Case C-374/04

Test Claimants in Class IV of the ACT Group Litigation

v

Commissioners of Inland Revenue

(Reference for a preliminary ruling from the High Court of Justice of England and Wales, Chancery Division

(Freedom of establishment – Free movement of capital – Corporation tax – Payment of dividends – Tax credit – Separate treatment of resident and non-resident shareholders – Bilateral double taxation conventions)

Summary of the Judgment

1. *Freedom of movement for persons – Freedom of establishment – Free movement of capital – Tax legislation*

2. *Freedom of movement for persons – Freedom of establishment – Free movement of capital – Tax legislation*

(Arts 43 EC and 56 EC)

3. *Freedom of movement for persons – Freedom of establishment – Free movement of capital – Tax legislation*

(Arts 43 EC and 56 EC)

1. Articles 43 EC and 56 EC must be interpreted as meaning that, where a Member State has a system for preventing or mitigating a series of charges to tax or economic double taxation for dividends paid to residents by resident companies, it must treat dividends paid to residents by non-resident companies in the same way.

The situation of shareholders resident in a Member State and receiving dividends from a company established in that State is comparable to that of shareholders who are resident in that State and receive dividends from a company established in another Member State, inasmuch as both the dividends deriving from a national source and those deriving from a foreign source may be subject, first, in the case of corporate shareholders, to a series of charges to tax and, secondly, in the case of ultimate shareholders, to economic double taxation. However, the company making the distribution and the shareholder to whom it is paid are not resident in the same Member State, the Member State in which the company making the distribution is resident is not in the same position as the Member State in which the shareholder receiving the distribution is resident. The position of a Member State in which both the companies making the distribution and the ultimate shareholders are resident is not comparable to that of a Member State in which a company is resident which pays dividends to a non-resident company, which pays them, in turn, to its ultimate shareholders, in that the second State acts, in principle, only as the State in which the distributed profits are derived. On the other hand, it is in its capacity as the Member State in which the shareholder is resident that, when a resident company pays dividends to its resident ultimate shareholders, that Member State grants to such shareholders, on payment of the dividends, a tax credit equal to the fraction of the advance corporation tax paid by the company which made the distributed profits.

(see paras 55-56, 58, 64-65)

2. Articles 43 EC and 56 EC do not prevent a Member State, on a distribution of dividends by a company resident in that State, from granting companies receiving those dividends which are also resident in that State a tax credit equal to the fraction of the corporation tax paid on the distributed profits by the company making the distribution, when it does not grant such a tax credit to companies receiving such dividends which are resident in another Member State and are not subject to tax on dividends in the first State.

(see para. 74, operative part 1)

3. Articles 43 EC and 56 EC do not preclude a situation in which a Member State does not extend the entitlement to a tax credit provided for in a double taxation convention concluded with another Member State for companies resident in the second State which receive dividends from a company resident in the first State to companies resident in a third Member State with which it has concluded a double taxation convention which does not provide for such an entitlement for companies resident in that third State.

The fact that the reciprocal rights and obligations under the first convention apply only to persons resident in one of the two contracting Member States is an inherent consequence of bilateral double taxation conventions.

(see paras 91, 94, operative part 2)

JUDGMENT OF THE COURT (Grand Chamber)

12 December 2006 (*)

(Freedom of establishment – Free movement of capital – Corporation tax – Payment of dividends – Tax credit – Separate treatment of resident and non-resident shareholders – Bilateral double taxation conventions)

In Case C-374/04,

REFERENCE for a preliminary ruling under Article 234 EC by the High Court of Justice of England and Wales, Chancery Division (United Kingdom), made by decision of 25 August 2004, received at the Court on 30 August 2004, in the proceedings

Test Claimants in Class IV of the ACT Group Litigation

v

Commissioners of Inland Revenue,

THE COURT (Grand Chamber),

composed of V. Skouris, President, P. Jann, C.W.A. Timmermans, A. Rosas, K. Lenaerts (Rapporteur), R. Schintgen and J. Klu?ka, Presidents of Chambers, J.N. Cunha Rodrigues, M. Ileši?, J. Malenovský and U. Lõhmus, Judges,

Advocate General: L.A. Geelhoed,

Registrar: L. Hewlett, Principal Administrator,

having regard to the written procedure and further to the hearing on 22 November 2005,

after considering the observations submitted on behalf of:

– Test Claimants in Class IV of the ACT Group Litigation, by G. Aaronson QC, D. Milne QC, P. Farmer and D. Cavender, Barristers,

– the United Kingdom Government, by E. O'Neill and C. Gibbs, acting as Agents, and by G. Barling QC, D. Ewart and J. Stratford, Barristers,

– the German Government, by W.-D. Plessing and U. Forsthoff, acting as Agents,

– the French Government, by J.C. Gracia, acting as Agent,

– Ireland, by D.J. O'Hagan, acting as Agent, and by A.M. Collins SC and G. Clohessy BL,

– the Italian Government, by I.M. Braguglia, acting as Agent, assisted by P. Gentili, avvocato dello Stato,

– the Netherlands Government, by H.G. Sevenster and M. De Grave, acting as Agents,

– the Finnish Government, by A. Guimaraes-Purokoski, acting as Agent,

– the Commission of the European Communities, by R. Lyal, acting as Agent,

after hearing the Opinion of the Advocate General at the sitting on 23 February 2006,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Articles 43 EC, 56 EC, 57 EC and 58 EC.

2 The reference has been made in proceedings between groups of companies and the Commissioners of Inland Revenue relating to the refusal by the latter to grant a tax credit to non-resident companies in those groups for dividends paid to them by resident companies.

Legal framework

Community legislation

3 Article 4(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) provides:

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

– refrain from taxing such profits, or

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

National legislation

4 Under the tax legislation in force in the United Kingdom, the profits made during an accounting period by every company resident in that Member State are subject to corporation tax in that State.

5 From 1973 onwards, the United Kingdom of Great Britain and Northern Ireland operated a system of taxation known as ‘partial imputation’, under which, in order to avoid economic double taxation when a resident company distributed profits, part of the corporation tax paid by that company was imputed to its shareholders. Until 6 April 1999, the basis of that system was, on the one hand, advance payment of corporation tax by the company making the distribution, and, on the other hand, a tax credit granted to shareholders who had received a dividend.

Advance corporation tax

6 Under section 14 of the Income and Corporation Taxes Act 1988 (‘ICTA’), in the version in force at the time of the facts in the main proceedings, a company resident in the United Kingdom which paid dividends to its shareholders was liable to pay advance corporation tax (‘ACT’), calculated by reference to the amount or value of the distribution made.

7 A company had the right to set the ACT paid in respect of a distribution made during a particular accounting period against the amount of mainstream corporation tax for which it was liable in respect of that accounting period, subject to certain restrictions. If the liability of a company for corporation tax was insufficient to allow the ACT to be set off in full, the surplus ACT could be carried back to a previous accounting period or carried forward to a later one, or surrendered to subsidiaries of that company, which could set it off against the amount for which they themselves were liable in respect of corporation tax. Surplus ACT could be surrendered only to United Kingdom-resident subsidiaries.

8 A group of companies in the United Kingdom could also elect to be taxed as a group, in which case companies belonging to that group could postpone payment of ACT until the parent company in the group made a distribution by way of dividend. That system, which formed the subject-matter of the judgment in Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I?1727, is not at issue in these proceedings.

The tax credit granted to resident shareholders

9 Under section 208 of ICTA, where a United Kingdom-resident company received dividends

from a company that was also resident in the United Kingdom, it was not liable to corporation tax in respect of those dividends.

10 In addition, by virtue of section 231(1) of ICTA, every payment of dividends subject to ACT by a resident company to another resident company gave rise to a tax credit in favour of the latter company equal to the fraction of the ACT paid by the former company. In terms of section 238(1) of ICTA, the dividend received and the tax credit together constituted ‘franked investment income’ (‘FII’) in the hands of the company receiving the dividends.

11 A United Kingdom-resident company which received dividends from another resident company, the payment of which gave rise to entitlement to a tax credit, could recover the amount of ACT paid by the latter company and deduct it from the amount of ACT which it itself had to pay when making a distribution to its own shareholders, with the result that it was liable for ACT only on the excess.

12 Under Schedule F of ICTA, individual shareholders resident in the United Kingdom were liable to income tax on dividends received from a company resident in that Member State. Those shareholders were, nevertheless, entitled to a tax credit equal to the fraction of the ACT paid by that company. That tax credit could be deducted from the amount owed by that shareholder by way of income tax on the dividend, or could be paid to that person in cash if the amount of the tax credit exceeded the amount of his tax liability.

13 The effect of those provisions was that profits distributed by resident companies were taxed once at company level and were taxed at the level of the ultimate shareholder only to the extent that the latter’s income tax exceeded the amount of the tax credit to which he was entitled.

The case of non-resident shareholders

14 A company not resident in the United Kingdom was, in principle, chargeable to tax on its income only in respect of revenue which had its source in that State, including dividends received from a United Kingdom-resident company. However, by virtue of section 233(1) of ICTA, since a non-resident company was not entitled to a tax credit in the United Kingdom, it was not liable to tax on those dividends.

15 By contrast, where, by virtue of a double taxation convention (‘DTC’) concluded by the United Kingdom, a non-resident company was entitled in that Member State to a full or partial tax credit, it was liable to income tax in the United Kingdom on the dividends which it received from a resident company.

16 Likewise, an individual who was not resident in the United Kingdom was, in principle, liable to income tax in that Member State on dividends deriving from a United Kingdom source but, in so far as that individual was not entitled in the United Kingdom to a tax credit under national legislation or a DTC, he was not liable to income tax on those dividends in that State.

17 Although the United Kingdom generally retains the right, in DTCs concluded with other Member States or with non-member countries, to tax the dividends paid by its residents to non-residents, the DTCs often contain restrictions on the rate of tax which the United Kingdom may charge. That maximum rate may vary depending on the circumstances and, in particular, according to whether the shareholder is entitled to a full or partial tax credit under the DTC.

18 Some DTCs concluded by the United Kingdom do not confer entitlement to a tax credit on companies resident in the other contracting State when those companies receive dividends from a United Kingdom?resident company. That is the case, in particular, with the DTCs concluded with

the Federal Republic of Germany and with Japan.

19 Other DTCs provide for a tax credit in certain circumstances. For example, the tax credit provided for under the DTC concluded by the United Kingdom with the Kingdom of the Netherlands is granted in full to shareholders resident in that Member State who control fewer than 10% of the voting rights in the company making the distribution and in part when shareholders control 10% or more of the voting rights.

20 The DTC concluded with the Kingdom of the Netherlands also contains a ‘limitation of benefits’ provision, in terms of which no entitlement to the tax credit under that DTC arises if the non-resident shareholder is itself owned by a company established in a State with which the United Kingdom has concluded a DTC which does not provide entitlement to a tax credit to companies receiving dividends from a United Kingdom?resident company.

21 Those provisions of the legislation which applied in the United Kingdom were significantly amended by the Finance Act 1998, which applies to dividends paid from 6 April 1999. The legal rules described above are those which applied prior to that date.

The main proceedings and the questions referred for preliminary ruling

22 The main proceedings are part of a group litigation concerning ACT consisting of claims for restitution and/or compensation brought against the Commissioners of Inland Revenue before the Chancery Division of the High Court of Justice of England and Wales, following the judgment in *Metallgesellschaft and Others.*

23 In that judgment, the Court, giving a ruling on questions referred for a preliminary ruling from the same national court, held, in reply to the first question referred, that it is contrary to Article 43 EC for the tax legislation of a Member State to afford companies resident in that State the possibility of benefiting from a taxation regime allowing them to pay dividends to their parent company without having to pay advance corporation tax where their parent company is also resident in that State but to deny them that possibility where their parent company has its seat in another Member State.

24 In its reply to the second question referred in those cases, the Court held that, where a subsidiary resident in one Member State has been obliged to pay advance corporation tax in respect of dividends paid to its parent company having its seat in another Member State even though, in similar circumstances, the subsidiaries of parent companies resident in the first State were entitled to opt for a taxation regime that allowed them to avoid that obligation, Article 43 EC requires that resident subsidiaries and their non-resident parent companies should have an effective legal remedy in order to obtain reimbursement of or reparation for the financial loss which they have sustained and from which the authorities of the Member State concerned have benefited as a result of the advance payment of tax by the subsidiaries.

25 In the main proceedings, the litigation before the national court concerning ACT comprises four separate classes, in respect of which common issues have been identified. Class IV of the litigation, at the time of the order for reference, encompasses claims by 28 groups of companies, all containing at least one non-resident company, which opposed the refusal of the Commissioners of Inland Revenue to grant a tax credit to such a non-resident company when it received dividends from a resident company. When the

26 The four cases selected by the national court as test cases for the purposes of this reference for a preliminary ruling concern applications brought both by resident companies and by non-resident companies belonging to the same group as the resident companies and which

received dividends from them (‘the claimants in the main proceedings’). The cases involve dividends paid between 1974 and 1998 to companies resident in Italy (the Pirelli Group), France (the Essilor Group) and the Netherlands (the BMW and Sony Groups).

27 While, in the case of the Pirelli Group, the non-resident company holds a minority shareholding of at least 10% in the resident company, the other cases concern non-resident parent companies which have 100% control over their resident subsidiary. In the cases of the two parent companies resident in the Netherlands, the first is wholly owned by a company resident in Germany, while the second is owned by a company resident in Japan.

28 The national court observes that those claims concern issues already raised before the Court in *Metallgesellschaft and Others*, which the Court did not need to answer because of the reply it gave to the first and second questions referred to it by the national court. While in those cases the grant of a tax credit was considered only as an alternative to reimbursement of ACT or reparation for the loss incurred as a result of payment of ACT, the claims brought before the national court are directly concerned with the grant of a tax credit.

29 In those circumstances, the High Court of Justice of England and Wales, Chancery Division, decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

‘1. Is it contrary to Article[s] 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:

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

(ii) 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;

(iii) 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 any part of Question 1(a) 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 Article 43 [EC] and/or [Article] 56 [EC], 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* [[1996] ECR I-1029] 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 Article 43 [EC] and/or [Article] 56 [EC], or

2. must the conditions for recovery laid down in [*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 [Member] 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 [*Metallgesellschaft and Others*] 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 [*Brasserie du Pêcheur 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?’

The questions referred

Question 1(a)

30 By Question 1(a), the national court essentially asks whether Articles 43 EC and 56 EC preclude a rule of a Member State, such as the rule at issue in the main proceedings, which, on a payment of dividends by a resident company, grants a full tax credit to the ultimate shareholders receiving the dividends who are resident in that Member State or in another State with which the first Member State has concluded a DTC providing for such a tax credit, but does not grant a full or partial tax credit to companies receiving such dividends which are resident in certain other Member States.

31 The file shows that, rather than putting before the Court an issue involving a difference in treatment between, on the one hand, ultimate shareholders, whether or not resident, receiving dividends paid by a resident company and, on the other hand, non?resident companies receiving such dividends, the national court requests an interpretation of Community law which will enable it to determine the compatibility with Community law of the different treatment in the United Kingdom which applies, on the one hand, to a resident company which is entitled to a tax credit when it receives dividends from another resident company and whose ultimate resident shareholders are also entitled to a tax credit when they are paid dividends and, on the other hand, to a non-resident company which is not, save in particular cases covered by DTCs, entitled in the United Kingdom to a tax credit when it receives dividends from a resident company and whose ultimate shareholders, whether or not resident, are also not entitled to a tax credit.

32 Under the relevant United Kingdom legislation, while a resident company receiving dividends from another resident company is entitled to a tax credit equal to the amount of the advance corporation tax paid by the latter, conversely, a non-resident company receiving dividends from a resident company is entitled to a full or partial tax credit by virtue of that distribution only where such a tax credit is provided for under a DTC concluded between the State in which the latter company is resident and the United Kingdom.

33 It is true that, in their observations to the Court, the claimants in the main proceedings also refer to the less favourable situation of ultimate shareholders receiving dividends from a non?resident company, who are not entitled to a tax credit, by comparison with ultimate shareholders who receive dividends from a resident company, who are entitled to such a credit under the relevant United Kingdom legislation, or, in the case of non-resident shareholders, by virtue of a DTC. However, it is clear that the claimants in the main proceedings rely on the less favourable treatment applying to shareholders in non?resident companies in order only to object to a restriction on freedom of establishment and free movement of capital as regards those companies themselves.

34 The claimants in the main proceedings argue that the United Kingdom legislation in question contravenes Articles 43 EC and 56 EC, since it is liable to discourage non-resident companies from establishing subsidiaries in that Member State, from investing in the capital of resident companies and from raising capital in that State. That legislation cannot be justified either by a relevant difference between the situation of resident companies receiving dividends from a resident company and that of non-resident companies receiving such dividends, or by the objective of ensuring the cohesion of the national tax system or that of preventing the economic double taxation of distributed profits.

35 According to the claimants in the main proceedings, in order to enable non-resident companies receiving dividends from a resident company to place their shareholders on the same footing as shareholders of resident companies receiving such dividends, the United Kingdom should grant a tax credit to non-resident companies.

36 It should be recalled at the outset that, according to well-established case?law, although direct taxation falls within their competence, the Member States must none the less exercise that competence consistently with Community law (see, inter alia, Case C-35/98 *Verkooijen* [2000] ECR I?4071, paragraph 32; *Metallgesellschaft and Others*, paragraph 37; and Case C?471/04 *Keller Holding* [2006] ECR I-2107, paragraph 28).

37 As regards the question whether the national legislation at issue in the main proceedings falls within the scope of Article 43 EC on freedom of establishment or Article 56 EC on free movement of capital, it must be noted that the question referred concerns national measures relating to the taxation of dividends, in terms of which, irrespective of the extent of the holding of the shareholder receiving the dividend, a resident company receiving dividends from another resident company is granted a tax credit, whereas, for a non-resident company receiving such dividends, the grant of a tax credit is dependent on the provisions of such DTC, if any, as the United Kingdom may have concluded with the State in which that company is resident. Under some DTCs, such as that concluded with the Kingdom of the Netherlands, the amount of the tax credit varies depending on the extent of the holding of the shareholder in the company making the distribution.

38 It follows that the measures at issue may fall within the scope of both Article 43 EC and Article 56 EC.

39 The order for reference shows that three of the cases chosen as test cases in the proceedings before the national court concern United Kingdom-resident companies which are wholly owned by non-resident companies. As the nature of the interest in question will confer on the holder definite influence over the company's decisions and allow it to determine the company's activities, the provisions of the EC Treaty on freedom of establishment will apply (Case C-251/98 *Baars* [2000] ECR I-2787, paragraphs 21 and 22; Case C-436/00 *X and Y* [2002] ECR I?10829, paragraphs 37 and 66 to 68; and Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-0000, paragraph 31).

40 However, as the Advocate General states in points 28 and 30 of his Opinion, there is not sufficient information before the Court to enable it to determine the nature of the relevant holding in the fourth test case or that of the holding of other companies that are parties to the dispute. It may therefore be that the dispute also relates to the effect of the national legislation at issue in the main proceedings on dividends paid by a resident company to non-resident companies having a holding which does not give them definite influence over the decisions of the company making the distribution and does not allow them to determine its activities. That legislation must therefore also be considered in the light of the Treaty provisions on the free movement of capital.

41 As regards, first of all, consideration of the question referred from the point of view of freedom of establishment, the claimants in the main proceedings contend that, since, apart from certain cases covered by DTCs, the relevant United Kingdom legislation does not grant a tax credit to a non-resident company receiving dividends from a resident company or to its ultimate shareholders, whether resident or non?resident, that legislation restricts the freedom of such a non-resident company to establish subsidiaries in that Member State. By comparison with resident companies receiving dividends from a resident company, a non-resident company is in an unfavourable position, in that, since its shareholders are not entitled to a tax credit, that company must increase the amount of its dividends in order for its shareholders to receive a sum equivalent to that which they would receive if they were shareholders in a resident company.

42 It should be pointed out in that regard that freedom of establishment, which Article 43 EC grants to Community nationals and which includes the right for them to take up and pursue activities as self-employed persons and to set up and manage undertakings, under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected, entails, in accordance with Article 48 EC, for companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the European Community, the right to exercise their activity in the Member State concerned through a subsidiary, branch or agency (see, in particular, Case C-307/97 *Saint?Gobain ZN* [1999] ECR I-6161, paragraph 35; Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, paragraph 30; and *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 41).

43 In the case of companies, it should be borne in mind that their registered office for the purposes of Article 48 EC serves, in the way same as nationality in the case of individuals, as the connecting factor with the legal system of a Member State. Acceptance of the proposition that the Member State in which a company seeks to establish itself may freely apply different treatment merely by reason of its registered office being situated in another Member State would deprive Article 43 EC of all meaning (see, to that effect, Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 18; Case C-330/91 *Commerzbank* [1993] ECR I?4017, paragraph 13; *Metallgesellschaft and Others*, paragraph 42; and *Marks & Spencer*, paragraph 37). Freedom of establishment thus aims to guarantee the benefit of national treatment in the host Member State, by prohibiting any discrimination based on the place in which companies have their seat (see, to

that effect, *Commission* v *France*, paragraph 14, and *Saint?Gobain ZN*, paragraph 35).

44 In the present case, it is not disputed that a company resident in the United Kingdom which receives dividends from another resident company is entitled to a tax credit in that Member State, equal to the fraction of the amount of the ACT paid by the latter, whereas a non?resident company receiving dividends from a resident company is not entitled to such an advantage, unless pursuant to such DTC, if any, as may have been concluded between the State in which it is resident and the United Kingdom.

45 Likewise, where a resident company in turn pays dividends to its ultimate shareholders and is accordingly liable to pay ACT, those shareholders are entitled, when they are resident in the United Kingdom or are subject to a DTC which provides for such an entitlement, to a tax credit in that State which may be deducted from the amount of their liability to income tax or, if the credit exceeds that amount, to be paid in cash. Conversely, where a non?resident company pays dividends to ultimate shareholders, the latter are not entitled to such a tax credit.

46 In order to determine whether a difference in tax treatment is discriminatory, it is, however, necessary to consider whether, having regard to the national measure at issue, the companies concerned are in an objectively comparable situation. According to well-established case-law, discrimination is defined as treating differently situations which are identical, or treating in the same way situations which are different (see Case C-279/93 *Schumacker* [1995] ECR I?225, paragraph 30, and Case C-311/97 *Royal Bank of Scotland* [1999] ECR I?2651, paragraph 26).

47 According to the United Kingdom Government, the German Government, the French Government, Ireland and the Italian Government, together with the Commission of the European Communities, in the case of a national measure which grants a tax credit to shareholders receiving dividends from a resident company, the situation of resident shareholders and that of non-resident shareholders are not identical, in that a non-resident company is not liable to tax in the United Kingdom on those dividends. Those Governments point out that a non-resident company is also not liable to ACT when it distributes profits to its own shareholders.

48 Conversely, the claimants in the main proceedings contend that, as regards the taxation of dividends received from a resident company, both resident and non-resident companies receiving those dividends are in an identical situation. While acknowledging that, as regards those dividends, a non-resident company receiving them is not liable to income tax in the United Kingdom or is, by virtue of a DTC, taxable there but is entitled to a tax credit for tax paid by the company making the distribution, they point out that a resident company to which such dividends are paid is also exempt from corporation tax in the United Kingdom on those dividends.

49 It should be noted in that regard that dividends paid by a company to its shareholders may be subject both to a series of charges to tax, since they are taxed, first, at distributing company level, as realised profits, and are then subject to corporation tax at parent company level, and to economic double taxation, since they are taxed, first, at the level of the company making the distribution and are then subject to income tax at ultimate shareholder level.

50 It is for each Member State to organise, in compliance with Community law, its system of taxation of distributed profits and, in that context, to define the tax base as well at the tax rates which apply to the company making the distribution and/or the shareholder to whom the dividends are paid, in so far as they are liable to tax in that State.

51 By virtue of Article 293 EC, Member States are required, so far as necessary, to enter into negotiations with each other with a view to securing for the benefit of their nationals the abolition of double taxation within the Community. However, apart from Convention 90/436/EEC of 23 July

1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (OJ 1990 L 225, p. 10), no unifying or harmonising measure for the elimination of double taxation has yet been adopted at Community level, and Member States have not yet concluded any multilateral convention to that effect under Article 293 EC (see Case C?336/96 *Gill* [1998] ECR I-2793, paragraph 23; Case C-376/03 *D*. [2005] ECR I-5821, paragraph 50; and Case C?470/04 *N.* [2006] ECR I-0000, paragraph 43).

52 It is against that background that the Court has already held that, in the absence of any unifying or harmonising Community measures, Member States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, particularly with a view to eliminating double taxation (*Gilly*, paragraphs 24 and 30; *Saint?Gobain ZN*, paragraph 57; and *N.*, paragraph 44).

53 It is only in the case of companies of Member States which have a minimum holding of 25% in the capital of a company of another Member State that Article 4 of Directive 90/435, read in conjunction with Article 3 of that directive, in the original version applying at the time of the facts in the main proceedings, obliges each Member State either to exempt profits received by a resident parent company from a subsidiary resident in another Member State or to authorise that parent company to deduct from the amount of tax due that fraction of the corporation tax paid by the subsidiary which relates to those profits and, if appropriate, the amount of the withholding tax levied by the Member State in which the subsidiary is resident.

54 The mere fact that, for holdings to which Directive 90/435 does not apply, it is for the Member States to determine whether, and to what extent, a series of charges to tax and economic double taxation are to be avoided and, for that purpose, to establish, either unilaterally or through DTCs concluded with other Member States, procedures intended to prevent or mitigate such a series of charges to tax and that economic double taxation, does not of itself mean that the Member States are entitled to impose measures that contravene the freedoms of movement guaranteed by the Treaty.

55 Thus, where a Member State has a system for preventing or mitigating a series of charges to tax or economic double taxation for dividends paid to residents by resident companies, it must treat dividends paid to residents by non-resident companies in the same way (see, to that effect, Case C-315/02 *Lenz* [2004] ECR I?7063, paragraphs 27 to 49, and Case C-319/02 *Manninen* [2004] ECR I?7477, paragraphs 29 to 55).

56 Under such systems, the situation of shareholders resident in a Member State and receiving dividends from a company established in that State is comparable to that of shareholders who are resident in that State and receive dividends from a company established in another Member State, inasmuch as both the dividends deriving from a national source and those deriving from a foreign source may be subject, first, in the case of corporate shareholders, to a series of charges to tax and, secondly, in the case of ultimate shareholders, to economic double taxation (see, to that effect, *Lenz*, paragraphs 31 and 32, and *Manninen*, paragraphs 35 and 36).

57 However, although the situation of those shareholders must be treated as being comparable as regards the application to them of the tax legislation of the Member State in which they are resident, the same is not necessarily true, as regards the application of the tax legislation of the Member State in which the company making the distribution is resident, of the situations in which shareholders receiving dividends resident in that Member State and shareholders receiving dividends resident in another Member State are placed.

58 Where the company making the distribution and the shareholder to whom it is paid are not resident in the same Member State, the Member State in which the company making the

distribution is resident, that is to say the Member State in which the profits are derived, is not in the same position, as regards the prevention or mitigation of a series of charges to tax and of economic double taxation, as the Member State in which the shareholder receiving the distribution is resident.

59 It must be held in that regard, first, that to require the Member State in which the company making the distribution is resident to ensure that profits distributed to a non-resident shareholder are not liable to a series of charges to tax or to economic double taxation, either by exempting those profits from tax at the level of the company making the distribution or by granting the shareholder a tax advantage equal to the tax paid on those profits by the company making the distribution, would mean in point of fact that that State would be obliged to abandon its right to tax a profit generated through an economic activity undertaken on its territory.

60 Secondly, as regards a procedure for preventing or mitigating economic double taxation by the grant of a tax advantage to the ultimate shareholder, it must be pointed out that it is usually the Member State in which the latter is resident that is best placed to determine the shareholder's ability to pay tax (see, to that effect, *Schumacker*, paragraphs 32 and 33, and *D.*, paragraph 27). Likewise, in the case of shareholdings to which Directive 90/435 applies, Article 4(1) of that directive requires the Member State of the parent company which receives profits distributed by a subsidiary which is resident in another Member State, and not the latter State, to avoid a series of charges to tax, either by refraining from taxing such profits or by taxing such profits while authorising that parent company to deduct from the amount of tax due that fraction of the corporation tax paid by the subsidiary which relates to those profits and, if appropriate, the amount of the withholding tax levied by the Member State in which the subsidiary is resident.

61 As regards the national legislation at issue in the main proceedings, it must be pointed out that, where a company resident in the United Kingdom pays dividends to another company, neither the dividends received by a resident company nor those received by a non-resident company are subject to tax in the United Kingdom.

62 There is therefore no difference in treatment in that respect.

63 However, there is a difference between resident companies receiving dividends and non-resident companies receiving dividends as regards the ability of those companies to pay dividends to their ultimate shareholders under rules which entitle those shareholders to a tax credit equal to the fraction of the corporation tax paid by the company which made the distributed profits. It is not in dispute that only resident companies may do so.

64 It is in its capacity as the Member State in which the shareholder is resident that, when a resident company pays dividends to its resident ultimate shareholders, that Member State grants to such shareholders, on payment of the dividends, a tax credit equal to the fraction of the advance corporation tax paid by the company which made the distributed profits.

65 As regards the application of procedures intended to prevent or mitigate the imposition of a series of charges to tax or economic double taxation, the position of a Member State in which both the companies making the distribution and the ultimate shareholders are resident is thus not comparable to that of a Member State in which a company is resident which pays dividends to a non-resident company, which pays them, in turn, to its ultimate shareholders, in that the second State acts, in principle, only as the State in which the distributed profits are derived.

66 In the latter case, it is only when a company resident in a Member State pays dividends to a company resident in another Member State and the shareholders of the lastmentioned company are resident, for their part, in the first State, that that State, as the State in which those

shareholders are resident, is obliged, in accordance with the principle laid down in *Lenz* and *Manninen* referred to in paragraph 55 of this judgment, to ensure that dividends received by those shareholders from a non?resident company are subject to the same tax treatment as that which applies to dividends received by a resident shareholder from a resident company.

67 It follows from paragraph 30 of this judgment that the obligation imposed in such a case on a Member State acting in its capacity as the State in which the ultimate shareholder is resident does not fall within the scope of the questions referred by the national court.

68 However, once a Member State, unilaterally or by a convention, imposes a charge to income tax not only on resident shareholders but also on non?resident shareholders in respect of dividends which they receive from a resident company, the position of those non-resident shareholders becomes comparable to that of resident shareholders.

69 As regards the national measures at issue in the main proceedings, that is the case when, as is mentioned in paragraph 15 of this judgment, a DTC concluded by the United Kingdom provides that a shareholder company which is resident in the other contracting Member State is entitled to a full or partial tax credit for dividends which it receives from a company resident in the United Kingdom.

70 If the Member State of residence of the company making distributable profits decides to exercise its taxing powers not only in relation to profits made in that State but also in relation to income arising in that State and paid to non?resident companies receiving dividends, it is solely because of the exercise by that State of its taxing powers that, irrespective of any taxation in another Member State, a risk of a series of charges to tax may arise. In such a case, in order for non-resident companies receiving dividends not to be subject to a restriction on freedom of establishment prohibited, in principle, by Article 43 EC, the State in which the company making the distribution is resident is obliged to ensure that, under the procedures laid down by its national law in order to prevent or mitigate a series of liabilities to tax, non-resident shareholder companies are subject to the same treatment as resident shareholder companies.

71 It is for the national court to determine, in each case, whether that obligation has been complied with, taking account, where necessary, of the provisions of the DTC that that Member State has concluded with the State in which the shareholder company is resident (see, to that effect, Case C-265/04 *Bouanich* [2006] ECR I-923, paragraphs 51 to 55).

72 It follows that legislation of a Member State which, on a payment of dividends by a resident company where no DTC is involved, grants a tax credit equal to the fraction of the advance corporation tax paid by the company making the distributed profits only to resident companies receiving the dividends and which extends the benefit of that tax credit exclusively to resident ultimate shareholders, does not constitute discrimination prohibited by Article 43 EC.

73 Since the reasoning set out in the above paragraphs applies in the same way to non-resident shareholder companies to which dividends have been paid on the basis of a holding which does not confer on them any definite influence on the decisions of the resident distributing company and does not allow them to determine its activities, such legislation also does not restrict the free movement of capital for the purposes of Article 56 EC.

74 The answer to Question 1(a) must therefore be that Articles 43 EC and 56 EC do not prevent a Member State, on a distribution of dividends by a company resident in that State, from granting companies receiving those dividends which are also resident in that State a tax credit equal to the fraction of the corporation tax paid on the distributed profits by the company making the distribution, when it does not grant such a tax credit to companies receiving such dividends

which are resident in another Member State and are not subject to tax on dividends in the first State.

Question 1(b) to (d)

75 By Question 1(b) to (d), the national court essentially asks whether Articles 43 EC and 56 EC preclude a Member State from applying DTCs concluded with other Member States in terms of which, on a payment of dividends by a resident company, companies receiving those dividends which reside in some Member States are not entitled to a tax credit, while companies receiving such dividends which reside in certain other Member States are granted a partial tax credit.

76 In that context, the national court also asks whether it is permissible for a Member State to apply a provision of a DTC, known as a ‘limitation of benefits’ provision, pursuant to which it does not grant a tax credit to a company resident in the other contracting Member State if that company is controlled by a company resident in a third State with which the first Member State has concluded a DTC which, when dividends are paid, makes no provision for a tax credit for a company which is resident in a third country and receives the dividends and whether it is relevant in that regard that the non?resident company to which the dividends are paid is controlled by a company resident in a Member State or a non-member country.

77 For the reasons set out in paragraphs 37 to 40 of this judgment, it is appropriate to consider the national measures at issue in the main proceedings both from the point of view of freedom of establishment and that of free movement of capital.

78 According to the claimants in the main proceedings, it is contrary to the freedoms of movement for a Member State to confer a tax advantage on nationals of a Member State while refusing it to nationals of another Member State. Under reference to paragraph 26 of the judgment in *Commission* v *France*, they contend that the grant of such an advantage cannot be made dependent on the existence of reciprocal advantages granted by the other contracting Member State.

79 The claimants in the main proceedings argue that the extension of advantages conferred by a DTC concluded with a particular Member State to natural or legal persons covered by another DTC would not affect the system of bilateral tax conventions. It is necessary to distinguish between, on the one hand, the right of Member States to allocate their taxing powers in order to avoid the same income being taxed more than once in a number of Member States and, on the other, the exercise by Member States of their taxing powers thus allocated. While a difference in treatment would be justified if it were to reflect differences between tax conventions as regards the allocation of taxing powers, in order, in particular, to reflect variations between the tax systems of the Member States concerned, a Member State cannot, in order to avoid or mitigate economic double taxation, exercise its powers in a selective and arbitrary manner.

80 Conversely, the United Kingdom Government, the German Government, the French Government, Ireland, the Italian Government and the Netherlands Government, together with the Commission, contest the argument that a Member State cannot protect a resident of another Member State against economic double taxation unless it grants the same protection to residents of all Member States. Were that proposition to be accepted, the equilibrium and reciprocity underlying the existing DTCs would be undermined, taxpayers would be able more easily to avoid the provisions of DTCs intended to combat tax avoidance and the legal certainty of taxpayers would be affected accordingly.

81 It should be pointed out in that regard that, in the absence of unifying or harmonising measures at Community level for the elimination of double taxation, the Member States retain

competence for determining the criteria for taxation on income with a view to eliminating double taxation by means, inter alia, of international agreements. In those circumstances, the Member States remain at liberty to determine the connecting factors for the allocation of fiscal jurisdiction by means of bilateral agreements (see *Gilly*, paragraphs 24 and 30; *Saint-Gobain ZN*, paragraph 57; *D*., paragraph 52; and *Bouanich*, paragraph 49).

82 The claimants in the main proceedings object to the difference in treatment imposed on companies that are not resident in the United Kingdom by reason of the fact that the DTCs concluded by that Member State with certain other Member States provide a tax credit for companies resident in those Member States while the DTCs concluded by the United Kingdom with other Member States do not so provide.

83 In order to determine whether such a difference in treatment is discriminatory, it is necessary to consider whether, as regards the measures at issue, the non-resident companies concerned are in an objectively comparable situation.

84 As the Court noted in paragraph 54 of *D*., the scope of a bilateral tax convention is limited to the natural or legal persons referred to in it.

85 In order to avoid distributed profits being taxed both by the Member State in which the distributing company is resident and by that of the company receiving them, each of the DTCs concluded by the United Kingdom provides for an allocation of taxing powers between that Member State and the other contracting State. While some of those DTCs do not provide for dividends received by a non?resident company from a company resident in the United Kingdom to be subject to tax in that Member State, other DTCs do provide for such a liability to tax. It is in the latter case that the DTCs provide, each according to its separate conditions, for the grant of a tax credit to a non-resident company to which dividends are paid.

86 As the United Kingdom Government, supported in that regard by most of the other Governments which submitted observations to the Court, observes, the terms under which the DTCs provide for a tax credit for non-resident companies which receive dividends from a resident company vary depending not only on the particular characteristics of the national tax regimes concerned, but also on when the DTCs were negotiated and the extent of the issues on which the Member States concerned managed to reach agreement.

87 The situations in which the United Kingdom grants a tax credit to companies resident in the other contracting State which receive dividends from a United Kingdom-resident company are those in which the United Kingdom also retains the right to tax the companies on those dividends. The rate of tax which the United Kingdom may charge in such cases varies according to the circumstances and, in particular according to whether the DTC provides for a full or a partial tax credit. There is thus a direct link between the entitlement to a tax credit and the rate of tax laid down under such a DTC (see, to that effect, Case C?58/01 *Océ Van der Grinten* [2003] ECR I?9809, paragraph 87).

88 Thus, the grant of a tax credit to a non-resident company receiving dividends from a resident company, as provided for under a number of DTCs concluded by the United Kingdom, cannot be regarded as a benefit separable from the remainder of those DTCs, but is an integral part of them and contributes to their overall balance (see, to that effect, *D*., paragraph 62).

89 The same applies to the provisions of the DTCs which make the grant of such a tax credit subject to the condition that the non-resident company is not owned, directly or indirectly, by a company resident in a Member State or a non-member country with which the United Kingdom has concluded a DTC which does not provide for such a tax credit.

90 Even where such provisions extend to the situation of a company which is not resident in one of the contracting Member States, they apply only to persons resident in one of those Member States and, by contributing to the overall balance of the DTCs in question, are an integral part of them.

91 The fact that those reciprocal rights and obligations apply only to persons resident in one of the two contracting Member States is an inherent consequence of bilateral double taxation conventions. It follows, as regards the taxation of dividends paid by a company resident in the United Kingdom, that a company resident in a Member State which has concluded a DTC with the United Kingdom which does not provide for such a tax credit is not in the same situation as a company resident in a Member State which has concluded a DTC which does provide for one (see, to that effect, *D*., paragraph 61).

92 It follows that the Treaty provisions on freedom of establishment do not preclude a situation in which the entitlement to a tax credit laid down in a DTC concluded by a Member State with another Member State for companies resident in the second State which receive dividends from a company resident in the first State does not extend to companies resident in a third Member State with which the first State has concluded a DTC which does not provide for such an entitlement.

93 Since such a situation does not discriminate against non-resident companies receiving dividends from a resident company, the conclusion drawn in the preceding paragraph also applies to the Treaty provisions relating to free movement of capital.

94 In view In view of the foregoing, the answer to Question 1(b) to (d) must be that Articles 43 EC and 56 EC do not preclude a situation in which a Member State does not extend the entitlement to a tax credit provided for in a DTC concluded with another Member State for companies resident in the second State which receive dividends from a company resident in the first State to companies resident in a third Member State with which it has concluded a DTC which does not provide for such an entitlement for companies resident in that third State.

Question 2

95 In view of the answer given by the Court to Question 1, there is no need to reply to Question 2.

Costs

96 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Grand Chamber) hereby rules:

1. **Articles 43 EC and 56 EC do not prevent a Member State, on a distribution of dividends by a company resident in that State, from granting companies receiving those dividends which are also resident in that State a tax credit equal to the fraction of the corporation tax paid on the distributed profits by the company making the distribution, when it does not grant such a tax credit to companies receiving such dividends which are resident in another Member State and are not subject to tax on dividends in the first State.**

2. **Articles 43 EC and 56 EC do not preclude a situation in which a Member State does not extend the entitlement to a tax credit provided for in a double taxation convention concluded with another Member State for companies resident in the second State which receive dividends from a company resident in the first State to companies resident in a third Member State with which it has concluded a double taxation convention which does not provide for such an entitlement for companies resident in that third State.**

[Signatures]

*Language of the case: English.