law, a hindrance to a freedom guaranteed by the Treaty can only be justified on the ground of counteraction of tax avoidance if the legislation in question is specifically designed to exclude from a tax advantage wholly artificial arrangements aimed at circumventing national law. [49]

88. The use of that formula, the language of which reproduces that of the doctrine of 'abuse of rights', [50] may be understood as intended to prevent the counteraction of tax avoidance from being used as a pretext for protectionism. Application of Community law may be refused only when the company in question relies on it abusively because it has set up an artificial arrangement in order to avoid tax.

89. The Court has thus held that a restrictive national measure cannot be justified by the counteraction of tax avoidance when that legislation applies to a situation which is defined too generally. Accordingly, the Court takes the view that in order for that justification to apply, the national legislation at issue must not apply 'generally to all situations in which the majority of a group's subsidiaries are established, for whatever reason, outside the United Kingdom' [51] nor concern 'generally, any situation in which, for whatever reason, the transfer at undervalue is to a company established under the legislation of another Member State [in which the transferor has a holding] or a branch set up in the Kingdom of Sweden by such a company'. [52]

90. Nor may it apply 'generally to any situation in which the parent company has its seat, for whatever reason, outside the Federal Republic of Germany' [53] or be aimed 'generally at any situation in which a taxpayer

48 — *ICI*, paragraph 26; Case C-436/00 *X and Y*, paragraphs 60 and 61; *Lankhorst-Hohorst*, paragraph 37; and *De Lasteyrie du Saillant*, paragraph 50.

49 — Ibid.

50 — See, in particular, Case C-110/99 *Emsland-Stärke* [2000] ECR I-11569, paragraph 56.

51 — *ICI*, paragraph 26.

52 — Case C-436/00 *X and Y*, paragraph 61.

53 — *Lankhorst-Hohorst*, paragraph 37.

with substantial holdings in a company subject to corporation tax transfers his tax residence outside France for any reason whatever'. [54]

91. On the other hand, the national courts may, case by case and on the basis of objective evidence, take account of abuse or fraudulent conduct on the part of the persons concerned in order to deny them the benefit of the provisions of Community law on which they seek to rely. [55]

92. It follows that, in order to be capable of being justified by counteraction of tax avoidance, national legislation must not merely refer to a given situation in general terms but must enable the national court to refuse, case by case, the benefit of Community law to certain taxpayers or certain companies which have made use of an artificial arrangement for the purpose of avoiding tax.

93. In the judgment in *Marks and Spencer*, for the first time as far as I am aware the Court made a broader application of the justification relating to counteraction of tax avoidance. It did so in a specific context regarding the United Kingdom legislation on 'group relief'. Under that legislation, United Kingdom resident companies in the same group may offset their profits and losses among themselves. That possibility is not available, however, to a resident parent company for losses made by its subsidiaries established in another Member State. That difference in treatment between subsidiaries according to their residence was predictably considered to be a hindrance to freedom of establishment.

94. Three grounds were put forward in order to justify the difference in treatment in question. It was submitted, first, that profits and losses must be treated symmetrically in the same tax system in order to protect a balanced allocation of the power to impose taxes between the Member States. Secondly, it was a question of preventing losses being taken into account twice. The third ground put forward was the prevention of a risk of tax avoidance.

95. The Court's examination of the justifications thus put forward contains matters I believe are relevant to the present case. It is useful to note them here.

54 — *De Lasteyrie du Saillant*, paragraph 50.

55 — *Centros*, paragraph 25, and Case C-436/00 *X and Y*, paragraph 42.

96. As regards the first justification, the Court reiterated its settled case-law, according to which a reduction in tax revenue cannot be regarded as an overriding reason in the public interest which may be relied on to justify a measure which is in principle contrary to a fundamental freedom.[56]

97. It made the following qualification, however. It added that, none the less, the preservation of the allocation of the power to impose taxes between Member States might make it necessary to apply to the economic activities of companies established in one of those States only the tax rules of that State in respect of both profits and losses. In effect, according to the Court, 'to give companies the option to have their losses taken into account in the Member State in which they are established or in another Member State would significantly jeopardise a balanced allocation of the power to impose taxes between Member States, as the taxable basis would be increased in the first State and reduced in the second to the extent of the losses transferred'.[57]

98. As regards the risk that losses would be used twice, the Court stated that the Member States must be able to prevent that from occurring.[58]

99. As regards, lastly, the risk of tax avoidance, the Court accepted that the possibility of transferring the losses of a non-resident subsidiary to a resident company entails the risk that within a group of companies losses will be transferred to companies established in the Member States which apply the highest rates of taxation and in which the tax value of the losses is therefore the highest. It stated that to exclude group relief for losses incurred by non-resident subsidiaries prevents such transfers, which may be inspired by the significant variation in the rates of taxation applied in the various Member States.[59]

100. The Court took the view, in the light of those three grounds taken as a whole, that the restriction at issue pursued legitimate objectives and that it was suitable for attaining them. It went on to examine its proportionality and determined under what conditions it might be justified.

101. From that reasoning two considerations may be derived which are relevant to the present case.

56 — *Marks and Spencer*, paragraph 44.

57 — Ibid., paragraphs 45 and 46.

58 — Ibid., paragraphs 47 and 48.

59 — Ibid., paragraphs 49 and 50.

102. The first of those is connected with the fact that the freedoms introduced by the Treaty are not designed to enable companies to transfer their profits or losses from one Member State to another to suit their convenience. In other words, the Court confirmed that those rules are not designed to call into question the allocation by the Member States of their power to impose taxes, nor the right of each State to tax economic activities carried out in its territory. The Member States may thus prevent such transfers, which are aimed at benefiting from disparities in the rates applicable for the taxation of profits which have already arisen.

103. The second consideration which can be inferred from the *Marks and Spencer* judgment is that the first consideration must not call into question the scope of Articles 43 EC and 48 EC, which has been set out in the first part of my analysis. In paragraph 44 of that judgment, the Court confirmed its own settled case-law, according to which a reduction in tax revenue cannot constitute an overriding reason in the public interest which may justify a restriction on the exercise of the freedoms guaranteed by the Treaty. The Member State in which the parent company is established cannot therefore prevent the establishment by the latter of a subsidiary in another Member State using the pretext, for example, that the activities carried on by it there could be carried on in its own territory and fall within its tax sovereignty.

104. The question whether, and to what extent, transactions between a CFC and its parent company which result in the reduction of the latter's taxable profits constitute tax avoidance involves seeking the right balance between those two principles.

105. That search means, in my view, taking as a starting point the criterion taken into consideration when assessing whether there is abuse, namely whether the objective pursued by the Community law provision relied on is fulfilled. [60] It is therefore a question of assessing whether the establishment of a CFC in a low-tax State and its transactions with the parent company which resulted in a reduction of the tax due by the parent company in the State of origin constitute transactions which fall clearly within the scope of the objective of freedom of establishment.

106. We have seen that 'establishment', within the meaning of Article 43 EC et seq., involves the actual pursuit of an economic activity in the host State. If the subsidiary is actually carrying on such an activity in that State and, in that connection, it provides genuine and actual services to the

60 — Case C-206/94 *Paletta* [1996] ECR I-2357, paragraph 25, Case C-373/97 *Diamantis* [2000] ECR I-1705, paragraph 34, and *Emsland-Stärke*, paragraph 52.

parent company, I do not think that that situation may be regarded, in itself, as tax evasion or avoidance, even if payment for those services leads to a reduction in the taxable profits of the parent company in the State of origin.

107. Having regard to the objective of freedom of establishment, as long as the subsidiary carries on a genuine economic activity in the host State, there is no difference between the provision of services to third parties and the provision of those services to companies belonging to the same group as the subsidiary.

108. In addition, the provision of services by a subsidiary to its parent company is an economic activity which takes the form of transactions between distinct legal persons. The fact that those companies are linked does not prevent the pricing of those transactions from being determined under normal competitive conditions.[61] The risk of tax avoidance in connection with such transactions is not therefore comparable to that which would be created by the transfer of losses of foreign subsidiaries to a resident parent company, at issue in the *Marks and Spencer* case, since such a transfer of losses would be done by means of merely adjusting the accounts. Transactions between a CFC and its parent company which result in reducing the taxable profits of the latter can therefore be regarded as tax avoidance only if the establishment of that subsidiary and those transactions constitute, according to the case-law cited above, a wholly artificial arrangement aimed at circumventing national law.

109. Likewise, in my view, the fact that a company centralises in another Member State with a low tax rate the carrying on of certain activities of use to the entire group and seeks by that means to reduce the group's overall tax burden does not in itself constitute abuse. In such a case, as long as the subsidiary responsible for those intragroup services is carrying on genuine economic activity in the host State, under the tax sovereignty of which it falls, the territorial allocation of the Member States' power to impose taxes is not, a priori, affected. The loss of taxable profits affecting the State of origin is the result of the economic activity which is carried out in the host State and taxed by that State.

61 — That type of intragroup transaction has given rise to the development by the OECD of the principles applicable to transfer pricing which lay down the method by which the pricing of such transactions should be calculated by national administrations in order to establish correctly the tax due in each country and to avoid double taxation (see, inter alia, the OECD's project on harmful tax practices — Consolidated application note — Guidance in applying the 1998 Report to preferential tax regimes (p. 30 et seq.), available on the internet at: http://www.oecd.org/dataoecd/60/32/30901132.pdf)

110. It can thus be inferred that the assessment of whether there is a wholly artificial arrangement intended to circumvent national tax legislation in a parent company's relationship with a CFC must entail a case-by-case examination of whether the subsidiary is genuinely established in the host State and carries on its activities in that State with regard to the services provided to the parent company, the payment for which has resulted in a reduction in the tax due by that company in the State of origin.

111. The United Kingdom and the Commission cited in that regard three criteria which appear relevant. First, the degree of physical presence of the subsidiary in the host State, secondly, the genuine nature of the activity provided by the subsidiary and, finally, the economic value of that activity with regard to the parent company and the entire group.

112. The first of those criteria relates to whether the subsidiary is genuinely established in the host State. It means examining whether the subsidiary has the premises, staff and equipment necessary to carry out the services provided to the parent company which have resulted in the reduction of the tax due in the State of origin. If that is not the case, the subjection of those services to the tax sovereignty of the host State does appear to be a wholly artificial arrangement designed to avoid tax.

113. The second of those criteria relates to the genuine nature of the services provided by the subsidiary. In that connection, it is a question of looking at the competence of the subsidiary's staff in relation to the services provided and the level of decision-making in carrying out those services. If, for example, the subsidiary proves to be nothing but a mere tool of execution because the decisions necessary to carry out the services it is paid for are taken at another level, it is also right to consider that the subjection of those services to the tax sovereignty of the host State constitutes a wholly artificial arrangement.

114. The third criterion, relating to the value added by the subsidiary's activity, is no doubt trickier to apply where the services provided by it in fact reflect the exercise of genuine activities in the host State. This criterion seems to me to be relevant, however, in so far as it might make it possible to take account of an objective situation in which the services provided by the subsidiary have no economic substance in the light of the parent company's activity. If that were the case, I think it can be accepted that there is a wholly artificial arrangement because there appears, in effect, to be no consideration for the payment by the parent company for the services in question. Payment for such

services could therefore be viewed quite simply as a transfer of profits from the parent company to the subsidiary.

115. On the other hand, like the Commission and unlike the United Kingdom, I do not believe that the motives for establishing a subsidiary and for the choice of country in which to establish it can constitute a relevant criterion. In other words, the existence of a wholly artificial arrangement cannot be inferred from the parent company's avowed purpose of obtaining a reduction of its taxation in the State of origin.

116. As we have seen, the subjective reasons for which an economic operator has exercised the rights conferred on it by the Treaty cannot call into question the protection it derives from those rights once the objective pursued by them is fulfilled. Where that is the case, the fact that a parent company decided to relocate certain services necessary for the pursuit of its activities in a low-tax State for the purpose of reducing its tax burden is not relevant to a finding of tax avoidance.

117. A wholly artificial arrangement intended to avoid national tax law can therefore be established only on the basis of objective factors.

118. The same conclusion is also arrived at by referring once again to the case-law of the Court on the doctrine of 'abuse of rights'. According to that case-law, it is on the basis of objective circumstances that an abusive practice must be established.[62] As the Court held recently in the judgment in *Halifax and Others*, such a practice can be found to exist only if, in the light of 'a number of objective factors', the essential aim of the transactions concerned is to obtain a tax advantage the grant of which would be contrary to the objective pursued by that legislation.[63]

119. The competent national authorities which are responsible for making that finding are not therefore called upon to inquire into the parties' subjective intentions, which would be very difficult to prove and would give rise to legal uncertainty. They are to take into account circumstances such as collusion between an exporter and an importer[64] or the wholly artificial nature of

62 — See *Emsland-Starke*, paragraph 53 and Advocate General Poiares Maduro's analysis of the criteria set out in that judgment in his Opinion in Case C-255/02 *Halifax and Others* [2006] ECR I-1609.

63 — *Halifax and Others*, paragraphs 74 and 75.

64 — *Emsland-Starke*, paragraphs 52 and 53. *Emsland-Starke* had exported goods into a third country which had almost immediately transported them back into the Community on payment of the relevant import duties, the amount of which was less than the export refunds granted to the exporter. At issue was whether the exporter could claim export refunds in such a case.

the transactions in question and the links of a legal, economic and/or personal nature between the operators involved in the scheme for reduction of the tax burden. [65]

120. If we apply that analysis to our case, we encounter again the objective criteria proposed by the United Kingdom and the Commission. We have, in fact, a situation in which a resident company has established a subsidiary under its control in a Member State with a more favourable tax regime than that of the State of origin and has entered into transactions with that subsidiary which have resulted in a reduction in its taxation in that State.

121. In such a case, proof that the establishment of that subsidiary and the transactions in question could have no purpose other than that of obtaining a reduction in tax which would be contrary to the objective of freedom of establishment entails, as I have already stated, an examination of whether the subsidiary is genuinely established in the host State and whether those transactions are genuine, without there being any need to address the motives and subjective intentions of those concerned.

122. It is in the light of those considerations that I am going to examine whether the United Kingdom legislation on CFCs is suitable for counteracting tax avoidance and whether it goes beyond what is necessary for that purpose. [66]

123. As I have stated, the legislation at issue is designed to counteract the diversion of profits made by a United Kingdom tax resident company by establishing a subsidiary in a low-tax country and carrying out intragroup transactions whose main purpose is to transfer those profits to that subsidiary.

124. The conduct objected to is therefore for a parent company to reduce its taxable profits by paying its subsidiary for services, relying on the fact that the subsidiary's profits will be taxed in the host State at a much lower rate than that in effect in the State of origin.

65 — See *Halifax and Others*, paragraph 81. That case concerned practices on the part of taxable entities carrying on exempt activities which could not therefore deduct, or could deduct only in part, the value added tax (VAT) paid in respect of construction works. Those practices consisted of transferring the lease of the property constructed to an entity under their control, which was entitled to opt for taxation of the letting of that property and thereby to deduct the total input VAT paid on the construction costs.

66 — Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, paragraph 26 and the case-law cited; Case C-436/00 *X and Y*, paragraph 49; and *De Lasteyrie du Saillant*, paragraph 49.

125. By adding the profits made by the CFC to the parent company's tax base, there is no doubt that the legislation in question cancels the effects of such a practice. That legislation is thus indeed suitable for guaranteeing fulfilment of the purpose for which it was adopted.

126. It remains to examine whether it goes beyond what is necessary to achieve that purpose.

127. The United Kingdom legislation on CFCs, as I have stated, is designed to apply when a subsidiary of a resident company, which controls it, is established in a State in which its profits are taxed at a rate which is less than three quarters the amount of tax which would have been payable had those profits been taxed in the United Kingdom.

128. That legislation also provides for five exceptions pursuant to which it will not apply. Those exceptions, we will recall, apply if the subsidiary distributes a significant part of its profits to the parent company, if it carries on certain activities such as, in particular, trading activities, if it fulfils the 'public quotation condition' or if the CFC's chargeable profits do not exceed a certain amount. If none of those four conditions are fulfilled, the legislation on CFCs applies unless the resident company satisfies the 'motive test'.

129. That test consists of two cumulative conditions which relate, first, to the transactions between the CFC and the parent company and, secondly, to the establishment of the subsidiary.

130. First, if the transactions reflected in the profits of the subsidiary for the accounting period in question produce a reduction in the tax which would have been due in the United Kingdom if those transactions had not been carried out and that reduction exceeds a certain amount, the taxpayer must show that the reduction in United Kingdom tax was not the main purpose, or one of the main purposes, of those transactions.

131. Secondly, the taxpayer must show that it was not the main reason, or one of the main reasons, for the subsidiary's existence in that accounting period to achieve a reduction in United Kingdom tax by means of the diversion of profits outside that Member State.

132. There is also a list of countries within which, subject to specified conditions, application of the legislation on CFCs is precluded.

133. Finally, it should also be noted that the United Kingdom legislation on CFCs includes a system for offsetting the tax which has been paid by the subsidiary in the host State in order to prevent those profits from being subject to double taxation by reason of their being attributed to the parent company.

134. Ireland submits that the objective pursued by that legislation could be attained by less restrictive measures, such as exchange of information under Directive 77/799. It also states that such exchange may also take place under the Convention of 2 June 1976 between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains. It submits, finally, that application of the legislation under consideration constitutes a significant and disproportionate burden on United Kingdom resident parent companies which have a subsidiary in Ireland.

135. I am not particularly persuaded by Ireland's assessment. Admittedly, exchange of information under Directive 77/799 is designed to facilitate counteraction of tax avoidance and that directive has often been relied on by the Court as offering the Member States sufficient opportunities to overcome administrative obstacles associated with knowledge of a non-resident's circumstances. [67] It is equally true that the United Kingdom legislation on CFCs sets up a presumption. Accordingly, when none of the first four conditions stated above applies and transactions between a subsidiary and its parent company result in reducing, by more than a minimum amount, the tax which would have been owed by the latter if those transactions had not taken place, it is for the taxpayer to prove the absence of tax avoidance.

136. In view of the particular situation covered by the legislation in question, however, I am not convinced that exchange of information under Directive 77/799 could be as effective as the legislation at issue. Likewise, I do not share the view that that legislation should be regarded, owing to the presumption it introduces, of imposing an unreasonable burden on the companies to which it applies.

67 — See, in particular, Case C-279/93 *Schumacker* [1995] ECR I-225, paragraph 45, and Case C-55/98 *Vestergaard* [1999] ECR I-7641, paragraph 26. See, for a recent example, Case C-334/02 *Commission* v *France* [2004] ECR I-2229, paragraph 31.

137. First, the United Kingdom legislation on CFCs, in view of all of its conditions for application and exemption, is designed to apply only in very specific circumstances which correspond to cases in which the probability of the risk of tax avoidance is highest.

138. Thus, as the Commission stated at the hearing, it is much easier to establish an artificial CFC which purports to provide services than one which is to carry on activity producing consumer goods. Thus, when the services in question consist, as in this case, of raising funds and providing them to subsidiaries in the worldwide Cadbury group, because of modern communication methods they can be carried out in the name of the CFC by staff and information technology which is not physically and materially located in Ireland. In the case of such services, the company formally established in Dublin may have no real substance and be exclusively what is termed a 'letter-box' company.

139. Further, such artificial arrangements are probably more to be feared when the CFC is established in a very low tax State. Finally, the finding that the transactions between the CFC and its parent company have resulted in a reduction of more than a minimum amount in the tax due in the United Kingdom and the fact that no taxable dividends are distributed in the State of origin constitute objective circumstances which may corroborate the inference of tax avoidance.

140. In such a case, given the ease with which such services can be relocated, I do not find it excessive for a Member State to introduce a presumption of tax avoidance instead of relying on the subsequent communication of information.

141. Second, the existence of such legislation has the advantage of contributing to the legal certainty of economic operators. It enables them to know in advance that, in the aforementioned case, there is a presumption of tax avoidance. Those operators are thus on notice that they must be able to show that their subsidiary is genuinely established in the host State and that the transactions with the subsidiary are real.

142. None the less, I do not believe that preparing that proof constitutes an unreasonable workload. It is reasonable to believe that such proof might also have to be adduced in an 'ordinary' tax check, carried out on the basis of the ordinary national legal

rules designed to counteract tax avoidance.[68] The legislation in question, since it lays down in advance the cases in which proof is to be provided, seems to me to be rather to the advantage of economic operators.

143. On the other hand, what is important is that the presumption set up by the law in question may in fact be rebutted. As several Member States and the Commission have rightly noted, the fact that none of the first four exceptions apply and that the transactions between the subsidiary and its parent company have resulted in a significant reduction in the tax due in the United Kingdom does not suffice to show the existence of a wholly artificial arrangement.

144. It is conceivable that the services which were the subject of the transactions in question reflect genuine business carried out by the subsidiary in the host State. Likewise, a subsidiary may have legitimate grounds for not distributing profits of an amount equal to that laid down by the legislation in question. It is therefore important that the presumption set up by the legislation at issue may be rebutted and that the application of that law may therefore be limited to wholly artificial arrangements the purpose of which is to circumvent national tax law.

145. In accordance with the case-law, the taxable person must be able to provide that proof in accordance with the rules of evidence under national law, provided that the effectiveness of Community law is not thereby undermined.[69]

146. It is the motive test which, in the scheme of the contested legislation, must enable the national authorities to take account of the particular circumstances of each taxpayer.

147. The Commission, supported by the Belgian and Cypriot Governments on that point, maintains that that test is not altogether satisfactory because, first, there is no indication that the United Kingdom tax authorities perform any analysis of the actual activities of the subsidiary and, secondly, that test would result in retaining within the scope of the legislation on CFCs companies

68 — The national court did not provide particulars in that respect. We may, however, assume that the establishment of an artificial CFC to avoid national tax could fall under the principle identified by the House of Lords in *W.T. Ramsay Ltd* v *Inland Revenue Commissioners* [1982] AC 300, which states that where a tax transaction comprises a series of artificial steps which serve no purpose other than to reduce tax, the proper approach is to tax the effect of the transaction as a whole (*Simon's Direct Tax Service*, Butterworths, London, 2005, Vol. 7, paragraphs I2.203 to I2.211).

69 — See, to that effect, *Emsland-Stärke*, paragraphs 52 to 54 and case-law cited.

which wished to benefit from the lower tax rate in the host State. The Commission notes that such a choice does not constitute a wholly artificial arrangement.

148. If the Commission's interpretation of the motive test were well founded, I would also take the view that the United Kingdom legislation on CFCs goes beyond what is necessary to counteract tax avoidance. As we have seen, the fact that a company has decided to centralise the performance of services in a Member State with very favourable taxation for the purpose of reducing its tax burden does not prove the existence of a wholly artificial arrangement.

149. However, in the light of the national court's description of the legal framework, it is not certain that the motive test should be given such an interpretation. Thus we do not know for sure if the first limb of that test, regarding the services which have resulted in a significant reduction in the tax due in the United Kingdom, enables the taxpayer to exempt itself by providing proof of the reality of those services. Likewise, it is not clear whether the second limb relates to the subjective motives of those concerned or whether it can be satisfied where the taxpayer proves that the subsidiary is genuinely established in the host State.

150. At this stage I am of the opinion that it is for the national court, which has the task of determining the compatibility with Community law of its national law on CFCs, to assess whether the motive test may be given an interpretation which makes it possible to limit the application of that law to artificial arrangements intended to circumvent national tax law.

151. In the light of all of the foregoing considerations, I am of the opinion that the answer to the question referred for a preliminary ruling is that Articles 43 EC and 48 EC do not preclude national tax legislation which provides for inclusion in the tax base of a resident parent company profits of a CFC established in another Member State where those profits are subject in that State to a much lower level of taxation than that in effect in the State of residence of the parent company, if that legislation applies only to wholly artificial arrangements intended to circumvent national law. Such legislation must therefore enable the taxpayer to be exempted by providing proof that the controlled subsidiary is genuinely established in the State of establishment and that the transactions which have resulted in a reduction in the taxation of the parent company reflect services which were actually carried out in that State and were not devoid of economic purpose with regard to that company's activities.

V — Conclusion

152. In light of all of those considerations, I propose that the following answer be given to the question put by the Special Commissioners:

Articles 43 EC and 48 EC do not preclude national tax legislation which provides for inclusion in the tax base of a resident parent company profits of a controlled foreign company established in another Member State where those profits are subject in that State to a much lower level of taxation than that in effect in the State of residence of the parent company, if that legislation applies only to wholly artificial arrangements intended to circumvent national law. Such legislation must therefore enable the taxpayer to be exempted by providing proof that the controlled subsidiary is genuinely established in the State of establishment and that the transactions which have resulted in a reduction in the taxation of the parent company reflect services which were actually carried out in that State and were not devoid of economic purpose with regard to that company's activities.