Case C-446/04

Test Claimants in the FII 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 – Directive 90/435/EEC – Corporation tax – Payment of dividends – Prevention or mitigation of a series of charges to tax – Exemption – Dividends received from companies resident in another Member State or a non?member country – Tax credit – Advance corporation tax – Equal treatment – Claim for repayment or claim for damages)

Summary of the Judgment

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

(Arts 43 EC and 56 EC)

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

(Arts 43 EC and 56 EC)

3. *Free movement of capital – Restrictions – Tax legislation*

(Art. 56 EC)

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

(Arts 43 EC and 56 EC)

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

(Arts 43 EC and 56 EC)

6. *Freedom of movement for persons – Freedom of establishment – Tax legislation*

(Art. 43 EC)

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

(Arts 43 EC and 56 EC)

8. *Free movement of capital – Restriction on capital movements to or from non-member countries*

(Arts 56 EC and 57(1) EC)

9. *Community law – Rights conferred on individuals – Infringement by a Member State – Obligation to make good damage caused to individuals*

10. *Community law – Rights conferred on individuals – Infringement by a Member State – Obligation to make good damage caused to individuals*

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

(see para. 72, operative part 1)

2. Articles 43 EC and 56 EC do not preclude legislation of a Member State which exempts from corporation tax dividends which a resident company receives from another resident company, when that State imposes corporation tax on dividends which a resident company receives from a non-resident company in which the resident company holds at least 10% of the voting rights, while at the same time granting a tax credit in the latter case for the tax actually paid by the company making the distribution in the Member State in which it is resident, provided that the rate of tax applied to foreign-sourced dividends is no higher than the rate of tax applied to nationally-sourced dividends and that the tax credit is at least equal to the amount paid in the Member State of the company making the distribution, up to the limit of the amount of the tax charged in the Member State of the company receiving the distribution.

The mere fact that, compared with an exemption system, an imputation system imposes additional administrative burdens on taxpayers, with evidence being required as to the amount of tax actually paid in the State in which the company making the distribution is resident, cannot be regarded as a difference in treatment which is contrary to freedom of establishment or free movement of capital, since particular administrative burdens imposed on resident companies receiving foreign-sourced dividends are an intrinsic part of the operation of a tax credit system.

(see paras 53, 60, 73, operative part 1)

3. Article 56 EC precludes legislation of a Member State which exempts from corporation tax dividends which a resident company receives from another resident company, where that State levies corporation tax on dividends which a resident company receives from a non-resident company in which it holds less than 10% of the voting rights, without granting the company receiving the dividends a tax credit for the tax actually paid by the company making the distribution in the State in which the latter is resident.

Such a difference in treatment constitutes a restriction on free movement of capital in that it has the effect of discouraging companies resident in the Member State concerned from investing their capital in companies established in another Member State. In addition, it also has a restrictive effect as regards companies established in other Member States in that it constitutes an obstacle to their raising of capital in the Member State concerned.

Irrespective of the fact that a Member State may, in any event, choose between a number of systems in order to prevent or mitigate the imposition of a series of charges to tax on distributed profits, the difficulties that may arise in determining the tax actually paid in another Member State cannot justify a restriction on the free movement of capital such as that which arises under the legislation at issue.

(see paras 64-65, 70, 74, operative part 1)

4. Articles 43 EC and 56 EC preclude legislation of a Member State which allows a resident company receiving dividends from another resident company to deduct from the amount which the former company is liable to pay by way of advance corporation tax the amount of that tax paid by the latter company, whereas no such deduction is permitted in the case of a resident company receiving dividends from a non?resident company as regards the corresponding tax on distributed profits paid by the latter company in the State in which it is resident.

That system leads, in practice, to a company receiving foreign-sourced dividends being less favourably treated than a company receiving nationally?sourced dividends. On a subsequent payment of dividends, the former is obliged to account for advance corporation tax in full, whereas the latter has to pay the tax only to the extent to which the distribution paid to its own shareholders exceeds that which the company has itself received.

The fact of not having to pay advance corporation tax represents a cash?flow advantage, in so far as the company concerned may retain the sums which it would otherwise have had to pay by way of advance corporation tax until corporation tax is payable.

Nor can such a difference in treatment be justified by the need to preserve the cohesion of the tax system in place in the Member State concerned on the basis of a direct link between the tax advantage made available, namely the tax credit granted to a resident company receiving dividends from another resident company, and the corresponding tax liability, namely the advance corporation tax paid by the latter when it makes the distribution. The need for such a direct link must in fact lead to the same tax advantage being granted to companies receiving dividends from non?resident companies, since those companies are also obliged to pay corporation tax on distributed profits in the State in which they are resident.

(see paras 84, 86, 93, 112, operative part 2)

5. Articles 43 EC and 56 EC do not preclude legislation of a Member State which provides that any relief for tax paid abroad made available to a resident company which has received foreign?sourced dividends is to reduce the amount of corporation tax against which that company may offset advance corporation tax when a subsequent distribution of dividends is made to its own shareholders.

The fact that a company receiving foreign?sourced dividends which is entitled to relief for foreign tax has to suffer a reduction as regards the amount of corporation tax against which surplus advance corporation tax may be offset will give rise to discrimination as between such a company and a company receiving nationally-sourced dividends only where the former company does not, in fact, have the same ability as the latter to offset the surplus advance corporation tax against the amount of corporation tax for which it is liable.

(see paras 120, 125, 138, operative part 3)

6. Article 43 EC precludes legislation of a Member State which allows a resident company to surrender to resident subsidiaries the amount of advance corporation tax paid which cannot be offset against the liability of that company to corporation tax for the current accounting period or previous or subsequent accounting periods, so that those subsidiaries may offset it against their

liability to corporation tax, but does not allow a resident company to surrender such an amount to non-resident subsidiaries where the latter are taxable in that Member State on the profits which they made there.

(see para. 139, operative part 3)

7. Articles 43 EC and 56 EC preclude legislation of a Member State which, while exempting from advance corporation tax resident companies paying dividends to their shareholders which have their origin in nationally-sourced dividends received by them, allows resident companies distributing dividends to their shareholders which have their origin in foreign-sourced dividends received by them to elect to be taxed under a regime which permits them to recover the advance corporation tax paid but, first, obliges those companies to pay that advance corporation tax and subsequently to claim repayment and, secondly, does not provide a tax credit for their shareholders, whereas those shareholders would have received such a tax credit in the case of a distribution made by a resident company which had its origin in nationally-sourced dividends.

While it is true that a Member State must be allowed some time to take into account, in determining the amount ultimately due by way of corporation tax, all of the taxes already levied on the profits distributed, this cannot justify legislation which refuses completely to allow a resident company receiving a payment of foreign-sourced dividends to offset the tax charged on profits distributed abroad against the amount due in respect of advance corporation tax, whereas, for nationally?sourced dividends, that amount is automatically deducted from the tax paid, albeit only in advance, by a resident company making a distribution.

As regards the fact that shareholders of resident companies distributing foreign-sourced dividends are not entitled to a tax credit under such legislation, the risk of economic double taxation arises not only in the case of dividends paid by a resident company subject to an obligation to account for advance corporation tax on dividends distributed by it, but also in the case of dividends paid by a non-resident company, the profits of which are also subject to corporation tax in the State in which it is resident, at the rates and according to the rules applying there.

(see paras 156, 158-159, 172-173, operative part 4)

8. Article 57(1) EC is to be interpreted as meaning that where, before 31 December 1993, a Member State has adopted legislation which contains restrictions on capital movements to or from non-member countries which are prohibited by Article 56 EC and, after that date, adopts measures which, while also constituting a restriction on such movements, are essentially identical to the previous legislation or do no more than restrict or abolish an obstacle to the exercise of the Community rights and freedoms arising under that previous legislation, Article 56 EC does not preclude the application of those measures to non-member countries when they apply to capital movements involving direct investment, including investment in real estate, establishment, the provision of financial services or the admission of securities to capital markets. Holdings in a company which are not acquired with a view to the establishment or maintenance of lasting and direct economic links between the shareholder and that company and do not allow the shareholder to participate effectively in the management of that company or in its control cannot, in this connection, be regarded as direct investments.

(see para. 196, operative part 5)

9. In the absence of Community legislation, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive from Community law, including the classification of claims brought by injured parties before the national

courts and tribunals. Those courts and tribunals are, however, obliged to ensure that individuals should have an effective legal remedy enabling them to obtain reimbursement of the tax unlawfully levied on them and the amounts paid to that Member State or withheld by it directly against that tax.

As regards other loss or damage which a person may have sustained by reason of a breach of Community law for which a Member State is liable, the latter is obligated to make reparation for the loss or damage caused to individuals in the conditions set out in the case?law of the Court, namely that the rule of law infringed must be intended to confer rights on individuals, that the breach must be sufficiently serious, and that there must be a direct causal link between the breach of the obligation resting on the State and the loss or damage sustained by those affected, but that does not preclude the state from being liable under less restrictive conditions.

Subject to the right of reparation which flows directly from Community law where the conditions referred to in the case-law are satisfied, it is on the basis of the rules of national law on liability that the State must make reparation for the consequences of the loss and damage caused, provided that the conditions for reparation of loss and damage laid down by national law are not less favourable than those relating to similar domestic claims and are not so framed as to make it, in practice, impossible or excessively difficult to obtain reparation.

(see paras 209, 219-220, operative part 6)

10. In order to determine whether a breach of Community law is sufficiently serious, capable of rendering a Member State liable for harm caused to individuals it is necessary to take account of all the factors which characterise the situation brought before the national court. Those factors include, in particular, the clarity and precision of the rule infringed, whether the infringement and the damage caused were intentional or involuntary, whether any error of law was excusable or inexcusable, and the fact that the position taken by a Community institution may have contributed towards the adoption or maintenance of national measures or practices contrary to Community law.

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

In an area such as direct taxation the national court should assess the matters referred to above, in particular the clarity and precision of the rules infringed and whether any errors of law were excusable or inexcusable, in the light of the fact that the consequences arising from the freedoms of movement guaranteed by the Treaty have been only gradually made clear, in particular by the principles identified by the Court.

(see paras 204, 213-215, 217)

JUDGMENT OF THE COURT (Grand Chamber)

12 December 2006 (*)

(Freedom of establishment – Free movement of capital – Directive 90/435/EEC – Corporation tax – Payment of dividends – Prevention or mitigation of a series of charges to tax – Exemption – Dividends received from companies resident in another Member State or a non?member country – Tax credit – Advance corporation tax – Equal treatment – Claim for repayment or claim for damages)

In Case C-446/04,

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 13 October 2004, received at the Court on 22 October 2004, in the proceedings

Test Claimants in the FII 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), P. K?ris and E. Juhász, Presidents of Chambers, J.N. Cunha Rodrigues, G. Arestis, A. Borg Barthet and M. Ileši?, Judges,

Advocate General: L.A. Geelhoed,

Registrar: K. Sztranc, Administrator,

having regard to the written procedure and further to the hearing on 29 November 2005,

after considering the observations submitted on behalf of:

– Test Claimants in the FII Group Litigation, by G. Aaronson QC, P. Farmer and D. Cavender, Barristers, instructed by S. Whitehead and M. Anderson, Solicitors,

– the United Kingdom Government, represented initially by E. O’Neill and subsequently by C. Gibbs, acting as Agents, and by G. Barling QC, D. Ewart and S. Stevens, Barristers,

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

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

after hearing the Opinion of the Advocate General at the sitting on 6 April 2006,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Articles 43 EC and 56 EC, together with Articles 4(1) and 6 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).

2 The reference has been made in proceedings between companies resident in the United Kingdom and the Commissioners of Inland Revenue concerning the tax treatment of dividends received from companies which are not resident in that Member State.

Legal framework

Community legislation

3 Article 4(1) of Directive 90/435, in its original version, 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.'

4 Pursuant to Article 6 of that directive, the Member State of a parent company may not charge withholding tax on the profits which such a company receives from a subsidiary.

5 Article 7 of Directive 90/435 states:

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

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

National legislation

6 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, and by each company which is not resident there but which conducts trading activities through a branch or agency there, are subject to corporation tax in that State.

7 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. In addition, a United Kingdom-resident company was exempt from corporation tax on dividends received from

another United Kingdom-resident company.

Advance corporation tax

8 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.

9 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.

10 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 regime, 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 case of resident shareholders receiving dividends from resident companies

11 Under section 208 of ICTA, where a United Kingdom-resident company received dividends from a company that was also resident in that Member State, it was not liable to corporation tax in respect of those dividends.

12 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.

13 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.

14 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.

The case of resident shareholders receiving dividends from non-resident companies

15 When a United Kingdom-resident company received dividends from a company resident outside the United Kingdom, it was liable to corporation tax on those dividends.

16 In such a case, the company receiving those dividends was not entitled to a tax credit and the dividends paid did not qualify as franked investment income. However, in terms of sections 788 and 790 of ICTA, it was entitled to relief for tax paid by the company making the distribution in the State in which the latter was resident. Such relief was granted either under the legislation in force in the United Kingdom or under a double taxation convention ('DTC') concluded by the United Kingdom with the other State.

17 Thus, the national legislation allowed withholding taxes paid on dividends from a non-resident company to be offset against the liability of a resident company receiving dividends to corporation tax. Where a resident company receiving dividends either directly or indirectly controlled, or was a subsidiary of, a company which directly or indirectly controlled 10% or more of the voting rights in the company making the distribution, the relief extended to the underlying foreign corporation tax on the profits out of which the dividends were paid. Relief on that foreign tax was available only on the amount due in the United Kingdom by way of corporation tax on the income concerned.

18 Similar provisions applied under the DTCs concluded by the United Kingdom.

19 When a resident company itself paid dividends to its own shareholders, it was liable to account for ACT.

20 As regards the ability to offset ACT paid on such a distribution against the amount for which the resident company was liable in respect of corporation tax, the fact that such a resident company received dividends from a non-resident company was liable to result in surplus ACT for two reasons.

21 First, as mentioned in paragraph 16 of this judgment, the payment of dividends by a non-resident company did not give rise to a tax credit which could be deducted from the amount of ACT for which the resident company was liable when it paid dividends to its own shareholders.

22 Secondly, when a resident company was entitled to relief on foreign tax paid by that non-resident company abroad, the offsetting of that tax against the amount due by way of corporation tax reduced the amount that the resident company might deduct from the ACT for which it was liable.

The FID regime

23 From 1 July 1994, a resident company receiving dividends from a non?resident company could elect that a dividend which it paid to its shareholders be treated as a 'foreign income dividend' ('FID'). ACT was payable on the FID but, to the extent to which the FID matched the foreign dividends received, the resident company could claim repayment of the surplus ACT.

24 While ACT was payable within 14 days of the end of the quarter in which the dividend was paid, surplus ACT was repayable when the resident company became liable for mainstream corporation tax, namely nine months after the end of the accounting period.

25 When a FID was paid to an individual shareholder, the latter ceased to be entitled to a tax credit, but was treated for income tax purposes as having received income which had borne tax at the lower rate. Tax?exempt shareholders, such as United Kingdom pension funds which received a FID, were also not entitled to a tax credit.

26 For dividends paid after 6 April 1999, the ACT system and the FID regime were abolished.

The main proceedings and the questions referred for preliminary ruling

27 The main proceedings are part of a group litigation concerning franked investment income ('Franked Investment Income Group Litigation') consisting of a number of claims brought before the Chancery Division of the High Court of Justice of England and Wales by companies resident in the United Kingdom which hold shares in companies resident in another Member State or in a non-member country.

28 The cases selected by the national court as test cases for the purposes of the present reference concern claims brought by companies resident in the United Kingdom which form part of the British American Tobacco group ('BAT') ('the claimants in the main proceedings'). The parent company in the group held, directly or indirectly, 100% of the capital of other companies which themselves held 100% of the capital of companies established in a number of Member States of the European Union and the European Economic Area, as well as in non-member countries.

29 The cases concern, first, dividends paid by those non-resident companies to the claimants in the main proceedings since the accounting period which ended on 30 September 1973 and, according to the order for reference, at least until the date on which the order was made, secondly, dividends paid by the parent company of the BAT group to its shareholders from the same accounting period until 31 March 1999, thirdly, payments of ACT by the claimants in the main proceedings from that accounting period until 14 April 1999 and, fourthly, FIDs paid between 30 September 1994 and 30 September 1997.

30 The claimants in the main proceedings seek repayment of and/or compensation for losses arising from the application to them of the United Kingdom legislation, in particular with regard to:

– corporation tax paid on foreign dividend receipts and for reliefs and tax credits applied against those liabilities which, were it not for the imposition of corporation tax, could have been used or carried forward to be used against other tax liabilities;

– the ACT paid on distributions to their shareholders of foreign?sourced dividends, to the extent to which the ACT remained surplus;

– in the latter case, the loss of use of the money concerned between the date of payment of the ACT and the date on which ACT was set off against the mainstream corporation tax liability, and

– as regards the payment of FIDs, the loss of use of the money paid as ACT between the date of payment of the ACT and the date of its repayment and the enhanced payments the claimants in the main proceedings had to make to their shareholders to compensate for the lack of any tax credit in their hands.

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

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

2. Where a Member State has a system which in certain circumstances imposes advance corporation tax … on the payment of dividends by a resident company to its shareholders and grants a tax credit to shareholders resident in that Member State in respect of those dividends, is it contrary to Article 43 or [Article] 56 EC or Article 4(1) or [Article] 6 of [Directive 90/435] for the Member State to keep in force and apply measures which provide for the resident company to pay dividends to its shareholders without being liable to pay ACT to the extent that it has received dividends from companies resident in that Member State (either directly or indirect1y through other companies resident in that Member State) and do not provide for the resident company to pay dividends to its shareholders without being liable to pay ACT to the extent that it has received dividends from non-resident companies?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

– a claim for compensation or damages such that the conditions set out in Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur and Factortame* [[1996] ECR I-1029] must be satisfied; or

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

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

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

(b) must the conditions for recovery laid down in … *Brasserie du Pêcheur and Factortame* be satisfied; or

(c) must some other conditions be met?

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

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

32 The national court takes the view that it follows from Article 57(1) EC that, as regards non-member countries, a restriction on the free movement of capital that existed on 31 December 1993 cannot be regarded as contrary to Article 56 EC. As Questions 1 to 3 concern rules which existed prior to that date, the scope of those questions is confined to intra-European Community situations. As Questions 4 and 5 relate to provisions introduced after that date, they relate, as regards the application of Article 56 EC, both to intra-Community situations and situations involving non-member countries.

The questions referred

Question 1

33 By Question 1, the national court essentially asks whether Articles 43 EC and 56 EC preclude legislation of a Member State which makes dividends received by a resident company from a company which is also resident in that State ('nationally-sourced dividends') exempt from corporation tax, when it imposes that tax on dividends received by a resident company from a company which is not resident in that State ('foreign?sourced dividends'), while granting relief in the latter case for all withholding tax levied in the State in which the company making the distribution is resident and, where the resident company receiving the dividends holds, directly or indirectly, 10% or more of the voting rights in the company making the distribution, relief against corporation tax paid by the company making the distribution on the profits underlying the dividends.

34 According to the claimants in the main proceedings, such national legislation is contrary to Articles 43 EC and 56 EC since, first, it is liable to discourage resident companies from establishing subsidiaries or investing in the capital of companies in other Member States and, secondly, it cannot be justified either by a difference between the situation of foreign?sourced dividends and that of nationally-sourced dividends, or by the objective of ensuring the cohesion of the national tax system.

35 The first point to be made is 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).

36 It should be pointed out in that regard that national legislation which makes the receipt of dividends by a resident company liable to tax, where not only the tax base but also the ability to deduct from that tax a tax paid in the State in which the company making the distribution is resident depends on whether the source of the dividends is national or otherwise and the extent of the holding which the company receiving the dividend has in the company paying it, may fall within both Article 43 EC on freedom of establishment and Article 56 EC on the free movement of capital.

37 The order for reference shows that the cases chosen as test cases in the proceedings before the national court concern United Kingdom-resident companies which received dividends from non-resident companies that are wholly owned by them. 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).

38 As the Advocate General stated at point 33 of his Opinion, the nature of the holdings of the other companies which are parties to the dispute has not been put before the Court. It may therefore be that the dispute also relates to the effect of the national legislation at issue in the main proceedings on the situation of resident companies which received dividends on the basis of 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.

Freedom of establishment

39 As regards, in the first place, the situation of the claimants in the main proceedings, it should be pointed out that freedom of establishment, which Article 43 EC grants to Community nationals and which includes the right 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, a branch or an 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).

40 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 same way as nationality in the case of individuals, as the connecting factor with the legal system of a 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).

41 In the case of the main proceedings, as regards a resident company receiving dividends from another company in which it holds, directly or indirectly, at least 10% of the voting rights, the national legislation at issue provides for a different tax treatment, according to whether the dividends received are paid by a company which is also resident in the United Kingdom or by a company which is resident in another Member State. In the former case, the dividends received are exempt from corporation tax, while in the latter they are subject to corporation tax but give rise to an entitlement to relief for all tax withheld on the payment of those dividends in the State in which the company making the distribution is resident and for corporation tax paid by that company on the underlying profits.

42 According to the claimants in the main proceedings, the fact that the relevant United Kingdom legislation applies, where dividends are paid to a resident company, an exemption system in the case of nationally?sourced dividends and an imputation system in the case of foreign-sourced dividends, leads to the latter being less favourably treated for tax purposes than the former.

43 It must be pointed out, first of all, that a Member State which wishes to prevent or mitigate the imposition of a series of charges to tax on distributed profits may choose between a number of systems. In the case of shareholders receiving those dividends, those systems do not necessarily have the same result. Thus, under an exemption system, a shareholder who receives a dividend is not, in principle, liable to tax on the dividends received, irrespective of the rate of tax to which the underlying profits are subject to tax in the hands of the company making the distribution and the amount of that tax which that company has in fact paid. By contrast, under an imputation system, such as the system at issue in the main proceedings, a shareholder may offset tax due on the dividends paid only to the extent of the amount of tax which the company making the distribution has actually had to pay on the underlying profits, and that amount may be offset only up to the limit of the amount of tax for which the shareholder is liable.

44 As regard dividends paid to a parent company resident in a Member State by a company resident in another Member State in which that parent company holds a minimum of 25% of the capital, Article 4(1) of Directive 90/435 expressly leaves it open to Member States to choose between an exemption system and an imputation system. The directive provides that where such a parent company receives distributed profits from its subsidiary, the State of the parent company is, except when the latter is liquidated, either to refrain from taxing such profits or to tax them while authorising that 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, up to the limit of the amount of the corresponding domestic tax.

45 However, in structuring their tax system and, in particular, when they establish a mechanism

for preventing or mitigating the imposition of a series of charges to tax or economic double taxation, Member States must comply with the requirements of Community law and especially those imposed by the Treaty provisions on free movement.

46 It is thus clear from case-law that, whatever the mechanism adopted for preventing or mitigating the imposition of a series of charges to tax or economic double taxation, the freedoms of movement guaranteed by the Treaty preclude a Member State from treating foreign-sourced dividends less favourably than nationally-sourced dividends, unless such a difference in treatment concerns situations which are not objectively comparable or is justified by overriding reasons in the general interest (see, to that effect, Case C?315/02 *Lenz* [2004] ECR I?7063, paragraphs 20 to 49, and Case C?319/02 *Manninen* [2004] ECR I?7477, paragraphs 20 to 55). Likewise, as regards the decisions which Directive 90/435 leaves in the hands of the Member States, the Court has pointed out that these may be exercised only in compliance with the fundamental provisions of the Treaty, in particular those relating to freedom of establishment (*Keller Holding*, paragraph 45).

47 As regards the question whether a Member State may operate an exemption system for nationally-sourced dividends when it applies an imputation system to foreign?sourced dividends, it must be stated that it is for each Member State to organise, in compliance with Community law, its system for taxing distributed profits and, in particular, to define the tax base and the tax rate which apply to the company making the distribution and/or the shareholder receiving them, in so far as they are liable to tax in that Member State.

48 Thus, Community law does not, in principle, prohibit a Member State from avoiding the imposition of a series of charges to tax on dividends received by a resident company by applying rules which exempt those dividends from tax when they are paid by a resident company, while preventing, through an imputation system, those dividends from being liable to a series of charges to tax when they are paid by a non-resident company.

49 In order for the application of an imputation system to be compatible with Community law in such a situation, it is necessary, first of all, that the foreign-sourced dividends are not subject in that Member State to a higher rate of tax than the rate which applies to nationally?sourced dividends.

50 Next, that Member State must prevent foreign-sourced dividends from being liable to a series of charges to tax, by offsetting the amount of tax paid by the non-resident company making the distribution against the amount of tax for which the recipient company is liable, up to the limit of the latter amount.

51 Thus, when the profits underlying foreign-sourced dividends are subject in the Member State of the company making the distribution to a lower level of tax than the tax levied in the Member State of the recipient company, the latter Member State must grant an overall tax credit corresponding to the tax paid by the company making the distribution in the Member State in which it is resident.

52 Where, conversely, those profits are subject in the Member State of the company making the distribution to a higher level of tax than the tax levied by the Member State of the company receiving them, the latter Member State is obliged to grant a tax credit only up to the limit of the amount of corporation tax for which the company receiving the dividends is liable. It is not required to repay the difference, that is to say, the amount paid in the Member State of the company making the distribution which is greater than the amount of tax payable in the Member State of the company receiving it.

53 Against that background, the mere fact that, compared with an exemption system, an

imputation system imposes additional administrative burdens on taxpayers, with evidence being required as to the amount of tax actually paid in the State in which the company making the distribution is resident, cannot be regarded as a difference in treatment which is contrary to freedom of establishment, since particular administrative burdens imposed on resident companies receiving foreign-sourced dividends are an intrinsic part of the operation of a tax credit system.

54 The claimants in the main proceedings none the less point out that when, under the relevant United Kingdom legislation, a nationally?sourced dividend is paid, it is exempt from corporation tax in the hands of the company receiving it, irrespective of the tax paid by the company making the distribution, that is to say, it is also exempt when, by reason of the reliefs available to it, the latter has no liability to tax or pays corporation tax at a rate lower than that which normally applies in the United Kingdom.

55 That point is not contested by the United Kingdom Government, which argues, however, that the application to the company making the distribution and to the company receiving it of different levels of taxation occurs only in highly exceptional circumstances, which do not arise in the main proceedings.

56 In that respect, it is for the national court to determine whether the tax rates are indeed the same and whether different levels of taxation occur only in certain cases by reason of a change to the tax base as a result of certain exceptional reliefs.

57 It follows that, in the case of the national legislation at issue in the main proceedings, the fact that nationally-sourced dividends are subject to an exemption system and foreign-sourced dividends are subject to an imputation system does not contravene the principle of freedom of establishment laid down under Article 43 EC, provided that the tax rate applied to foreign-sourced dividends is not higher than the rate applied to nationally-sourced dividends and that the tax credit is at least equal to the amount paid in the Member State of the company making the distribution, up to the limit of the tax charged in the Member State of the company receiving the dividends.

Free movement of capital

58 With respect, in the second place, to dividends paid to resident companies by a company in which they hold 10% or more of the voting rights, without that holding conferring on them a definite influence over the decisions of that company or allowing them to determine its activities, it is clear that those companies are also subject in the United Kingdom, first, when they receive nationally-sourced dividends, to an exemption system and, secondly, when they receive foreign-sourced dividends, to an imputation system.

59 According to the claimants in the main proceedings, that situation gives rise to a difference in treatment which discourages United Kingdom?resident companies from investing in the capital of companies resident in other Member States and constitutes, in the absence of any objective justification, an infringement of Article 56 EC on the free movement of capital.

60 It is sufficient to state in that regard that, as was held in paragraphs 47 to 56 of this judgment, legislation such as that at issue in the main proceedings does not discriminate against companies receiving foreign?sourced dividends. Accordingly, the conclusion arrived at in paragraph 57 of this judgment also applies to the provisions of the Treaty relating to the free movement of capital.

61 As regards, lastly, resident companies which received dividends from companies in which they hold fewer than 10% of the voting rights, it is clear from the national legislation at issue in the main proceedings that nationally-sourced dividends are exempt from corporation tax, whilst foreign-

sourced dividends are subject to that tax and are entitled to relief only as regards any withholding tax charged on those dividends in the State in which the company making the distribution is resident.

62 In that regard, it must be held, first of all, that in the context of a tax rule which seeks to prevent or to mitigate the taxation of distributed profits, the situation of a shareholder company receiving foreign-sourced dividends is comparable to that of a shareholder company receiving nationally-sourced dividends in so far as, in each case, the profits made are, in principle, liable to be subject to a series of charges to tax.

63 While, in the case of a resident company receiving dividends from another resident company, the exemption system that applies eliminates the risk of the distributed profits being subject to a series of charges to tax, the same is not true for profits distributed by non-resident companies. If, in the latter case, the State in which the company receiving the distributed profits is resident grants relief on withholding tax levied in the State in which the company making the distribution is resident, such relief does no more than eliminate a double legal charge to tax in the hands of the company receiving those profits. Conversely, that relief does not extinguish the series of charges to tax which arises when distributed profits are subject to tax, first of all, in the form of corporation tax for which the company making the distribution is liable in the State in which it is resident and, subsequently, in the form of corporation tax for which the company receiving the distribution is liable.

64 Such a difference in treatment has the effect of discouraging United Kingdom-resident companies from investing their capital in companies established in another Member State. In addition, it also has a restrictive effect as regards companies established in other Member States in that it constitutes an obstacle to their raising of capital in the United Kingdom. In so far as income arising from foreign-sourced capital is treated less favourably from a tax point of view than dividends paid by companies established in the United Kingdom, shares in companies established in other Member States are less attractive to United Kingdom-resident investors than those of companies having their seat in that Member State (see *Verkooijen*, paragraphs 34 and 35; *Lenz*, paragraphs 20 and 21; and *Manninen*, paragraphs 22 and 23).

65 It follows that the difference in treatment arising from legislation such as that at issue in the main proceedings as regards dividends received by resident companies from non-resident companies in which they hold fewer than 10% of the voting rights constitutes a restriction on the free movement of capital which is, in principle, prohibited by Article 56 EC.

66 According to the United Kingdom Government, it is legitimate and proportionate to restrict the availability of the corporation tax relief granted to resident companies to the amount of any withholding tax levied on the dividend. There are practical obstacles which preclude a company which has a less than 10% shareholding in the company making the distribution from benefiting from a tax credit corresponding to the tax actually paid by the latter. Unlike a tax credit for withholding tax, such a tax credit could be granted only after lengthy and complex checks had been carried out. It is therefore legitimate to set a threshold by reference to the size of the relevant shareholding. The threshold of 10% set by the United Kingdom is, moreover, more generous than that of 25% adopted by the Organisation for Economic Cooperation and Development (OECD) Model Convention and, in its original version, by Directive 90/435.

67 It is true that, when introducing mechanisms designed to prevent or mitigate distributed profits being liable to a series of charges to tax, it is in principle for Member States to determine the category of taxpayers entitled to benefit from those mechanisms and, for that purpose, to set thresholds based on the shareholdings which taxpayers have in the companies making the distributions in question. It is only in the case of Member State companies having a minimum

shareholding of 25% in a company of another Member State that Article 4 of Directive 90/435, read in conjunction with Article 3, in the version in force at the time of the events in the main proceedings, requires Member States, if they do not exempt profits received by a resident parent company from a subsidiary resident in another Member State, to authorise the parent company to deduct from the amount of tax due not only the amount of the withholding tax levied by the Member State in which the subsidiary is resident, but also the fraction of the tax paid by the subsidiary which relates to those profits.

68 However, while, in the case of shareholdings to which Directive 90/435 does not apply, Article 4 of that directive accordingly does not prevent a Member State from taxing profits paid by a non-resident company to a resident company, without granting any relief to the latter in respect of corporation tax paid by the former in the Member State in which it is resident, a Member State may exercise the power to do so only to the extent to which, under its national law, dividends which a resident company receives from another resident company are also subject to tax in the hands of the company receiving the dividends, without the latter being entitled to relief for the corporation tax paid by the company making the distribution.

69 The mere fact that it is for a Member State to determine for such holdings whether, and to what extent, the imposition of a series of charges to tax on distributed profits is to be avoided does not of itself mean that it may operate a system under which foreign-sourced dividends and nationally-sourced dividends are not treated in the same way.

70 Furthermore, irrespective of the fact that a Member State may, in any event, choose between a number of systems in order to prevent or mitigate the imposition of a series of charges to tax on distributed profits, the difficulties that may arise in determining the tax actually paid in another Member State cannot justify a restriction on the free movement of capital such as that which arises under the legislation at issue in the main proceedings (see, to that effect, Case C?334/02 *Commission* v *France* [2004] ECR I?2229, paragraph 29, and *Manninen*, paragraph 54).

71 It follows that tax legislation such as that at issue in the main proceedings is contrary to the principle of the free movement of capital laid down under Article 56 EC.

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

73 Articles 43 EC and 56 EC do not preclude legislation of a Member State which exempts from corporation tax dividends which a resident company receives from another resident company, when that State imposes corporation tax on dividends which a resident company receives from a non-resident company in which the resident company holds at least 10% of the voting rights, while at the same time granting a tax credit in the latter case for the tax actually paid by the company making the distribution in the Member State in which it is resident, provided that the rate of tax applied to foreign-sourced dividends is no higher than the rate of tax applied to nationally-sourced dividends and that the tax credit is at least equal to the amount paid in the Member State of the company making the distribution, up to the limit of the amount of the tax charged in the Member State of the company receiving the distribution.

74 Article 56 EC precludes legislation of a Member State which exempts from corporation tax dividends which a resident company receives from another resident company, where that State levies corporation tax on dividends which a resident company receives from a non-resident company in which it holds less than 10% of the voting rights, without granting the company

receiving the dividends a tax credit for the tax actually paid by the company making the distribution in the State in which the latter is resident.

Question 2

75 By Question 2, the national court essentially asks whether Articles 43 EC and 56 EC, and/or Articles 4(1) and 6 of Directive 90/435 must be interpreted as meaning that they preclude national legislation such as that at issue in the main proceedings which, in granting a tax credit to a resident company receiving dividends from another resident company by reference to the ACT paid by the latter in respect of the distribution, allows the former company to pay dividends to its own shareholders without being obliged to account for the ACT, whereas a resident company which has received dividends from a non-resident company must, in a similar case, pay the ACT in full.

76 It should be noted at the outset that, with regard to distributions of profits received by companies of one Member State from subsidiaries resident in other Member States, Directive 90/435 applies, in accordance with Article 3(1) of the version applying at the time of the events in the main proceedings, to parent companies having a minimum holding of 25% in the capital of their subsidiaries. As has been noted in paragraph 38 of this judgment, since the order for reference gives no details of the nature of the holdings of other companies that are parties to the dispute before the national court, it may be that the dispute also involves holdings which do not, on that basis, fall within the material scope of that directive.

77 Furthermore, in so far as the test cases in the main proceedings concern payments of dividends going back to the accounting period ending on 31 January 1973, they involve, at least in part, situations which do not come within the temporal scope of Directive 90/435.

78 In order to answer the question referred, it is therefore necessary to consider first of all to what extent legislation such as that at issue in the main proceedings is compatible with the provisions of the Treaty.

The provisions of the Treaty relating to freedom of establishment and the free movement of capital

79 Under the national legislation at issue in the main proceedings, a resident company receiving dividends paid by another resident company is entitled to a tax credit equal to the fraction of the amount of ACT paid by the latter company, with the result that when the former pays dividends to its own shareholders it may offset the ACT already paid by the latter company against the ACT due on that distribution. By contrast, a resident company receiving foreign-sourced dividends is not entitled to such a tax credit and must, on making a distribution to its own shareholders, accordingly account for ACT in full.

80 Since that legislation applies to payments of dividends to shareholder companies irrespective of the size of their holding, it is capable of coming under both Article 43 EC on the freedom of establishment and Article 56 EC on the free movement of capital.

81 However, to the extent to which the holdings in question confer on their owner a definite influence over the decisions of the companies concerned and allow it to determine their activities, it is the provisions of the Treaty relating to freedom of establishment which apply. The facts of the test cases in the main proceedings indicate that consideration of the national legislation at issue in the main proceedings should be approached first from the point of view of Article 43 EC (see paragraph 37 of this judgment).

82 As the claimants in the main proceedings contend, the effect of legislation such as that at issue in the main proceedings is that a resident company which has received foreign-sourced dividends and pays dividends of the same amount to its own shareholders must pay ACT in full, whereas a resident company which has received nationally-sourced dividends and pays dividends to its own shareholders of the same amount as the dividends received has the benefit of the tax credit granted and is thus no longer obliged to pay ACT.

83 In the case of a resident company receiving dividends from another resident company, that system ensures that when the company receiving the dividends in turn distributes profits to its own shareholders, ACT is paid only once. The exemption from ACT which is thus granted to that company is the same as that to which it is entitled, as regards corporation tax, in respect of dividends received from another resident company.

84 It must be held that the fact of not having to pay ACT represents a cash?flow advantage, in so far as the company concerned may retain the sums which it would otherwise have had to pay by way of ACT until corporation tax is payable (*Metallgesellschaft and Others*, paragraph 44).

85 According to the United Kingdom Government, that difference in treatment does not constitute discrimination prohibited by Community law, since it is not based on a distinction between nationally-sourced dividends and foreign-sourced dividends, but between dividends on which ACT has been paid and those on which no ACT has been paid. The tax credit granted to a resident company receiving dividends from another resident company is designed to prevent economic double taxation in the field of ACT. Since, in the case of a company receiving dividends from a non?resident company, no ACT has been paid by the latter, there is no risk of economic double taxation as regards ACT.

86 While it is true that under the national legislation at issue in the main proceedings the amount of ACT which a resident company must pay on a distribution by way of dividend to its own shareholders depends on whether that company has, or has not, received dividends from a company which has already paid ACT, the fact remains that that system leads, in practice, to a company receiving foreign-sourced dividends being less favourably treated than a company receiving nationally?sourced dividends. On a subsequent payment of dividends, the former is obliged to account for ACT in full, whereas the latter has to pay ACT only to the extent to which the distribution paid to its own shareholders exceeds that which the company has itself received.

87 Contrary to what the United Kingdom Government contends, a company receiving foreign-sourced dividends is, seen in the light of the objective of preventing the imposition of a series of charges to tax which the legislation at issue in the main proceedings seeks to avoid, in a comparable situation to that of a company receiving nationally?sourced dividends, even though only the latter receives dividends on which ACT has been paid.

88 As the Advocate General states in points 65 to 68 of his Opinion, the ACT payable by a United Kingdom-resident company is nothing more than a payment of corporation tax in advance, even though it is levied in advance when dividends are paid and calculated by reference to the amount of those dividends. The ACT which is paid on a distribution by way of dividend may, in principle, be set off against the corporation tax which a company must pay on its profits for the corresponding accounting period. Likewise, as the Court held when it ruled on the group income scheme established under the same tax legislation which was in force in the United Kingdom, the proportion of corporation tax which a resident company need not pay in advance under such a scheme when paying dividends to its parent company is, in principle, paid when the liability of the first company to corporation tax falls due (see *Metallgesellschaft and Others*, paragraph 53).

89 In the case of companies which, because their seat is outside the United Kingdom, are not obliged to pay ACT when they pay dividends to a resident company, it is clear that they are also liable to corporation tax in the State in which they are resident.

90 That being the case, the fact that a non-resident company has not been required to pay ACT when paying dividends to a resident company cannot be relied on in order to refuse that company the opportunity to reduce the amount of ACT which it is obliged to pay on a subsequent distribution by way of dividend. The reason why such a non-resident company is not liable to ACT is that it is subject to corporation tax, not in the United Kingdom, but in the State in which it is resident. A company cannot be required to pay in advance a tax to which it will never be liable (see, to that effect, *Metallgesellschaft and Others*, paragraphs 55 and 56).

91 Since both resident companies distributing dividends to other resident companies and non-resident companies making such a distribution are subject, in the State in which they are resident, to corporation tax, a national measure which is designed to avoid a series of charges to tax on distributed profits only as regards companies receiving dividends from other resident companies, while exposing companies receiving dividends from non-resident companies to a cash-flow disadvantage, cannot be justified by a relevant difference in the situation of those companies.

92 It cannot be contended, as the United Kingdom Government maintains, that such unequal treatment does not, in fact, exist inasmuch as a company resident outside the United Kingdom which has made a distribution by way of dividend without having had to account for ACT is in a position to distribute larger amounts to its shareholders. That argument disregards the fact that such a company is also subject, in the State in which it is resident, to corporation tax in accordance with the rules and at the rates which are applicable there.

93 Nor can the difference in treatment be justified by the need to preserve the cohesion of the tax system in place in the United Kingdom on the basis of a direct link between the tax advantage made available, namely the tax credit granted to a resident company receiving dividends from another resident company, and the corresponding tax liability, namely the ACT paid by the latter when it makes the distribution. The need for such a direct link must in fact lead to the same tax advantage being granted to companies receiving dividends from non?resident companies, since those companies are also obliged to pay corporation tax on distributed profits in the State in which they are resident.

94 It follows that Article 43 EC precludes a national measure which allows a resident company which has received dividends from another resident company to deduct the amount of ACT paid by the latter company from the amount of ACT for which the former company is liable, whereas a resident company which has received dividends from a non-resident company is not entitled to make such a deduction in respect of the corporation tax which the lastmentioned company is obliged to pay in the State in which it is resident.

95 Since it is possible that the dispute before the national court also concerns resident companies which received dividends in respect of a holding which does not confer on them a definite influence over the decisions of the company making the distribution and does not allow them to determine its activities, that measure must also be considered in the light of Article 56 EC on the free movement of capital.

96 It should be noted in that regard that resident companies receiving foreign-sourced dividends are treated differently, inasmuch as they suffer a cash-flow disadvantage which is not justified by a relevant difference in their situation.

97 Such a difference in treatment has the effect of discouraging United Kingdom-resident companies from investing their capital in a company established in another Member State and also has a restrictive effect as regards companies established in other Member States in that it constitutes an obstacle on their part to the raising of capital in the United Kingdom.

98 As the grounds relied on by the United Kingdom Government in order to justify that impediment to the free movement of capital are the same as those which have already been rejected in the examination of the national measure at issue in the main proceedings from the point of view of freedom of establishment, it must be held that Article 56 EC is to be interpreted as meaning that it also precludes such a measure.

Directive 90/435

99 According to the claimants in the main proceedings, the national tax rules referred to in Question 2 of the reference also contravene Articles 4(1) and 6 of Directive 90/435.

100 First, they submit, there is a breach of Article 4(1) of the directive in that, unlike a resident parent company receiving nationally-sourced dividends, a resident parent company receiving foreign-sourced dividends is obliged, when it makes a distribution to its own shareholders, to pay ACT in full and is not entitled to any relief in that respect as regards foreign corporation tax paid by the subsidiary on the distributed profits.

101 Secondly, the ACT payable on foreign-sourced dividends constitutes a withholding tax prohibited by Article 6 of Directive 90/435, and is also not permitted under Article 7 of that directive.

102 It should be noted in that regard that, by virtue of Article 4(1) of Directive 90/435, a Member State which does not exempt profits received by a resident parent company from a subsidiary which is resident in another Member State must authorise that parent company to deduct from the amount of tax due the fraction of the 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, up to the limit of the amount of the corresponding domestic tax.

103 As appears particularly from the third recital in its preamble, the aim of that directive is, by the introduction of a common system of taxation, to eliminate any disadvantage to cooperation between companies of different Member States as compared with cooperation between companies of the same Member State and thereby to facilitate the grouping together of companies at Community level (Joined Cases C?283/94, C-291/94 and C-292/94 *Denkavit and Others* [1996] ECR I?5063, paragraph 22, and Case C-294/99 *Athinaïki Zithopiïa* [2001] ECR I?6797, paragraph 25).

104 As regards the obligation imposed on Member States under Article 4(1) of Directive 90/435 to offset the tax accounted for by a non-resident subsidiary in the Member State in which it is resident against the tax payable by a resident parent company on distributed profits, the object of that provision, which is to prevent the imposition of a series of charges to tax on distributed profits, can be attained only if the tax system of the first Member State guarantees to the parent company concerned that the tax paid abroad by its foreign subsidiary on its distributed profits will be offset in full against the amount due by way of corporation tax in that Member State.

105 However, contrary to what the claimants in the main proceedings contend, that provision does not oblige a Member State having a system of advance payment of corporation tax, which is payable by a resident parent company when it in turn pays dividends received from a non?resident

subsidiary, to ensure that the amount payable in advance is, in every case, to be determined by reference to the corporation tax paid by the subsidiary in the State in which it is resident.

106 It should also be stated that, contrary to what the claimants in the main proceedings contend, the national measures at issue are not within the scope of the prohibition imposed by Article 6 of Directive 90/435 on Member States charging any form of withholding tax on the profits which a resident parent company receives from its non-resident subsidiary.

107 In that regard, it must be pointed out that, for the purposes of that directive, the expression 'withholding tax' is not restricted to certain specific types of national taxes and that the categorisation of a tax, duty or charge must be determined by the Court, under Community law, according to the objective characteristics by which it is levied, irrespective of its classification under national law (see, inter alia, *Athinaïki Zythopoiïa*, paragraphs 26 and 27, and Case C-58/01 *Océ Van der Grinten* [2003] ECR I?9809, paragraph 46).

108 As regards the prohibition laid down by Article 5 of Directive 90/435 on Member States levying a withholding tax on profits distributed by a resident subsidiary to its parent company, when that parent company is resident in another Member State, the Court has already held that any tax on income received in the State in which dividends are distributed is a withholding tax on distributed profits where the chargeable event for the tax is the payment of dividends or of any other income from shares, the taxable amount is the income from those shares and the taxable person is the holder of the shares (Case C-375/98 *Epson Europe* [2000] ECR I-4243, paragraph 23; *Athinaïki Zithopiïa*, paragraphs 28 and 29; and *Océ Van der Grinten*, paragraph 47).

109 The expression 'withholding tax' must be given a similar interpretation for the purposes of Article 6 of Directive 90/435. There is thus a 'withholding tax' for the purposes of that article in the case of every tax on income received by a parent company from a subsidiary established in another Member State, the chargeable event being the payment of dividends or of any other income from shares, where the taxable amount is the income from those shares and the taxable person is the holder of those shares.

110 As the United Kingdom Government points out, a resident company is obliged to account for ACT when it pays dividends to its own shareholders. The chargeable event for the ACT which a company receiving foreign-sourced dividends must pay is therefore not the receipt of those dividends but the payment of those dividends to its own shareholders.

111 It follows that the ACT which a company receiving foreign-sourced dividends must pay on a subsequent distribution by way of dividend is not within the scope of the prohibition on levying withholding tax laid down under Article 6 of Directive 90/435.

112 The answer to Question 2 must therefore be that Articles 43 EC and 56 EC preclude legislation of a Member State which allows a resident company receiving dividends from another resident company to deduct from the amount which the former company is liable to pay by way of advance corporation tax the amount of that tax paid by the latter company, whereas no such deduction is permitted in the case of a resident company receiving dividends from a non-resident company as regards the corresponding tax on distributed profits paid by the latter company in the State in which it is resident.

Question 3

113 By Question 3, the national court essentially asks whether Articles 43 EC and 56 EC and/or Articles 4(1) and 6 of Directive 90/435 must be interpreted as meaning that they preclude legislation such as that at issue in the main proceedings:

– which provides that any relief made available to a resident company which has received foreign-sourced dividends in respect of tax paid abroad is to reduce the amount of corporation tax against which it may offset the ACT which is due, and

– which does not allow a resident company to surrender the amount of ACT paid which cannot be set off against the corporation tax due for the current accounting period or for previous or subsequent accounting periods to non-resident subsidiaries in order that they may offset it against the corporation tax for which they are liable.

114 The question sets out a number of difficulties faced by a resident company with non-resident subsidiaries and/or receiving foreign-sourced dividends as regards the setting off against the amount of corporation tax for which it is liable of the amount of ACT for which that resident company is obliged to account when it pays dividends to its own shareholders.

115 With respect to the second part of the question, it should be observed at the outset that the arguments presented to the Court were limited to the inability of a resident company to surrender surplus ACT to non?resident subsidiaries in order for them to set it off against the corporation tax for which they are liable in the United Kingdom in respect of activities carried on in that Member State.

116 For the reasons set out in paragraphs 76 to 78 of this judgment, in order to answer the question, it is necessary first to consider whether the legislation at issue in the main proceedings contravenes the provisions of the Treaty.

117 It must be held that the national measures which form the subject-matter of Question 3 are capable of falling within the scope of both Article 43 EC on freedom of establishment and Article 56 EC on the free movement of capital. As regards the reliefs made available to a resident company which has received foreign-sourced dividends in respect of foreign tax paid, consideration of the national legislation at issue in the main proceedings in the context of the answer to Question 1 has shown that the reliefs available vary according to the extent of the holdings of those companies.

118 As regards the second aspect of the national legislation at issue referred to in Question 3, since it concerns only groups of companies, it falls within the scope of Article 43 EC rather than that of Article 56 EC.

119 According to the claimants in the main proceedings, the legislation at issue contravenes Articles 43 EC and 56 EC inasmuch as it restricts the ability of a company having foreign income and/or belonging to a group which includes non?resident companies, to obtain relief on surplus ACT in respect of the amount of corporation tax for which it is liable in the United Kingdom. That legislation gives rise to manifest differences of treatment in terms of offsetting and surrendering ACT, to the detriment of resident companies receiving foreign?sourced dividends and/or having non-resident subsidiaries. Those differences are neither appropriate nor necessary as regards the objective of avoiding the economic double taxation of dividends which have been the subject of distribution.

120 It must be held that any relief for corporation tax owed by a resident company receiving foreign-sourced dividends in respect of foreign tax – whether that tax is a withholding tax levied on

those dividends in advance or corporation tax paid by the non-resident company on the underlying profits – necessarily reduces the amount for which the resident company is liable in respect of corporation tax against which that resident company may offset the ACT paid on a subsequent distribution by way of dividend to its own shareholders.

121 With respect to the ACT which a company receiving dividends from a non-resident company is required to pay on making a distribution to its own shareholders, it is clear from the foregoing that, on any basis, Articles 43 EC and 56 EC preclude any discrimination as between companies receiving nationally?sourced dividends and those receiving foreign-sourced dividends at the time when ACT is levied (see paragraph 112 of this judgment).

122 It is true that the possibility remains that, even if there were no such discrimination, a company receiving large foreign-sourced dividends may have to pay an amount of ACT which exceeds its liability to corporation tax and which may thus give rise to surplus ACT. However, such a situation would be the direct result of the application of a national rule which is intended to prevent or to mitigate the taxation of profits distributed in the form of dividends.

123 In the case of a mechanism adopted in order to prevent or to mitigate the imposition of a series of charges to tax on distributed profits, such a rule cannot be regarded as contrary to the Treaty provisions relating to the freedoms of movement unless it treats dividends from foreign companies less favourably than those paid by resident companies, where the situations are objectively comparable and a difference in treatment is not justified by overriding reasons in the general interest.

124 The documents before the Court do not show that the mere fact that, for companies receiving foreign-sourced dividends, the relief granted in respect of tax paid abroad goes to reduce the amount of corporation tax due in the United Kingdom constitutes less favourable treatment of those dividends compared with nationally-sourced dividends. As the United Kingdom Government contends, such surplus ACT may also arise in the case of a company receiving nationally-sourced dividends on each occasion when the amount of ACT it has paid is greater than its liability to corporation tax, in particular when such a company is entitled to exemptions or relief which result in its liability to corporation tax being reduced.

125 The fact that a company receiving foreign?sourced dividends which is entitled to relief for foreign tax has to suffer a reduction as regards the amount of corporation tax against which surplus ACT may be offset will give rise to discrimination as between such a company and a company receiving nationally-sourced dividends only where the former company does not, in fact, have the same ability as the latter to offset the surplus ACT against the amount of corporation tax for which it is liable.

126 The description by the national court of the legislation at issue in the main proceedings does not show in this regard that a resident company receiving foreign-sourced dividends is treated differently from a company receiving nationally-sourced dividends.

127 It follows that the provisions of the Treaty relating to freedom of establishment do not preclude a national measure which provides that any relief in respect of tax paid abroad given to a resident company which has received foreign?sourced dividends will reduce the amount of corporation tax against which it may offset ACT.

128 Since such a measure does not discriminate against companies receiving foreign-sourced dividends, the conclusion reached in the preceding paragraph also applies to the provisions of the Treaty relating to the free movement of capital.

129 As regards the second aspect of the national legislation referred to in Question 3, it must be noted that, as the national court points out, if a resident company may surrender the amount of ACT which it has not been able to offset against the amount of corporation tax due for the current accounting period or for previous or subsequent accounting periods to its resident subsidiaries, which may then offset it against the amount of corporation tax for which they are liable, it is, by contrast, not open to such a company to surrender such surplus ACT to non?resident companies in the same group in order to enable them to offset it against the corporation tax for which they are liable in the United Kingdom.

130 According to the United Kingdom Government, a resident company cannot rely on the fact that its non-resident subsidiaries may not offset the surplus ACT against corporation tax for which they are liable, since that resident company is not itself disadvantaged as a result.

131 It must, however, be held that the provisions relating to freedom of establishment preclude a Member State from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation (see, inter alia, Case C?264/96 *ICI* [1998] ECR I?4695, paragraph 21; *Marks & Spencer*, paragraph 31; and *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 42).

132 The possibility under the national legislation at issue for a group of companies to surrender a particular amount of tax which a group company cannot offset against the corporation tax for which it is liable in the United Kingdom to another group company so that the latter may offset that amount against its liability to corporation tax in that Member State, constitutes a tax advantage for the companies concerned. The fact that non-resident companies in the group are not entitled to the same advantage is liable to hinder the exercise by those resident group companies of their freedom of establishment, by discouraging them from creating subsidiaries in other Member States (see, to that effect, as regards group relief for losses suffered by non-resident subsidiaries, *Marks & Spencer*, paragraphs 32 and 33).

133 As the claimants in the main proceedings and the Commission of the European Communities contend, the fact that a resident company may not surrender surplus ACT to non?resident subsidiaries which are liable to corporation tax in the United Kingdom thus constitutes a restriction on freedom of establishment. Neither the order for reference nor the observations of the United Kingdom Government disclose any legitimate objective which is compatible with the Treaty and which could justify such a restriction.

134 It follows from the above that Article 43 EC precludes a national measure which does not allow a resident company to surrender surplus ACT to its non-resident subsidiaries, even though the latter are liable to corporation tax in the Member State concerned.

135 Lastly, the claimants in the main proceedings maintain that, in so far as those provisions of the national legislation lead to a resident parent company incurring a liability to pay surplus ACT, they are also contrary to Articles 4(1) and 6 of Directive 90/435.

136 As was held in paragraphs 106 to 111 of this judgment, the relevant aspects of the national legislation at issue in the main proceedings do not fall within the scope of Article 6 of that directive.

137 As regards Article 4(1) of Directive 90/435, it is sufficient to hold that, while that provision obliges a Member State to guarantee to a parent company receiving dividends from a subsidiary established in another Member State that the foreign tax paid by its subsidiary on distributed profits will be offset in full against the amount of corporation tax for which the parent company is liable in the first Member State (see paragraph 104 of this judgment), it does not impose any

obligation on that State to ensure in such a case that the relief granted to that parent company in respect of the foreign tax will not reduce the amount against which it may offset the fraction of the advance corporation tax paid on a distribution by way of dividend to its own shareholders, or to allow that parent company to surrender the amount of that advance corporation tax paid which it cannot set off against its liability to tax to non-resident subsidiaries liable to corporation tax in that State.

138 The answer to Question 3 must therefore be that Articles 43 EC and 56 EC do not preclude legislation of a Member State which provides that any relief for tax paid abroad made available to a resident company which has received foreign?sourced dividends is to reduce the amount of corporation tax against which that company may offset advance corporation tax.

139 Article 43 EC precludes legislation of a Member State which allows a resident company to surrender to resident subsidiaries the amount of advance corporation tax paid which cannot be offset against the liability of that company to corporation tax for the current accounting period or previous or subsequent accounting periods, so that those subsidiaries may offset it against their liability to corporation tax, but does not allow a resident company to surrender such an amount to non-resident subsidiaries where the latter are taxable in that Member State on the profits which they made there.

Question 4

140 By Question 4, the national court essentially asks whether Articles 43 EC and 56 EC, together with Articles 4(1) and 6 of Directive 90/435, preclude national legislation, such as the legislation at issue in the main proceedings, which, while allowing resident companies receiving foreign-sourced dividends to elect to recover ACT accounted for on a subsequent distribution to their own shareholders, first, obliges those companies to pay the ACT and to reclaim it subsequently and, secondly, does not provide any tax credit to their shareholders, whereas those shareholders would have received such a tax credit if the resident companies had made a distribution based on nationally-sourced dividends.

141 The application of the provisions of Directive 90/435 to the issue raised by the national court can be excluded at the outset. First, as was stated at paragraph 137 of this judgment, Article 4(1) of the directive does not lay down rules as to the way in which a liability to pay advance corporation tax may be imposed. In providing rules designed to prevent the imposition of a series of charges to tax on profits distributed to a resident parent company by a non-resident subsidiary, that provision does not apply where the shareholders concerned are individuals. Secondly, it must be recalled that ACT is not a withholding tax for the purposes of Article 6 of the directive (see paragraph 111 of this judgment).

142 As regards the Treaty provisions relating to the freedoms of movement, since the legislation at issue applies to payments of dividends to resident companies irrespective of the size of their holding, it is capable of coming within the scope of both Article 43 EC on freedom of establishment and Article 56 EC on the free movement of capital.

143 Having regard to the facts in the main proceedings (see paragraph 37 of this judgment), the legislation at issue in those proceedings should be considered in the first place from the perspective of Article 43 EC.

144 As the Advocate General stated at point 94 of his Opinion, the national court is, by that question, asking the Court to rule on the lawfulness of the FID regime, introduced in the United Kingdom with effect from 1 July 1994. That regime permits resident companies receiving foreign?sourced dividends to obtain a repayment of the amount of surplus ACT, that is to say, the

amount of ACT which could not be offset against the amount due by way of corporation tax.

145 However, it must be held that the tax treatment of resident companies receiving foreign-sourced dividends and opting for the FID regime remains less favourable in two respects than that which applies to resident companies receiving nationally-sourced dividends.

146 As regards, in the first place, the ability to recover surplus ACT, the order for reference shows that, while ACT must be accounted for within 14 days of the quarter in which the company concerned pays dividends to its shareholders, surplus ACT is repayable only when corporation tax becomes due, that is to say, nine months after the end of the accounting period. Depending on when the company paid the dividends, it must wait between 8 ½ months and 17 ½ months to obtain repayment of the ACT accounted for.

147 Accordingly, as the claimants in the main proceedings contend, resident companies electing to be taxed under such a regime by reason of their receipt of foreign-sourced dividends are exposed to a cash-flow disadvantage which does not arise in the case of resident companies receiving nationally-sourced dividends. In the latter case, since the resident company making the distribution has already accounted for ACT on the profits distributed, a tax credit is granted to the resident company receiving the distribution, thereby allowing that company to pay an equivalent amount by way of dividends to its own shareholders without having to account for ACT.

148 In the second place, a shareholder receiving a payment of dividends from a resident company which has its origin in foreign-sourced dividends treated as FIDs, is not entitled to a tax credit, but is treated as having received income which has been taxed at the lower rate for the tax year in question. In the absence of a tax credit, such a shareholder has no right to any repayment if he is not liable to income tax or where the income tax due is less than the tax on the dividend at the lower rate.

149 As the claimants in the main proceedings contend, that means that a company which has elected to be taxed under the FID regime must increase the amount of its distributions if it wishes to guarantee its shareholders a return equivalent to that which would be achieved from a payment of nationally?sourced dividends.

150 The United Kingdom Government claims that those differences in treatment do not involve any restriction on freedom of establishment.

151 As regards the obligation on a company which has elected to be taxed under the FID regime to account for ACT pending subsequent repayment, the United Kingdom Government repeats its argument that the situation of a company receiving foreign-sourced dividends is not comparable to that of a company receiving nationally-sourced dividends, in that the obligation on the former company to account for ACT on a subsequent payment of dividends is explained by the fact that, unlike the latter, it receives dividends on which no ACT has been accounted for. If, in that different context, a company receiving foreign?sourced dividends which elects to be taxed under the FID regime is entitled to reimbursement of the ACT accounted for, such treatment cannot constitute discrimination in any way.

152 Nevertheless, as was held in paragraphs 87 to 91 of this judgment, since profits distributed by a company are subject to corporation tax in the Member State in which the company is resident, where a system of advance payment of corporation tax which applies to the company receiving the dividends determines the amount due by having regard to the tax on distributed profits paid by a resident distributing company but not to the tax paid abroad by a non-resident distributing company, such a system treats a company receiving foreign-sourced dividends less favourably than a company receiving nationally-sourced dividends, even though the situation of

the former is comparable to the latter.

153 While it is true that the situation of the former company is improved by the fact that the tax paid in advance which cannot be offset against the amount due in respect of corporation tax may be repaid, such a company remains in a less favourable situation than that of a company receiving nationally-sourced dividends, in that it suffers a cash-flow disadvantage.

154 Such a difference in treatment, which makes the acquisition of a holding in a non-resident company less attractive than a holding in a resident company, constitutes, in the absence of any objective justification, an infringement of freedom of establishment.

155 Contrary to what the United Kingdom Government contends, the cash?flow disadvantage to which companies which have elected to be taxed under the FID regime are exposed cannot be justified by practical constraints linked to the fact that, in assessing the tax due on the dividend, the taking into account by a Member State of all the taxes which may have been levied on the profits distributed, whether in that State or abroad, requires some time.

156 It is true that a Member State must be allowed some time to take into account, in determining the amount ultimately due by way of corporation tax, all of the taxes already levied on the profits distributed. Nevertheless, that cannot justify a situation where, in the case of nationally-sourced dividends, a Member State decides to take into account, in determining the amount due in respect of ACT by a company paying dividends, the fraction of the ACT paid by a resident company from which the company making the distribution has itself received dividends – at a time when the amount for which that other resident company will ultimately be liable in respect of corporation tax has not even been able to be determined – when, in the case of foreign?sourced dividends, that State fixes the amount due by way of ACT without a resident company which pays dividends to its own shareholders having any opportunity to offset the tax which is levied on the profits which have been distributed to it by a non?resident company against that amount.

157 Were it to be the case that, for practical reasons, the tax paid on the profits distributed could be taken into account under a system of advance payment of corporation tax only for nationally-sourced dividends, the Member State concerned would have to change part of its system for taxing resident companies in order to eliminate such unequal treatment.

158 As regards the fact that shareholders are not entitled to a tax credit under the FID regime, the United Kingdom Government argues that such a tax credit is granted to a shareholder receiving a distribution only where there is economic double taxation of the profits distributed which must be prevented or mitigated. That does not apply to the FID regime inasmuch as, first, no ACT has been accounted for on foreign-sourced dividends and, secondly, the ACT which the resident company receiving those dividends must account for on making a distribution to its shareholders is subsequently repaid.

159 However, that argument is based on the same false premiss that a risk of economic double taxation arises only in the case of dividends paid by a resident company subject to an obligation to account for ACT on dividends distributed by it, whereas the true position is that such a risk also exists in the case of dividends paid by a non-resident company, the profits of which are also subject to corporation tax in the State in which it is resident, at the rates and according to the rules applying there.

160 For the same reason, the United Kingdom Government cannot suggest that dividends received from a non-resident company are not less favourably treated by arguing that, because such a company is not obliged to account for ACT, it may pay higher dividends to its shareholders.

161 It is also necessary to reject the argument that the differences in treatment to which foreign-sourced dividends paid under the FID regime are subject do not constitute a restriction on the freedom of establishment because that scheme is merely optional.

162 As the claimants in the main proceedings point out, the fact that a national scheme which restricts the freedoms of movement is optional does not mean that it is not incompatible with Community law.

163 As regards, lastly, the argument of the United Kingdom Government that the restrictions at issue are justified by the need to preserve the cohesion of the United Kingdom tax system, it must be held that that argument is based on the same reasoning that has already been rejected in considering Question 2 (see paragraph 93 of this judgment).

164 It follows that Article 43 EC precludes a regime having the characteristics of the FID regime described by the national court in Question 4.

165 In so far as, according to the national court, that question also concerns companies established in non-member countries which, accordingly, do not fall within the scope of Article 43 EC on freedom of establishment, and for the reason set out in paragraph 38 of this judgment, the question arises whether national measures such as those at issue in the main proceedings also contravene Article 56 EC on the free movement of capital.

166 It must be pointed out in that regard that the difference in treatment to which foreign-sourced dividends are subject when they are received by a resident company which has elected to be taxed under the FID regime (see paragraphs 145 to 149 of this judgment) has the effect of discouraging such a company from investing its capital in a company established in another State and also has a restrictive effect on companies established in other States in that it constitutes an obstacle to their raising capital in the United Kingdom.

167 In order for such a difference in treatment to be compatible with the provisions of the Treaty on the free movement of capital, it must concern situations which are not objectively comparable or be justified by an overriding reason in the general interest.

168 As the United Kingdom Government refers in that respect to the same arguments as those made in relation to the analysis of Article 43 EC, it is sufficient to point out that, for the reasons set out in paragraphs 150 to 163 of this judgment, that difference in treatment concerns situations which are objectively comparable and constitutes a restriction on the free movement of capital for which no justification has been provided.

169 The only argument specifically raised by that Government in relation to the free movement of capital is based on the fact that, where companies making distributions are established in non-member countries, it may be more difficult to determine the tax paid by those companies in the State in which they are resident than in a purely Community context.

170 It is true that, because of the degree of legal integration that exists between Member States of the Union, in particular by reason of the presence of Community legislation which seeks to ensure cooperation between national tax authorities, such as 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), the taxation by a Member State of economic activities having cross-border aspects which take place within the Community is not always comparable to that of economic activities involving relations between Member States and non-member countries.

171 Furthermore, as the Advocate General noted at point 121 of his Opinion, it may be that a Member State will be able to demonstrate that a restriction on capital movements to or from non-member countries is justified for a particular reason in circumstances where that reason would not constitute a valid justification for a restriction on capital movements between Member States.

172 Nevertheless, the United Kingdom Government has, as regards the national legislation at issue, relied on the difficulties arising from the verification of the tax paid abroad only in order to explain the period of time between the time when ACT is accounted for and the time when it is repaid. As was held at paragraph 156 of this judgment, that is not a reason justifying legislation which refuses completely to allow a resident company receiving a payment of foreign-sourced dividends to offset the tax charged on profits distributed abroad against the amount due in respect of advance corporation tax, whereas, for nationally?sourced dividends, that amount is automatically deducted from the tax paid, albeit only in advance, by a resident company making a distribution.

173 The answer to Question 4 must therefore be that Articles 43 EC and 56 EC preclude legislation of a Member State which, while exempting from advance corporation tax resident companies paying dividends to their shareholders which have their origin in nationally?sourced dividends received by them, allows resident companies distributing dividends to their shareholders which have their origin in foreign-sourced dividends received by them to elect to be taxed under a regime which permits them to recover the advance corporation tax paid but, first, obliges those companies to pay that advance corporation tax and subsequently to claim repayment and, secondly, does not provide a tax credit for their shareholders, whereas those shareholders would have received such a tax credit in the case of a distribution made by a resident company which had its origin in nationally-sourced dividends.

Question 5

174 By Question 5, the national court essentially asks whether, having regard to the fact that the national measures referred to in Questions 1 and 2 were adopted before 31 December 1993, the measures referred to in Question 4, which were adopted after that date but which amend those national measures, to the extent to which they also constitute restrictions on capital movements prohibited in principle by Article 56 EC, are authorised as restrictions which existed on 31 December 1993, for the purposes of Article 57(1) EC.

175 Article 57(1) EC states that Article 56 EC is to be without prejudice to the application to non-member countries of restrictions which existed on 31 December 1993 under national or Community law adopted in respect of the movement of capital to or from non-member countries involving direct investment, including investment in real estate, establishment, the provision of financial services or the admission of securities to capital markets.

176 It is accordingly necessary to determine whether the national measures referred to in Question 4 fall within the scope of Article 57(1) EC, as being restrictions on the movement of

capital involving direct investment, establishment, the provision of financial services or the admission of securities to capital markets.

177 As regards, more particularly, the concept of ‘direct investment’, it must be stated that this is not defined by the Treaty.

178 Nevertheless, that concept has been defined in Community law in the nomenclature of the capital movements set out in Annex I to Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [article repealed by the Treaty of Amsterdam] (OJ 1988 L 178, p. 5), which sets out 13 categories of capital movements.

179 It is settled case-law that, inasmuch as Article 56 EC substantially reproduced the content of Article 1 of Directive 88/361, and even if the latter was adopted on the basis of Articles 69 and 70(1) of the EEC Treaty (Articles 67 to 73 of the EEC Treaty were replaced by Articles 73b to 73g of the EC Treaty, now Articles 56 EC to 60 EC), that nomenclature retains the same indicative value, for the purposes of defining the term ‘movement of capital’, as it did before their entry into force, subject to the qualification, contained in the introduction to the nomenclature, that the list set out therein is not exhaustive (see, inter alia, Case C-222/97 *Trummer and Mayer* [1999] ECR I?1661, paragraph 21, and Case C-513/03 *Van Hilten-van der Heijden* [2006] ECR I-1957, paragraph 39).

180 The same indicative value must be given to that nomenclature in interpreting the concept of direct investment. The first section of that nomenclature, entitled ‘Direct investments’ includes the establishment and extension of branches or new undertakings belonging solely to the person providing the capital and the acquisition in full of existing undertakings, participation in new or existing undertakings with a view to establishing or maintaining lasting economic links, long-term loans with a view to establishing or maintaining lasting economic links, and reinvestment of profits with a view to maintaining lasting economic links.

181 As that list and the relative explanatory notes show, the concept of direct investments concerns investments of any kind undertaken by natural or legal persons and which serve to establish or maintain lasting and direct links between the persons providing the capital and the undertakings to which that capital is made available in order to carry out an economic activity.

182 As regards shareholdings in new or existing undertakings, as the explanatory notes confirm, the objective of establishing or maintaining lasting economic links presupposes that the shares held by the shareholder enable him, either pursuant to the provisions of the national laws relating to companies limited by shares or otherwise, to participate effectively in the management of that company or in its control.

183 Contrary to what the claimants in the main proceedings contend, the restrictions on capital movements involving direct investment or establishment within the meaning of Article 57(1) EC extend not only to national measures which, in their application to capital movements to or from non-member countries, restrict investment or establishment, but also to those measures which restrict payments of dividends deriving from them.

184 It is clear from case-law that any less favourable treatment of foreign?sourced dividends in comparison with nationally-sourced dividends must be regarded as a restriction on the free movement of capital in so far as it is liable to make the acquisition of holdings in companies established in other Member States less attractive (*Verkooijen*, paragraph 35, *Lenz*, paragraph 21, and *Manninen*, paragraph 23).

185 It follows that a restriction on capital movements, such as a less favourable tax treatment of

foreign-sourced dividends, comes within the scope of Article 57(1) EC, inasmuch as it relates to holdings acquired with a view to establishing or maintaining lasting and direct economic links between the shareholder and the company concerned and which allow the shareholder to participate effectively in the management of the company or in its control.

186 Were that not to be the case, a restriction on capital movements prohibited by Article 56 EC could not be applied, even in relations with non-member countries.

187 Conversely, it is clear from Article 57(1) EC that a Member State may, in its relations with non-member countries, apply restrictions on capital movements which come within the substantive scope of that provision, even though they contravene the principle of the free movement of capital laid down under Article 56 EC, provided that those restrictions already existed on 31 December 1993.

188 The United Kingdom Government argues that, should the Court hold that Article 56 EC precludes national legislation governing the taxation of foreign-sourced dividends, such as the legislation at issue in the main proceedings, that would apply not only to the measures covered by Questions 1 to 3, which were adopted prior to 31 December 1993, but also to the FID regime, which came into effect on 1 July 1994, inasmuch as that regime did not introduce any new restrictions vis-à-vis the existing measures but, on the contrary, did no more than abolish a number of the restrictive effects of the existing legislation.

189 It is necessary first of all to clarify the concept of ‘restrictions which exist’ on 31 December 1993 within the meaning of Article 57(1) EC.

190 As the claimants in the main proceedings, the United Kingdom and the Commission propose, reference should be made to Case C-302/97 *Konle* [1999] ECR I?3099, in which the Court had to provide an interpretation of the concept of ‘existing legislation’ contained in a derogating provision in the Act concerning the conditions of accession of the Republic of Austria, the Republic of Finland and the Kingdom of Sweden and the adjustments to the Treaties on which the European Union is founded (OJ 1994 C 241, p. 21, and OJ 1995 L 1, p. 1), allowing the Republic of Austria to maintain its existing legislation governing secondary residences for a limited period.

191 While it is, in principle, for the national court to determine the content of the legislation which existed on a date laid down by a Community measure, the Court held in that case that it is for the Court of Justice to provide guidance on interpreting the Community concept which constitutes the basis of a derogation from Community rules for national legislation ‘existing’ on a particular date (see, to that effect, *Konle*, paragraph 27).

192 As the Court stated in *Konle*, any national measure adopted after a date laid down in that way is not, by that fact alone, automatically excluded from the derogation laid down in the Community measure in question. If the provision is, in substance, identical to the previous legislation or is limited to reducing or eliminating an obstacle to the exercise of Community rights and freedoms in the earlier legislation, it will be covered by the derogation. By contrast, legislation based on an approach which is different from that of the previous law and establishes new procedures cannot be regarded as legislation existing at the date set down by the Community measure in question (see *Konle*, paragraphs 52 and 53).

193 Next, as regards the relationship between the FID regime and the existing national legislation governing the taxation of foreign-sourced dividends, as described by the national court, it is apparent that the objective of that regime is to limit the restrictive effects arising from the existing legislation for resident companies receiving foreign-sourced dividends, in particular by

offering those companies the opportunity to obtain a repayment of the surplus ACT which is due when they pay dividends to their own shareholders.

194 It is, however, for the national court to determine whether the fact that, as the claimants in the main proceedings point out, shareholders receiving a FID are not entitled to a tax credit, must be regarded as a new restriction. While it is true that, in the national system of which the FID regime forms part, the grant of such a tax credit to a shareholder receiving a distribution is the counterpart of the payment by the company making the distribution of the ACT on that distribution, it cannot be inferred from the description of the national tax legislation provided in the order for reference that the fact that a company which has elected to be taxed under the FID regime is entitled to be reimbursed surplus ACT justifies, under the logic governing the legislation which existed on 31 December 1993, its shareholders not being entitled to any tax credit.

195 In any event, contrary to what the United Kingdom Government contends, the FID regime cannot be categorised as an existing restriction merely on the basis that, because it is optional, the companies concerned can always elect to be taxed under the system previously in place, with the restrictive effects to which it gave rise. As mentioned in paragraph 162 of this judgment, a system which restricts the freedoms of movement still remains incompatible with Community law, even though its application may be optional.

196 The answer to Question 5 must therefore be that Article 57(1) EC is to be interpreted as meaning that where, before 31 December 1993, a Member State has adopted legislation which contains restrictions on capital movements to or from non-member countries which are prohibited by Article 56 EC and, after that date, adopts measures which, while also constituting a restriction on such movements, are essentially identical to the previous legislation or do no more than restrict or abolish an obstacle to the exercise of the Community rights and freedoms arising under that previous legislation, Article 56 EC does not preclude the application of those measures to non-member countries when they apply to capital movements involving direct investment, including investment in real estate, establishment, the provision of financial services or the admission of securities to capital markets. Holdings in a company which are not acquired with a view to the establishment or maintenance of lasting and direct economic links between the shareholder and that company and do not allow the shareholder to participate effectively in the management of that company or in its control cannot, in this connection, be regarded as direct investments.

Questions 6 to 9

197 By Questions 6 to 9, which should be considered together, the national court essentially asks whether, in the event that the national measures referred to in the preceding questions are incompatible with Community law, claims such as those brought by the claimants in the main proceedings in order to remedy that incompatibility should be classified as claims for the repayment of sums unduly levied or benefits unduly claimed or, conversely, as claims for compensation for damage suffered. In the latter case, it asks whether it is necessary to satisfy the conditions laid down in the *Brasserie du Pêcheur and Factortame* judgment and, if so, whether account should be taken of the form in which such claims must be brought under national law.

198 As regards the application of the conditions in which a Member State is liable to make reparation for the loss and damage caused to claimants as a result of an infringement of Community law, the national court asks the Court to provide guidance as to the need for a sufficiently serious breach of Community law and the need for a causal link between the breach of the obligation imposed on the Member State and the loss and damage suffered by those affected.

199 The claimants in the main proceedings argue that each of the claims referred to in Question 6 falls to be categorised as a claim for repayment, both because those claims seek repayment of

the excess tax that was unlawfully levied or of the loss arising from the loss of use of money due to premature payment of taxes, and because those claims seek reinstatement of tax reliefs or reimbursement of the amount by which the resident companies concerned had to increase the amount of FIDs in order to compensate for the lack of any tax credit in the hands of their shareholders. Should Community law provide that only a claim for damages was competent under national law, such a claim would, in any event, be a different type of claim from that which formed the subject?matter of *Brasserie du Pêcheur and Factortame*.

200 Conversely, the United Kingdom Government contends that each of the remedies sought by the claimants in the main proceedings constitutes a claim for damages which is subject to the conditions laid down in *Brasserie du Pêcheur and Factortame*. The way in which those claims were brought under national law has no bearing on how they are to be classified in Community law.

201 It must be stated that it is not for the Court to assign a legal classification to the actions brought before the national court by the claimants in the main proceedings. In the circumstances, it is for the latter to specify the nature and basis of their actions (whether they are actions for repayment or actions for compensation for damage), subject to the supervision of the national court (see *Metallgesellschaft and Others*, paragraph 81).

202 However, the fact remains that, according to established case-law, the right to a refund of charges levied in a Member State in breach of rules of Community law is the consequence and complement of the rights conferred on individuals by Community provisions as interpreted by the Court (see, inter alia, Case 199/82 *San Giorgio* [1983] ECR 3595, paragraph 12, and *Metallgesellschaft and Others*, paragraph 84). The Member State is therefore required in principle to repay charges levied in breach of Community law (Joined Cases C-192/95 to C?218/95 *Comateb and Others* [1997] ECR I-165, paragraph 20, and *Metallgesellschaft and Others*, paragraph 84).

203 In the absence of Community rules on the refund of national charges levied though not due, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive from Community law, provided, first, that such rules are not less favourable than those governing similar domestic actions (principle of equivalence) and, secondly, that they do not render virtually impossible or excessively difficult the exercise of rights conferred by Community law (principle of effectiveness) (see, inter alia, Case 33/76 *Rewe* [1976] ECR 1989, paragraph 5, and Case 45/76 *Comet* [1976] ECR 2043, paragraphs 13 and 16; and, more recently, Case C-231/96 *Edis* [1998] ECR I-4951, paragraphs 19 and 34; Case C-343/96 *Dilexport* [1999] ECR I?579, paragraph 25; and *Metallgesellschaft and Others*, paragraph 85).

204 In addition, the Court held in paragraph 96 of its judgment in *Metallgesellschaft and Others*, that, where a resident company or its parent have suffered a financial loss from which the authorities of a Member State have benefited as the result of a payment of advance corporation tax, levied on the resident company in respect of dividends paid to its non-resident parent but which would not have been levied on a resident company which had paid dividends to a parent company which was also resident in that Member State, the Treaty provisions on freedom of movement require that resident subsidiaries and their non?resident parent companies should have an effective legal remedy in order to obtain reimbursement or reparation of the loss which they have sustained.

205 It follows from that case-law that, where a Member State has levied charges in breach of the rules of Community law, individuals are entitled to reimbursement not only of the tax unduly levied

but also of the amounts paid to that State or retained by it which relate directly to that tax. As the Court held in paragraphs 87 and 88 of *Metallgesellschaft and Others*, that also includes losses constituted by the unavailability of sums of money as a result of a tax being levied prematurely.

206 In so far as the rules of national law governing the availability of tax relief have prevented a tax, such as ACT, levied in breach of Community law, from being recovered by a taxpayer who has accounted for it, the latter is entitled to repayment of that tax.

207 However, contrary to what the claimants in the main proceedings contend, neither the reliefs waived by a taxpayer in order to be able to offset in full a tax levied unlawfully, such as ACT, against an amount due in respect of another tax, nor the loss and damage suffered by resident companies which elected to be taxed under the FID regime because they saw themselves as having to increase the amount of their dividends so as to compensate for the lack of a tax credit in the hands of their shareholders, can form the basis of an action under Community law for the reimbursement of the tax unlawfully levied or of sums paid to the Member State concerned or withheld by it directly against that tax. Such waivers of relief or increases in the amount of dividends are the result of decisions taken by those companies and do not constitute, on their part, an inevitable consequence of the refusal by the United Kingdom to grant those shareholders the same treatment as that afforded to shareholders receiving a distribution which has its origin in nationally?sourced dividends.

208 That being the case, it is for the national court to determine whether the waivers of relief or the increases in the amount of dividends constitute, on the part of the companies concerned, financial losses suffered by reason of a breach of Community law for which the Member State in question is responsible.

209 While it has not gone so far as to rule out the possibility of a State being liable in less restrictive conditions on the basis of national law, the Court has held that there are three conditions under which a Member State will be liable to make reparation for loss and damage caused to individuals as a result of breaches of Community law for which it can be held responsible, namely that the rule of law infringed must be intended to confer rights on individuals, that the breach must be sufficiently serious, and that there must be a direct causal link between the breach of the obligation resting on the State and the loss or damage sustained by those affected (*Brasserie du Pêcheur and Factortame*, paragraphs 51 and 66, and Case C-224/01 *Köbler* [2003] ECR I-10239, paragraphs 51 and 57).

210 It is, in principle, for the national courts to apply the criteria for establishing the liability of Member States for damage caused to individuals by breaches of Community law (*Brasserie du Pêcheur and Factortame*, paragraph 58, and *Köbler*, paragraph 100), in accordance with the guidelines laid down by the Court for the application of those criteria (*Brasserie du Pêcheur and Factortame*, paragraphs 55 to 57; Case C-392/93 *British Telecommunications* [1996] ECR I?1631, paragraph 41; *Denkavit and Others*, paragraph 49; and *Konle*, paragraph 58).

211 In the main proceedings, the first condition is plainly satisfied as regards Articles 43 EC and 56 EC. Those provisions confer rights on individuals (see, respectively, *Brasserie du Pêcheur and Factortame*, paragraphs 23 and 54, and Joined Cases C?163/94, C?165/94 and C?250/94 *Sanz de Lera and Others* [1995] ECR I?4821, paragraph 43).

212 As regards the second condition, it should be pointed out, first, that a breach of Community law will be sufficiently serious where, in the exercise of its legislative power, a Member State has manifestly and gravely disregarded the limits on its discretion (see *Brasserie du Pêcheur and Factortame*, paragraph 55; *British Telecommunications*, paragraph 42; and Case C-424/97 *Haim* [2000] ECR I?5123, paragraph 38). Secondly, where, at the time when it committed the

infringement, the Member State in question had only considerably reduced, or even no, discretion, the mere infringement of Community law may be sufficient to establish the existence of a sufficiently serious breach (Case C?5/94 *Hedley Lomas* [1996] ECR I-2553, paragraph 28, and *Haim*, paragraph 38).

213 In order to determine whether a breach of Community law is sufficiently serious, it is necessary to take account of all the factors which characterise the situation brought before the national court. Those factors include, in particular, the clarity and precision of the rule infringed, whether the infringement and the damage caused were intentional or involuntary, whether any error of law was excusable or inexcusable, and the fact that the position taken by a Community institution may have contributed towards the adoption or maintenance of national measures or practices contrary to Community law (*Brasserie du Pêcheur and Factortame*, paragraph 56, and *Haim*, paragraphs 42 and 43).

214 On any view, a breach of Community law will clearly be sufficiently serious if it has persisted despite a judgment finding the infringement in question to be established, or a preliminary ruling or settled case-law of the Court on the matter from which it is clear that the conduct in question constituted an infringement (*Brasserie du Pêcheur and Factortame*, paragraph 57).

215 In the present case, in order to determine whether a breach of Article 43 EC committed by the Member State concerned was sufficiently serious, the national court must take into account the fact that, in a field such as direct taxation, the consequences arising from the freedoms of movement guaranteed by the Treaty have been only gradually made clear, in particular by the principles identified by the Court since delivering judgment in Case 270/83 *Commission* v *France*. Moreover, as regards the taxation of dividends received by resident companies from non-resident companies, it was only in *Verkooijen*, *Lenz* and *Manninen* that the Court had the opportunity to clarify the requirements arising from the freedoms of movement, in particular as regards the free movement of capital.

216 Apart from cases to which Directive 90/435 applied, Community law gave no precise definition of the duty of a Member State to ensure that, as regards mechanisms for the prevention or mitigation of the imposition of a series of charges to tax or economic double taxation, dividends paid to residents by resident companies and those paid by non-resident companies were treated in the same way. It follows that, until delivery of the judgments in *Verkooijen*, *Lenz* and *Manninen*, the issue raised by the order for reference in the present case had not yet been addressed as such in the case-law of the Court.

217 It is in the light of those considerations that the national court should assess the matters referred to in paragraph 213 of this judgment, in particular the clarity and precision of the rules infringed and whether any errors of law were excusable or inexcusable.

218 As regards the third condition, namely the requirement for a causal link between the breach of the obligation resting on the State and the loss or damage sustained by those affected, it is for the national court to assess whether the loss and damage claimed flows sufficiently directly from the breach of Community law to render the State liable to make it good (see, to that effect, as regards the non-contractual liability of the Community, Joined Cases 64/76, 113/76, 167/78, 239/78, 27/79, 28/79 and 45/79 *Dumortier frères and Others* v *Council* [1979] ECR 3091, paragraph 21).

219 Subject to the right of reparation which flows directly from Community law where the conditions referred to in the previous paragraph are satisfied, it is on the basis of the rules of national law on liability that the State must make reparation for the consequences of the loss and damage caused, provided that the conditions for reparation of loss and damage laid down by

national law are not less favourable than those relating to similar domestic claims and are not so framed as to make it, in practice, impossible or excessively difficult to obtain reparation (Joined Cases C-6/90 and C-9/90 *Francovich and Others* [1991] ECR I?5357, paragraphs 41 to 43; *Brasserie du Pêcheur and Factortame*, paragraph 67; and *Köbler*, paragraph 58).

220 The answer to Questions 6 to 9 should therefore be that, in the absence of Community legislation, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive from Community law, including the classification of claims brought by injured parties before the national courts and tribunals. Those courts and tribunals are, however, obliged to ensure that individuals should have an effective legal remedy enabling them to obtain reimbursement of the tax unlawfully levied on them and the amounts paid to that Member State or withheld by it directly against that tax. As regards other loss or damage which a person may have sustained by reason of a breach of Community law for which a Member State is liable, the latter is obligated to make reparation for the loss or damage caused to individuals in the conditions set out in paragraph 51 of the judgment in *Brasserie du Pêcheur and Factortame*, but that does not preclude the State from being liable under less restrictive conditions, where national law so provides.

The application for a limitation on the temporal effects of the judgment

221 At the hearing, the United Kingdom Government requested the Court, if it were to interpret Community law as precluding national legislation such as the legislation at issue in the main proceedings, to limit the temporal effects of its judgment, even as regards legal proceedings brought before the date on which this judgment is delivered.

222 In support of its request, that Government refers, first, to the fact that, since the adoption of the domestic legislation in 1973, its compatibility with Community law has never been challenged and, secondly, to the serious financial implications, estimated at GBP 4 700 million (EUR 7 000 million), which the applications brought before the national court would have for the United Kingdom.

223 The latter amount is contested by the claimants in the main proceedings, who contend that the figure in fact lies somewhere between GBP 100 million and GBP 2 000 million. They also point out that, while it is true that the national legislation had never previously been challenged before the national courts on the basis of its compatibility with Articles 43 EC and 56 EC, its effect on cross-border activities had none the less been the subject of a number of legal actions.

224 It is sufficient to hold in that regard that the United Kingdom Government has put forward an amount which includes the actions brought by the claimants in the main proceedings and which form the subject-matter of each of the questions referred for preliminary ruling, thereby proceeding on the, incorrect, assumption that the Court would answer each of the questions in the manner proposed by the claimants in the main proceedings.

225 In those circumstances, it is not necessary to limit the temporal effects of this judgment.

Costs

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

Articles 43 EC and 56 EC do not preclude legislation of a Member State which exempts from corporation tax dividends which a resident company receives from another resident company, when that State imposes corporation tax on dividends which a resident company receives from a non?resident company in which the resident company holds at least 10% of the voting rights, while at the same time granting a tax credit in the latter case for the tax actually paid by the company making the distribution in the Member State in which it is resident, provided that the rate of tax applied to foreign-sourced dividends is no higher than the rate of tax applied to nationally-sourced dividends and that the tax credit is at least equal to the amount paid in the Member State of the company making the distribution, up to the limit of the amount of the tax charged in the Member State of the company receiving the distribution.

Article 56 EC precludes legislation of a Member State which exempts from corporation tax dividends which a resident company receives from another resident company, where that State levies corporation tax on dividends which a resident company receives from a non-resident company in which it holds less than 10% of the voting rights, without granting the company receiving the dividends a tax credit for the tax actually paid by the company making the distribution in the State in which the latter is resident.

2. **Articles 43 EC and 56 EC preclude legislation of a Member State which allows a resident company receiving dividends from another resident company to deduct from the amount which the former company is liable to pay by way of advance corporation tax the amount of that tax paid by the latter company, whereas no such deduction is permitted in the case of a resident company receiving dividends from a non?resident company as regards the corresponding tax on distributed profits paid by the latter company in the State in which it is resident.**

3. **Articles 43 EC and 56 EC do not preclude legislation of a Member State which provides that any relief for tax paid abroad made available to a resident company which has received foreign-sourced dividends is to reduce the amount of corporation tax against which that company may offset advance corporation tax.**

Article 43 EC precludes legislation of a Member State which allows a resident company to surrender to resident subsidiaries the amount of advance corporation tax paid which cannot be offset against the liability of that company to corporation tax for the current accounting period or previous or subsequent accounting periods, so that those subsidiaries may offset it against their liability to corporation tax, but does not allow a resident company to surrender such an amount to non-resident subsidiaries where the latter are taxable in that Member State on the profits which they made there.

4. **Articles 43 EC and 56 EC preclude legislation of a Member State which, while exempting from advance corporation tax resident companies paying dividends to their shareholders which have their origin in nationally-sourced dividends received by them, allows resident companies distributing dividends to their shareholders which have their origin in foreign-sourced dividends received by them to elect to be taxed under a regime which permits them to recover the advance corporation tax paid but, first, obliges those companies to pay that advance corporation tax and subsequently to claim repayment and,**

secondly, does not provide a tax credit for their shareholders, whereas those shareholders would have received such a tax credit in the case of a distribution made by a resident company which had its origin in nationally-sourced dividends.

5. **Article 57(1) EC is to be interpreted as meaning that where, before 31 December 1993, a Member State has adopted legislation which contains restrictions on capital movements to or from non-member countries which are prohibited by Article 56 EC and, after that date, adopts measures which, while also constituting a restriction on such movements, are essentially identical to the previous legislation or do no more than restrict or abolish an obstacle to the exercise of the Community rights and freedoms arising under that previous legislation, Article 56 EC does not preclude the application of those measures to non-member countries when they apply to capital movements involving direct investment, including investment in real estate, establishment, the provision of financial services or the admission of securities to capital markets. Holdings in a company which are not acquired with a view to the establishment or maintenance of lasting and direct economic links between the shareholder and that company and do not allow the shareholder to participate effectively in the management of that company or in its control cannot, in this connection, be regarded as direct investments.**

6. **In the absence of Community legislation, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive from Community law, including the classification of claims brought by injured parties before the national courts and tribunals. Those courts and tribunals are, however, obliged to ensure that individuals should have an effective legal remedy enabling them to obtain reimbursement of the tax unlawfully levied on them and the amounts paid to that Member State or withheld by it directly against that tax. As regards other loss or damage which a person may have sustained by reason of a breach of Community law for which a Member State is liable, the latter is under a duty to make reparation for the loss or damage caused to individuals in the conditions set out in paragraph 51 of the judgment in Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur and Factortame* [1996] ECR I-1029, but that does not preclude the State from being liable under less restrictive conditions, where national law so provides.**

[Signatures]

* Language of the case: English