Court of Justice of the European Communities

Metallgesellschaft Ltd and others v Inland Revenue Commissioners and another

Hoechst AG and another v Inland Revenue Commissioners and another

(Joined Cases C-397 and 410/98)

2000 May 25;
Sept 12;
2001 March 8

President of Chamber A La Pergola
Judges M Wathelet, D A O Edward,
P Jann and L Sevón
Advocate General N Fennelly

Revenue — Corporation tax — Advance corporation tax — Dividend paid by subsidiary resident in United Kingdom to parent — Dividend not subject to advance corporation tax only if parent resident in UK — Whether restriction of freedom of establishment — Whether contrary to Community law — EC Treaty, art 52

European Community — Breach of Community law — Remedy — Dividend paid by subsidiary resident in United Kingdom to parent — Dividend not subject to advance corporation tax only if parent resident in UK — Cashflow disadvantage to non-resident parent — Restriction of freedom of establishment — Whether entitlement to sum representing interest on tax paid prematurely — EC Treaty, art 52

Under provisions of the Income and Corporation Taxes Act 1988 as in force at the material time, certain distributions made by companies resident in the United Kingdom were subject to advance corporation tax, which was payable quarterly. Tax so paid could later be set off against any liability to corporation tax arising either in the concurrent corporation tax year or, if there was no such liability in that year, in a subsequent one. It was also provided that two companies resident in the United Kingdom, one of which owned at least 51% of the other, could make a group income election, a consequence of which was that the subsidiary company was not obliged to pay advance corporation tax on dividends paid to the parent company, resulting in the deferment pro tanto of the charge to corporation tax, which was not payable until nine months after the end of the tax year in which liability arose. The claimants, companies resident in Germany and their United Kingdom subsidiaries, who were not entitled to group income election so that the subsidiaries were liable to advance corporation tax on dividends paid by them to the parents, alleged that the consequent cashflow disadvantage suffered by the subsidiaries by comparison with subsidiaries with resident parent companies gave rise to a restriction of the parents' freedom of establishment, contrary to article 52 of the EC Treaty[1] as extended to companies by article 58, and they claimed, by way of restitution or alternatively as damages, a sum representing interest for the loss of use, between the dates of payment of advance corporation tax and the dates when corporation tax became due, of sums paid as

[1] EC Treaty, art 52: "Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a member state in the territory of another member state shall be abolished . . . Such . . . abolition shall also apply to restrictions on the setting up of agencies, branches or subsidiaries by nationals of any member state established in the territory of any member state . . ."

Art 58: "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 Community shall, for the purposes of the Chapter, be treated in the same way as natural persons who are nationals of member states . . ."

A advance corporation tax. On a reference to the Court of Justice of the European Communities for a preliminary ruling on questions arising, the United Kingdom Government contended that there was no breach of article 52 as any prima facie discrimination was justified; that, even if such a breach was established, no compensation was payable to the claimants since the rules relating to actions for the recovery of sums unduly paid were a matter for the member states' domestic legal systems alone, under English law interest could not be awarded where no principal B sum was any longer due to the claimant and there was no such debt in the present cases since the due dates for payment of corporation tax had elapsed before the actions were brought; and that, further, the claimants ought to have sought to make a group income election and, on the tax inspector's refusal, appealed to the courts, invoking the primacy of Community law, and their failure to do so was inimical to their claim.

On the reference—

Held, (1) that since a tax regime which allowed resident parent companies but C not non-resident ones to receive dividends from their resident subsidiaries without the payment of advance corporation tax resulted in a cashflow disadvantage to the subsidiaries of non-resident companies, and the difference in treatment could not be justified on the ground either that it was necessary in order to preserve the cohesion of the tax system or that the situations of the two groups of companies were not comparable, the legislation creating such a regime imposed an unwarranted restriction on freedom of establishment and hence was contrary to article 52 of the D Treaty (post, pp 656F–G, 657F–H, 658E–F, 661E–F, G–H, 668A–B).

(2) That a company that had been obliged to make advance payments of tax contrary to Community law was entitled to a sum equivalent to the interest that would have been generated on the sums forgone, since were it otherwise the exercise of rights conferred by Community law would be rendered impossible in practice or excessively difficult, and where the interest sought was not merely ancillary but was of the essence of the claim and was itself the principal sum claimed, so that any E national rule excluding the payment of interest where no principal sum was due was in any event irrelevant, the Community rule that it was for national law alone to determine matters ancillary to a claim such as the payment of interest did not apply; and that the question whether the claim was to be framed as one for restitution or for damages was a matter for the claimant and the national court (post, pp 663A–B, 664A–E, G–H, 665D–G, 668B–E).

Marshall v Southampton and South West Hampshire Area Health Authority F *(Teaching) (No 2)* (Case C-271/91) [1994] QB 126, ECJ and *R v Secretary of State for Social Security, Ex p Sutton* (Case C-66/95) [1997] ICR 961, ECJ considered.

(3) That the claim could not be refused or reduced on the sole ground that the non-resident company and its subsidiary had not applied to the tax authority to be granted exemption from advance corporation tax and then appealed from the authority's refusal, relying on the primacy of Community law, where on any view the application must have been refused under national law (post, pp 667E–G, 668E–G).

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The following cases are referred to in the judgment:

Amministrazione delle Finanze dello Stato v SpA San Giorgio (Case 199/82) [1983] ECR 3595, ECJ

Aprile Srl v Amministrazione delle Finanze dello Stato (No 2) (Case C-228/96) [2000] 1 WLR 126; [1998] ECR I-7141, ECJ

Asscher v Staatssecretaris van Financiën (Case C-107/94) [1996] ECR I-3089, ECJ

H *BP Supergas Anonimos Etairia Geniki Emporiki-Viomichaniki kai Antiprossopeion v Greek State* (Case C-62/93) [1995] ECR I-1883; [1995] All ER (EC) 684, ECJ

Baars v Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem (Case C-251/98) [2000] ECR I-2787, ECJ

Bachmann v Belgian State (Case C-204/90) [1992] ECR I-249, ECJ

Barra v Belgian State (Case 309/85) [1988] ECR 355, ECJ

Brasserie du Pêcheur SA v Federal Republic of Germany; R v Secretary of State for Transport, Ex p Factortame Ltd (No 4) (Joined Cases C-46 and 48/93) [1996] QB 404; [1996] 2 WLR 506; [1996] ECR I-1029; [1996] All ER (EC) 301, ECJ A
Comateb, Société v Directeur Général des Douanes et Droits Indirects (Joined Cases C-192–218/95) [1997] ECR I-165, ECJ
Commission of the European Communities v French Republic (Case 270/83) [1986] ECR 273, ECJ
Commission of the European Communities v Hellenic Republic (Case 305/87) [1989] ECR 1461, ECJ B
Commission of the European Communities v Kingdom of Belgium (Case C-300/90) [1992] ECR I-305, ECJ
Dilexport Srl v Amministrazione delle Finanze dello Stato (Case C-343/96) [1999] ECR I-579, ECJ
Edilizia Industriale Siderurgica Srl v Ministero delle Finanze (Case C-231/96) [1998] ECR I-4951, ECJ C
Express Dairy Foods Ltd v Intervention Board for Agricultural Produce (Case 130/79) [1980] ECR 1887, ECJ
Halliburton Services BV v Staatssecretaris van Financiën (Case C-1/93) [1994] ECR I-1137, ECJ
Imperial Chemical Industries plc v Colmer (Case C-264/96) [1999] 1 WLR 108; [1998] ECR I-4695, ECJ
Kapniki Mikhailidis AE v Idrima Kinonikon Asphaliseon (Joined Cases C-441 and 442/98) [2000] ECR I-7145, ECJ D
Marshall v Southampton and South West Hampshire Area Health Authority (Teaching) (No 2) (Case C-271/91) [1994] QB 126; [1993] 3 WLR 1054; [1993] ECR I-4367; [1993] 4 All ER 586, ECJ
Ministero delle Finanze v SPAC SpA (Case C-260/96) [1998] ECR I-4997, ECJ
R v Secretary of State for Social Security, Ex p Sutton (Case C-66/95) [1997] ICR 961; [1997] ECR I-2163; [1997] All ER (EC) 497, ECJ E
Roquette Frères, Société v Commission of the European Communities (Case 26/74) [1976] ECR 677, ECJ
Royal Bank of Scotland plc v Elliniko Dimosio (Case C-311/97) [1999] ECR I-2651, ECJ
Saint-Gobain, Zweigniederlassung Deutschland, Cie de v Finanzamt Aachen-Innenstadt (Case C-307/97) [1999] ECR I-6161, ECJ
Skanavi, Criminal proceedings against (Case C-193/94) [1996] ECR I-929; [1996] All ER (EC) 435, ECJ F
Wielockx v Inspecteur der Directe Belastingen (Case C-80/94) [1996] 1 WLR 84; [1995] ECR I-2493, ECJ

The following additional cases are referred to in the opinion of the Advocate General:

Biehl v Administration des contributions du grand-duché de Luxembourg (Case C-175/88) [1990] ECR I-1779, ECJ G
Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna (Case C-294/97) [1999] ECR I-7447, ECJ
Francovich v Italian Republic (Joined Cases C-6/90 and C-9/90) [1995] ICR 722; [1991] ECR I-5357, ECJ
Fromme v Bundesanstalt für landwirtschaftliche Marktordnung (Case 54/81) [1982] ECR 1449, ECJ
GT-Link A/S v De Danske Statsbaner (Case C-242/95) [1997] ECR I-4449, ECJ H
Haahr Petroleum Ltd v Åbenrå Havn (Case C-90/94) [1997] ECR I-4085, ECJ
London, Chatham and Dover Railway Co v South Eastern Railway Co [1893] AC 429, HL(E)
Ministero delle Finanze v IN CO GE '90 Srl (Joined Cases C-10–22/97) [1998] ECR I-6307, ECJ

A *President of India v La Pintada Cia Navigacion SA* [1985] AC 104; [1984] 3 WLR 10; [1984] 2 All ER 773, HL(E)
R v HM Treasury, Ex p British Telecommunications plc (Case C-392/93) [1996] QB 615; [1996] 3 WLR 203; [1996] ECR I-1631; [1996] All ER (EC) 411, ECJ
R v Inland Revenue Comrs, Ex p Commerzbank AG (Case C-330/91) [1994] QB 219; [1994] 2 WLR 128; [1993] ECR I-4017; [1993] 4 All ER 37, ECJ
Rechberger v Austrian Republic (Case C-140/97) [1999] ECR I-3499, ECJ
B *Safir v Skattemyndigheten i Dalarnas Län* (Case C-118/96) [1999] QB 451; [1999] 2 WLR 66; [1998] ECR I-1897, ECJ
Staatssecretaris van Financiën v Verkooijen (Case C-35/98) [2000] ECR I-4071, ECJ
Stichting Collectieve Antennevoorziening Gouda v Commissariaut voor de Media (Case C-288/89) [1991] ECR I-4007, ECJ
Svensson v Ministre du Logement et de l'Urbanisme (Case C-484/93) [1995] ECR I-3955, ECJ

C REFERENCE by the High Court, Chancery Division

In proceedings between (in Case C-397/98) the claimants, Metallgesellschaft Ltd, Metallgesellschaft AG, Metallgesellschaft Handel & Beteiligungen AG and The Metal and Commodity Co Ltd, and the defendants, the Inland Revenue Commissioners and HM Attorney General, and (in Case C-410/98) the claimants, Hoechst AG and Hoechst UK Ltd, D and the same defendants, the High Court, by order of 2 October 1998, referred to the Court of Justice for a preliminary ruling under article 177 of the EC Treaty (now article 234 EC) five questions (see post, pp 628E–629D) on the interpretation of articles 6, 52, 58 and 73b of the EC Treaty (now, respectively, articles 12 and 43 EC, after amendment, and articles 48 and 56 EC). The cases were joined for the purposes of the procedure before the Court of Justice.

E The Judge Rapporteur was Judge Wathelet. The facts are stated in the judgment.

John Gardiner QC and *Francis Fitzpatrick* for the claimants in Case C-397/98.

Mark Barnes QC for the claimants in Case C-410/98.

Derrick Wyatt QC and *Rabinder Singh* for the United Kingdom F Government.

B Muttelsee-Schön, agent, for the German Government.

S Seam, agent, for the French Government.

M A Fierstra, agent, for the Netherlands Government.

H Rotkirch and *T Pynnä*, agents, for the Finnish Government.

R Lyal, H Michard and *M Patakia*, agents, for the Commission of the G European Communities.

12 September 2000. MR ADVOCATE GENERAL FENNELLY delivered the following opinion.

1 This reference from the High Court of Justice (England and Wales), Chancery Division, concerns the extent to which, in the absence of harmonised Community rules, member state competence in respect of direct H corporate taxation is limited by the overriding requirements flowing from the fundamental Treaty principles of free movement. The Court of Justice is particularly asked to consider whether the relatively novel notion of fiscal cohesion can be invoked to justify a difference in the tax treatment of certain corporate taxpayers based on the place of residence of their parent companies. If it does not, a consequential question is whether Community

law requires that a remedy, either for restitutionary or compensatory damages, be available in national law notwithstanding that the differential treatment resulted merely in the early payment of tax.

The legal and factual context

The relevant United Kingdom legal provisions

2 Under sections 8 and 11 of the Income and Corporation Taxes Act 1988, corporation tax is charged on the profits of UK-resident companies, as well as on those of non-resident companies which trade in the United Kingdom through branches or agencies, during a given accounting period. (An accounting period, under section 12, is generally a period of 12 months.) For accounting periods ending before 1 October 1993, corporation tax was payable nine months after the end of the accounting period or one month after the issue of the notice of assessment relating to that accounting period, whichever was the later. Since 1 October 1993, it has been payable nine months and one day after the end of the accounting period. (For convenience, I shall hereafter adopt the expression "mainstream corporation tax", also used by the national court, to describe the normal obligation to pay corporation tax which arises only following this year-long accounting period.)

3 The present case concerns the payment of advance corporation tax (which was abolished by section 31 of the Finance Act 1998 with effect from 6 April 1999). It is important to note that the national court has unambiguously found as a matter of United Kingdom law that, under section 4 of the 1988 Act, "advance corporation tax is corporation tax and there is nothing in any other provision of the 1988 Act which calls that into question": see the judgment of Neuberger J of 2 October 1998 annexed to the order for reference. (The payment of corporation tax following the end of the relevant tax year will be referred to as "mainstream" corporation tax, so as to distinguish it, for the sake of convenience, from the advance payments of the same tax due by way of advance corporation tax.) Under section 14, certain "qualifying distributions", most typically the payment of dividends, entailed the obligation to pay advance corporation tax. Any company resident in the United Kingdom which made such a distribution was liable, on that occasion, to pay advance corporation tax on a sum equal to the amount or value of the "distribution" made. Companies were obliged to make quarterly returns showing the amount of any "distributions" made during that period. The resulting advance corporation tax was payable within 14 days of the end of that quarterly period: see Schedule 13 to the 1988 Act, paragraphs (1) and (3).

4 In principle, any advance corporation tax paid during an advance corporation tax accounting period could be set off against the paying company's mainstream corporation tax liability for the corporation tax accounting period in question, or, alternatively, transferred to its subsidiaries, which could then set it off against mainstream corporation tax for which they were liable (sections 239 and 240). Corporation tax was not payable until nine months after the expiry of each corporate tax year. However, advance corporation tax had to be paid within 14 days of the end of the relevant quarterly advance corporation tax period so that, as the national court has found,

A "the effect of advance corporation tax [on a company which chose to distribute profits by way of dividend] was therefore to advance the date for payment of the corporation tax which would otherwise be due, by a period that would vary from $8\frac{1}{2}$ months (in the case of a distribution made on the last day of an accounting period) to one year and $5\frac{1}{2}$ months (where the distribution was made on the first day of an accounting period)."

B Moreover, where no mainstream corporation tax was payable in respect of the period in question, it is also pointed out in the order for reference that the advance corporation tax paid "could be set off against profits of subsequent periods, in which case the advance would have been made for a longer and perhaps indefinite period".

5 Central to the present case, however, is the exemption from liability to C pay advance corporation tax which was available where a subsidiary and its parent company made a "group income election" pursuant to section 247 of the 1988 Act. Such an election was open only to companies one of which owned at least 51% of the other and both of which were resident in the United Kingdom. The effect of exercising such a right of election was that the subsidiary (the paying company) was not required to pay advance corporation tax in respect of dividends paid to its parent company, unless it D gave notice that it did not wish the group income election to apply in respect of a particular dividend. The request for group income election had to be made to an inspector of taxes. If the request was rejected, the requesting company could appeal to the special or general commissioners, from whose decision an appeal on a point of law lay (in England and Wales) to the High Court of Justice.

E 6 The alternative claim advanced in the main proceedings concerns the entitlement to a tax credit in respect of advance corporation tax paid. Under section 231(1) of the 1988 Act, the payment of advance corporation tax by a subsidiary on dividends distributed to its parent company entitled the latter to a tax credit provided the parent company was resident in the United Kingdom. The amount of the tax credit was equal to the amount of advance corporation tax paid by the subsidiary. Such a tax credit could be used by F the parent to offset its own liability to pay advance corporation tax when it made distributions to its shareholders; i e it would be liable to pay advance corporation tax only on the excess of those later dividends over those received from its subsidiary. Where a company that was resident in the United Kingdom, but wholly exempt from mainstream corporation tax liability, received a dividend from a subsidiary in respect of which advance G corporation tax had been paid, it was entitled to a reimbursement of an amount equal to the tax credit.

7 Under section 208 of the 1988 Act, "corporation tax was not chargeable on dividends or other distributions of a company resident in the United Kingdom, nor were any such dividends or distributions to be taken into account in computing income for corporation tax". Non-resident companies, on the other hand, or those which did not trade in the United H Kingdom through a branch or agency, although not chargeable to corporation tax, were, in principle, subject to United Kingdom income tax in respect of income having its source in the United Kingdom, which included dividends paid by companies resident in the United Kingdom. However, under section 233(1) of the 1988 Act, in so far as a non-resident parent

company of a UK-resident subsidiary was not entitled to a tax credit in respect of such a dividend, it was not subject to a charge to United Kingdom income tax on it either. Conversely, where it was entitled to a tax credit by virtue of a double taxation convention in force between the United Kingdom and its country of residence, it was chargeable in the United Kingdom to income tax on dividends received from its UK-resident subsidiaries.

8 The double taxation convention of 26 November 1964 between the United Kingdom and Germany, as amended on 23 March 1970, grants no right to a tax credit to companies resident in Germany and holding shares in and receiving distributions from companies resident in the United Kingdom. Accordingly, under United Kingdom law, a German parent company is not assessable to tax in respect of dividends received from its subsidiary resident in the United Kingdom and is therefore not entitled to any tax credit. However, a number of double taxation conventions between the United Kingdom and certain EU Member and non-member countries enable parent companies resident in the other country to obtain at least a partial tax credit. (The national court, whilst observing that the "arrangements vary" under such double taxation conventions, states that "the general pattern is to grant the tax credit in whole or in part and to make a reduced charge to tax on the aggregate of the amount of the dividend and the amount of the tax credit", with the result that "the net effect is to give a partial refund of the advance corporation tax".) Under the double taxation convention between the Netherlands and the United Kingdom, which has been relied on by the claimants in the main proceedings, the relevant charge to tax in respect of the Netherlands-resident parent companies amounted, at the material time, to 5% of what may conveniently be described as the "grossed-up amount" of the dividend, namely the total of half the tax credit plus the dividend. (On the example used by the Hoechst claimants in their written and oral observations—which has not been disputed by the United Kingdom—which related to a distribution of £43m paid by Hoechst UK Ltd to its German parent, Hoechst AG, on 16 January 1989, advance corporation tax of £14,333,333 was paid. Thus, if Hoechst AG had been a UK-resident parent company, it would have benefited from a full tax credit of £14,333,333, while if it had been Dutch, it would have been entitled to a payment of half that tax credit less the 5% charge on the grossed-up amount, viz to £4,658,333.)

Facts and reference

9 The companies involved in Case C-397/98 are Metallgesellschaft Ltd, The Metal and Commodity Co Ltd, both of which are companies incorporated and resident in the United Kingdom, and Metallgesellschaft AG and Metallgesellschaft Handel & Beteiligungen AG, which are both incorporated and resident in the Federal Republic of Germany (hereafter "Metallgesellschaft and others"). The companies involved in Case C-410/98 are Hoechst AG, a company incorporated and resident in Germany, and its UK-resident subsidiary, Hoechst UK Ltd (hereafter "Hoechst"). Metallgesellschaft Ltd, The Metal and Commodity Co Ltd and Hoechst UK Ltd (hereafter "the United Kingdom subsidiaries") each paid, over periods stretching from 1974 to 1995, advance corporation tax in respect of dividends paid to their German parent companies. (The date of the facts in

A the main proceedings is not stated in the orders for reference. However, in response to a written question from the Court of Justice, it was agreed between the claimants, Metallgesellschaft and others and Hoechst, on the one hand, and the United Kingdom, on the other, that the disputed payments of advance corporation tax in Case C-397/98 were made between 16 January 1989 and 26 April 1994, while those involved in Case C-410/98 were made B between 16 April 1974 and 13 October 1995.)

10 The claimants brought actions in 1995 before the national court in which they maintained that their United Kingdom subsidiaries had suffered a cashflow disadvantage in comparison with the subsidiaries of parent companies resident in the United Kingdom, since, unlike the latter, which were permitted to benefit from a group income election, no such option was available to them. They claim principally that that disadvantage constituted C discrimination contrary to articles 6 and 52 of the EC Treaty. By way of an alternative limb to this claim, the claimants contend that the contested restriction on the entitlement to make a group income election infringed article 73b of the EC Treaty. Their second and alternative claim is that the parents should be entitled to a tax credit corresponding, at least in part, to the advance corporation tax paid by the United Kingdom subsidiaries. By D way of a remedy, they are seeking damages or compensation for the loss of the use of the money in respect of the periods between the payments of advance corporation tax made and the time when their mainstream corporation tax, against which those payments were set off, was due.

11 The defendants, the Inland Revenue Commissioners and the Attorney General, contend that advance corporation tax was designed to ensure that the company making the distribution made a payment to match E the tax credit or income tax exemption given to the shareholder. If resident subsidiaries of non-resident parents could distribute profits free of advance corporation tax, the result would facilitate tax avoidance since neither the parent nor the subsidiary would have to pay advance corporation tax, while, conversely, in the case of a UK-resident parent company, advance corporation tax would be payable once a distribution was made by them F outside the group. Thus, any differentiation based on the place of residence of a subsidiary company's parent company was justified. As to the alternative tax credit claim, the fact that there is no provision for tax credits in the United Kingdom-Germany double taxation convention, while such a provision exists in certain other double taxation conventions, reflects differences between the German tax system and those of the other countries concerned, as well as the result of the overall negotiated arrangements agreed G by the parties to the various double taxation conventions. The defendants also deny that any breach of Community law which might have occurred gives rise to an actionable claim for damages. Moreover, they maintain that, as a matter of English law, interest cannot be claimed by way of damages or restitution where, as in the present case, no principal sum is owing.

12 The national court points out that the following matters are H common ground. (1) Under United Kingdom law, group income elections can be made only where both the parent company and its subsidiary are resident in the United Kingdom. (2) The claimants never made a group income election but could have been expected to do so if they had appreciated that Community law required the right of election to be available where the parent company was non-resident. (3) If they had tried

to exercise such a right, their application would have been rejected by an inspector of taxes, since the parent companies were not resident in the United Kingdom, but such a rejection could have been challenged. (4) Before any such challenge was finally determined, the claimants would still have been obliged, on pain of financial penalties including possible statutory penalties (if they were deemed to have acted negligently and without reasonable excuse in failing to provide such an account of dividends paid), to pay the advance corporation tax relating to all the dividends which they had paid. (5) Under the law of the United Kingdom there would have been no right to the repayment of such advance corporation tax even if the action had been successful.

(In their written observations, Metallgesellschaft and others observe that the defendants' submission is based on what they describe as a much criticised rule upheld and confirmed (albeit reluctantly) by the House of Lords in *President of India v La Pintada Cia Navigacion SA* [1985] AC 104. The rule itself dates back at least to *London, Chatham and Dover Railway Co v South Eastern Railway Co* [1893] AC 429, where the House of Lords, as a matter of English common law, held that "in the absence of any agreement or statutory provisions for the payment of interest, a court had no power to award interest, simple or compound, by way of damages for the detention (i e, the late payment) of a debt": per Lord Brandon of Oakbrook in *President of India*, at p 115. Lord Brandon, with whose speech the other Law Lords concurred, later, at pp 127–129, expressed approval for the view that the rule now only applies to claims for interest in respect of debts paid late but before any legal proceedings for their recovery have been brought. Metallgesellschaft and others contest the view that this rule covers a claim such as that involved in the main proceedings. Since that is a matter for the national court alone to decide, I shall assume that the rule, even as now restricted, applies to a claim such as that involved in these proceedings.)

13 The following questions have been referred to the court:

> "(1) In the circumstances set out in the order for reference, is it consistent with Community law and, in particular, with articles 6, 52, 58 and/or 73b of the EC Treaty for the legislation of a member state to permit a group income election (allowing distributions to be paid by a subsidiary to its parent without accounting for advance corporation tax) only where both the subsidiary and parent are resident in that member state?
>
> "(2) If the answer to question (1) is 'no', do the above-mentioned provisions of the EC Treaty give rise to a restitutionary right for a resident subsidiary of a parent company resident in another member state and/or the said parent to claim a sum of money by way of interest on the advance corporation tax which the subsidiary paid on the basis that the national laws did not allow it to make a group income election, or can such a sum only be claimed, if at all, by way of an action for damages pursuant to the principles laid down by the Court of Justice in *Brasserie du Pêcheur SA v Federal Republic of Germany; R v Secretary of State for Transport, Ex p Factortame Ltd (No 4)* (Joined Cases C-46 and 48/93) [1996] QB 404 and *R v Secretary of State for Social Security, Ex p Sutton* (Case C-66/95) [1997] ICR 961, and in either case is the national court obliged to grant a remedy even if under national law interest cannot be awarded (whether

A directly or by way of restitution or damages) on principal sums which are no longer owing to the claimants?

"(3) In the circumstances set out in the order for reference, is it consistent with the above-mentioned provisions of the EC Treaty for the authorities of one member state to deny any tax credit to a company resident in another member state when it grants such credit to resident B companies and to companies resident in certain other member states by virtue of the terms of its double taxation conventions with those other member states?

"(4) If the answer to question (3) above is 'no', is and was the first member state at all material times obliged to make a tax credit available to such company on the same terms as to resident companies or as to companies resident in member states with provision for such credits in C their double taxation conventions?

"(5) Is a member state entitled to plead in answer to such a claim for restitution, tax credit or damages, that the claimants are not entitled to recover, or that the claimants' claim should be reduced, on the grounds that, despite the terms of the national statute which prevented them from doing so, as a matter of national law they ought to have made a group D income election, or claimed a tax credit and have appealed to the commissioners and, if necessary, the courts, against the decision of the inspector of taxes refusing the election or claim, relying on the primacy and direct effect of the provisions of Community law?"

(The national court asks about article 73b of the EC Treaty only in respect of periods after 1 January 1995. It observes that, before that date, the relevant E provision concerning the free movement of capital was article 67 of the EC Treaty (repealed by the Treaty of Amsterdam), as implemented by relevant Directives: see Council Directive 60/921, First Directive for the implementation of article 67 of the Treaty (OJ, English Special Edition 1959–62, p 49) (as amended by Second Council Directive 63/21/EEC of 18 December 1962 adding to and amending the First Directive for the F implementation of article 67 of the Treaty (OJ, English Special Edition 1963–64, p 5)) for periods before 1 July 1990, and Council Directive 88/361/EEC of 24 June 1988 for the implementation of article 67 of the Treaty (OJ 1988 L178, p 5) for the period between 1 July 1990 and 31 December 1994. As pointed out in paragraph 9 above, it is common ground that periods involved in the main proceedings concern, respectively, 16 January 1989–26 April 1994 and 16 April 1974–13 October 1995.)

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Observations

14 Written and oral observations were submitted by the claimants, the United Kingdom, Netherlands and the Commission. In addition, the Republic of Finland submitted written observations, while France and Germany presented oral observations. The observations of the claimants, H the United Kingdom, Finland and the Commission treat of the various issues raised by the questions referred. The Netherlands has submitted observations in respect of the first and third questions concerning the group income election and the tax credits, while France and Germany limited their oral observations to the third question.

Overview

15 The claimants' fundamental claim is that the United Kingdom subsidiaries' exclusion from the possibility of making a group income election, on the basis that their parent companies were resident in Germany, was incompatible with the freedom of establishment guaranteed by articles 52 and 58 of the EC Treaty. (Counsel for the claimants stressed at the oral hearing that the alternative claims were "wholly subsidiary" to this principal claim.) In support of their principal claim, it is also clear that the claimants rely principally on article 52 of the EC Treaty and not on the Treaty provisions concerning the free movement of capital. It is appropriate, therefore, first to consider the compatibility with Community law of limiting the availability of a relief such as group income relief to companies resident in the United Kingdom.

Question (1) and group income relief

Synopsis of the observations

16 The claimants submit that member states must exercise their fiscal sovereignty in respect of their domestic systems of direct taxation consistently with the fundamental principles of Community law. Denying the possibility of making a group income election deters non-United Kingdom companies from establishing subsidiaries in the United Kingdom and is incompatible with the Treaty-guaranteed freedom of establishment. By placing the subsidiaries of foreign companies on the same footing as those of companies established in the United Kingdom for the purposes of their respective corporation tax liabilities, the United Kingdom has acknowledged that there is no objective difference between them which could justify a difference in treatment with regard to a tax advantage like the group income election: reference is made in particular to *Commission of the European Communities v French Republic* (Case 270/83) [1986] ECR 273, 305, para 20. It is immaterial that it is possible to avoid advance corporation tax by setting up branches or agencies rather than subsidiaries, since articles 52 and 58 of the Treaty require that traders be free to choose the appropriate legal form in which to exercise the right of establishment: *Commission v France*, para 22. The difference in treatment is not justified on grounds of preventing tax avoidance, since the only effect of granting the right to make a group income election would be to postpone until the time when mainstream corporation tax liability arose, but not remove, the ultimate tax liability of the subsidiary. The fact that a non-resident company is not required to pay advance corporation tax when it later pays a dividend, because it is not subject to United Kingdom corporation tax, whereas a similar payment by a UK-resident company would be so subject, does not justify the difference in treatment: first, there is no tax avoidance since the former will be subject to the tax legislation of the state in which it is established (*Imperial Chemical Industries plc v Colmer* (Case C-264/96) [1999] 1 WLR 108, 126, paras 25 and 26); secondly, the possible diminution in the tax revenue of one member state is neither a ground listed in article 56 of the EC Treaty (now, after amendment, article 46 EC) nor a matter of overriding general interest capable of justifying unequal treatment contrary to article 52: reference is made to *Commission v France* [1986] ECR 273, 306, para 25; *Biehl v Administration des contributions du grand-*

A *duché de Luxembourg* (Case C-175/88) [1990] ECR I-1779, 1793, para 16; *Stichting Collectieve Antennevoorziening Gouda v Commissariaat voor de Media* (Case C-288/89) [1991] ECR I-4007, 4040, para 11; *Svensson v Ministre du Logement et de l'Urbanisme* (Case C-484/93) [1995] ECR I-3955, 3976–3977, para 15, and *Imperial Chemical Industries* [1999] 1 WLR 108, 126, para 28.

B 17 Furthermore, the denial of the group income election is not justified in the interests of fiscal cohesion. In *Bachmann v Belgian State* (Case C-204/90) [1992] ECR I-249 and *Commission of the European Communities v Kingdom of Belgium* (Case C-300/90) [1992] ECR I-305 there was a "direct link" between the tax deductibility of contributions and the taxation of sums payable by insurers under sickness and invalidity as well as under old-age insurance and life assurance policies. Under Belgian tax C law, the loss of revenue resulting from the deductions allowed against taxable income was compensated by the taxation of sums payable under such policies in respect of the same taxpayer. There is no such link between the exercise of a group income election by a subsidiary in respect of a dividend paid to its parent company and the payment of advance corporation tax by the latter on the subsequent distribution of a similar amount outside a D group income election. The subsidiary remains liable to United Kingdom corporation tax. The claimants draw attention to the different provisions in force in Ireland in respect of non-resident parent companies. (In Ireland, under section 46 of the Finance Act 1983, a group income election was permitted once the Irish subsidiary was at least 75% owned by the foreign parent and provided there was a double taxation convention in force between Ireland and the state of residence of the parent company.) They E submit that the United Kingdom's blanket refusal of the election to groups with foreign-resident parent companies was disproportionate.

18 The United Kingdom submits that the difference of treatment in respect of group income elections is justified by the need to preserve the cohesion of its tax system. The principle is that there should be a charge to corporation tax on company profits while their shareholders should be F subject to income tax whenever profits are distributed to them by way of dividend. As the straightforward application of that principle would result in the double taxation of the same profits, i e once in the hands of the company and again in the hands of the shareholder, the partial imputation system introduced in 1973 and reflected in the Income and Corporation Taxes Act 1988 was adopted. It mitigates such double taxation by exempting corporate shareholders resident in the United Kingdom from G corporation tax on the dividends they receive. As a company may have distributable profits and make distributions without making a taxable profit, to ensure that the tax exemption for the dividend in the hands of the corporate shareholder is matched by a charge to tax, the company paying the dividend is required to account for the advance corporation tax. That ensures that, before any relief or mitigation is afforded to the shareholder, H there is a liability to tax on the paying company. (Once advance corporation tax has been charged to match the exemption from tax which is accorded to dividends in the hands of a corporate shareholder, the United Kingdom observes that any further charge to advance corporation tax made when the corporate shareholder distributed to its own shareholders the dividends it had received would give rise to another type of double taxation. That is why

a corporate shareholder resident in the United Kingdom and receiving a dividend from another UK-resident company is entitled to a tax credit.) There is thus, in the United Kingdom's view, "a clear and direct link between the tax exemption accorded to the dividend in the hands of the shareholder, and the matching charge to advance corporation tax", while "the logic of allowing a group income election for dividends paid between a subsidiary and a parent company is that such distributions amount in effect to internal transfers within a single *economic* entity (even though between two *corporate* entities)": United Kingom's written observations; emphasis in original. On the other hand, the exemption from liability to United Kingdom tax of the receipt by a non-resident company of dividends from a company resident in the United Kingdom is matched by a charge to advance corporation tax.

19 The United Kingdom, supported by Finland and the Netherlands, submits that the difference in treatment between groups with resident parent companies and those with non-resident parents regarding such group income elections is objectively justified because the positions of the two respective groups are not comparable—where the parent is resident, the exemption from advance corporation tax on the occasion of a distribution by the subsidiary (which matches the tax exemption of the dividend in the hands of the parent company) is itself matched by a charge to advance corporation tax on the occasion of making a distribution by the parent company, whereas, in the case of non-resident parents, the waiver of advance corporation tax on the occasion of making a distribution by the subsidiary is matched by no corresponding payment. Whilst acknowledging that a different system could be applied, the United Kingdom denies that the restriction on the availability of the election is disproportionate. In *Bachmann* [1992] ECR I-249 it would have been possible for the Belgian tax rules to have allowed nationals of other member states to deduct life assurance contributions paid in other member states, notwithstanding the fact that no tax would be paid in Belgium on the sums paid out in due course by the insurers: reference is made to paragraph 23, at p 282, in particular. Yet the court upheld Belgium's right to *formulate* its own tax system. The legislative choice made by the United Kingdom falls within the legitimate range of choices allowed to member states by Community law.

20 The Commission submits that there is no justification for the difference in treatment. The mere desirability of ensuring that the profits of the United Kingdom subsidiary of a non-resident company should bear a certain minimum amount of United Kingdom tax does not justify requiring advance corporation tax to be paid by such subsidiaries earlier than the normal date for the payment of mainstream corporation tax. Advance corporation tax is an advance payment of corporation tax, but non-resident parent companies are not liable to United Kingdom corporation tax. A group income election does not enable a subsidiary to escape its United Kingdom mainstream corporation tax liability and allowing it to subsidiaries of non-resident parents would not therefore assist tax avoidance. There is no loss of tax revenue for the United Kingdom tax authorities in respect of the subsidiary's profits, since the deferral of advance corporation tax inherent in the group election relieves the subsidiary only of its obligation to make advance payments of corporation tax. The mere economic advantage for the United Kingdom of receiving such corporation

A tax payments in advance so as to compensate for the fact that no advance corporation tax will later be payable by non-resident parents in respect of dividends received from United Kingdom subsidiaries cannot justify such discrimination: see *Staatssecretaris van Financiën v Verkooijen* (Case C-35/98) [2000] ECR I-4071, 4130, para 48 and the case law cited there.

Analysis

B 21 The court has consistently emphasised that "although direct taxation falls within their competence, the member states must none the less exercise that competence consistently with Community law": see *Verkooijen*, p 4126, para 32, and the case law cited there. The issues raised in this case essentially concern whether the United Kingdom respected the limits imposed by Community law on its fiscal sovereignty in the direct taxation field when it C restricted group income elections in respect of advance corporation tax to UK-resident companies.

(i) Tax revenues

22 I agree with the claimants' submission that extending the right to make a group income election to United Kingdom subsidiaries of non-D resident parents would not facilitate tax avoidance or evasion. It is clear that advance corporation tax is nothing other than an advance payment of mainstream corporation tax. The exercise of a group income election by subsidiaries of non-resident parents would merely enable them to enjoy the same cashflow advantage as that enjoyed by subsidiaries of UK-resident companies. In the case of both types of subsidiary, mainstream corporation E tax liability would, in due course, arise in the same manner on their respective corporate profits. In my opinion, permitting subsidiaries of non-resident companies to make group income elections would not facilitate the avoidance of advance corporation tax on the part of their parents. As a non-resident parent company is not liable to United Kingdom corporation tax, it should not be liable to pay advance corporation tax either. The situations of the resident and non-resident parent are not objectively comparable. The F former will be obliged to pay advance corporation tax *if and only if* it makes a qualifying distribution, for the very reason that it is liable to pay mainstream United Kingdom corporation tax on its own profits, while the latter is not liable to pay United Kingdom corporation tax but will be subject to the tax laws of its country of residence. The relevance of this factor was recognised by the court in *Imperial Chemical Industries plc v Colmer* (Case G C-264/96) [1999] 1 WLR 108, which, moreover, also unambiguously rejected the argument advanced by the United Kingdom in that case that a diminution in tax revenue could justify the discriminatory treatment of non-resident subsidiaries: see p 126, paras 26 and 28.

23 Furthermore, allowing a subsidiary with a non-resident parent to make an election would not be to grant any "exemption" from advance corporation tax. It is a fallacy to speak in terms of an "exemption" (see H paragraph 18 above). The true position is that United Kingdom corporation tax is due by the subsidiary of the non-resident parent but the latter is not subject to corporation tax on its own profits in the United Kingdom. The fact that parent companies resident in the United Kingdom may, in certain cases, have to pay advance corporation tax on the excess of their own

dividends over those received from their subsidiaries cannot justify imposing an obligation on United Kingdom subsidiaries of non-resident companies always to pay advance corporation tax whenever they opt to pay dividends to their parents. As is mentioned in the previous paragraph, this flows from their objectively different situation, to wit from their fiscal residence in the United Kingdom. A

24 The United Kingdom considers that the effect of a group income election on dividend payments made within the group is to transform them into mere "internal transfers" whose effect is to transfer the subsidiary's liability, whenever a dividend is paid outside the group, to pay advance corporation tax to the parent company. Since a non-resident parent would not be liable to pay advance corporation tax even though, under a group income election, its subsidiary's liability to advance corporation tax would have been transferred to it, it is said that its situation is distinguishable from that of the resident subsidiary and parent companies. The Netherlands expresses this in another way by invoking the principle of territoriality, which, it asserts, would be infringed if one member state were required to treat a company established in another member state and not doing business in the former state as part of a fiscal group in that state. It should only be possible, in its view, to transfer profits and losses between those members of a corporate group which are resident in the same member state. B C D

25 These submissions effectively amount to a contention that the difference in treatment of subsidiaries of non-resident companies is justified by the fact that they are not subject to United Kingdom corporation tax liability on their profits. This difference in the respective fiscal situations of the parents does not provide a justification, in my view, for denying to the subsidiaries duly established in the United Kingdom, who are so subject, a tax advantage available to comparable subsidiaries of United Kingdom parents. E

(ii) Fiscal cohesion

26 The United Kingdom relies principally on *Bachmann v Belgian State* (Case C-204/90) [1992] ECR I-249 and *Commission of the European Communities v Kingdom of Belgium* (Case C-300/90) [1992] ECR I-305 to justify its refusal to allow group income elections by subsidiaries of non-resident companies, citing the need to preserve the fiscal cohesion of its tax system. In those cases, a Belgian tax rule differentiated between contributions made to Belgian insurance companies and contributions made to other non-resident insurance companies. Only those contributions which were made to resident insurance companies were tax deductible. The loss of revenue thereby resulting for Belgian tax revenues was offset by subjecting the capital sums or surrender values of the policies in question to a tax which was not payable where there had been no deductions of contributions. Belgium justified its differential treatment of insurance contributions by reference to the need to ensure the coherence of its fiscal system. In particular, it could not be sure that tax on capital sums could be collected from non-resident insurance companies. F G H

27 The court accepted that argument. It found:

"The cohesion of such a tax system . . . presupposes that, in the event of a state being obliged to allow the deduction of life assurance contributions paid in another member state, it should be able to tax sums

A payable by insurers": *Bachmann* [1992] ECR I-249, 282, para 23; see also *Commission v Belgium* [1992] ECR I-305, 319, para 16.

The court was not satisfied that an undertaking by an insurer to pay the tax in question could "constitute an adequate safeguard" (*Bachmann*, para 24; *Commission v Belgium*, para 17), since it would probably have to be supported by the deposit of a guarantee, the overall effects of which "would B involve the insurer in additional expense" (*Bachmann*, para 25; *Commission v Belgium*, para 18) which would be passed on and probably remove the incentive for migrant workers to retain their existing policies on moving to Belgium. Although it recognised that bilateral treaties allocating fiscal competence between member states or harmonised Community direct taxation rules could remove Belgium's concern, the court concluded that, as C Community law then stood, "it is not possible to ensure the cohesion of such a tax system by means of measures which are less restrictive than those at issue in the main proceedings" (*Bachmann*, para 27; *Commission v Belgium*, mutatis mutandis, para 20). (For convenience, all references concerning these cases will hereafter be to *Bachmann* only.)

28 The court did not in *Bachmann* define the notion of fiscal cohesion and that remains the only case in which a member state has successfully D invoked it to defend a national provision otherwise incompatible with one of the fundamental Treaty provisions. *Wielockx v Inspecteur der Directe Belastingen* (Case C-80/94) [1996] 1 WLR 84 was a case which, at first sight, was reasonably comparable with *Bachmann*. In the Netherlands, resident but not non-resident taxpayers could deduct payments to a pension reserve. Payments made on the liquidation of the reserve, or made periodically from E it, were treated as income and subject to tax. The Netherlands relied, inter alia, on the Netherlands-Belgium double taxation convention, under which such income was taxable only in the state of residence, to claim that the fiscal cohesion of its system would be jeopardised if Belgian residents like Mr Wielockx could deduct payments into the reserve from their Netherlands tax liability. The court stated that the fiscal cohesion discussed in *Bachmann* required "a correlation between the sums which are deducted from the F taxable income and the sums which are subject to tax": *Wielockx*, p 97, para 23. It noted that the effect of the double taxation convention was that the state of residence would tax all pensions received by its residents regardless of where the contributions were paid and, conversely, waive the right to tax pensions received abroad even where it had treated the contributions made thereto on its territory as being tax deductible. The G court ruled:

> "Fiscal cohesion has not therefore been established in relation to one and the same person by a strict correlation between the deductibility of contributions and the taxation of pensions but is shifted to another level, that of the reciprocity of the rules applicable in the contracting states": paragraph 24.

H Where fiscal cohesion is secured by a double taxation convention with another member state, "that principle may not be invoked to justify the refusal of a deduction such as that at issue": paragraph 25.

29 A similar strict approach was applied a year later to a different tax situation in *Asscher v Staatssecretaris van Financiën* (Case C-107/94) [1996]

ECR I-3089. The Netherlands tax authorities sought to justify applying a higher initial (first band) rate of income tax to non-resident than to resident taxpayers. A less favourable rate of taxation for non-residents could not be justified by pointing to the fact that social security contributions were no longer deductible in the Netherlands, which was not necessarily the case in other member states. The court held, at p 3129, para 59, that there was

> "no . . . direct link between the application of a higher rate of tax to the income of certain non-residents who receive less than 90% of their worldwide income in the Netherlands and the fact that no social security contributions are levied on the income of such non-residents from sources in the Netherlands."

(The court noted that the non-application of the Netherlands social security system to non-residents like Mr Asscher was probably justified under Council Regulation (EEC) No 1408/71 of 14 June 1971 on the application of social security schemes to employed persons and their families moving within the Community (OJ, English Special Edition 1971 (II), p 416).)

In *Imperial Chemical Industries plc v Colmer* (Case C-264/96) [1999] 1 WLR 108, 127, para 29, the court rejected the United Kingdom's submission that fiscal cohesion required that consortium relief, whereby the members of a consortium could transfer losses incurred by subsidiaries of a holding company owned by them for relief against their own profits, be limited to cases where the majority of the subsidiaries in question were United Kingdom residents.

It emerges clearly from those cases that a mere threat to fiscal revenues of a member state does not qualify for consideration as fiscal cohesion in the sense recognised by the court.

30 National rules designed to alleviate double imposition of tax on the same or similar economic activity have led member states to provide certain tax advantages which are generally limited to resident individuals or companies. The pursuit of such a policy, which is clearly legitimate and desirable in itself, underlies three of the more recent cases concerning fiscal cohesion. The problem is that, in withholding the benefits in question from non-residents, member states refuse to take account of the foreign taxes which they pay.

31 *Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna* (Case C-294/97) [1999] ECR I-7447 concerned certain German trade tax rules which treated traders leasing assets from non-resident lessors less favourably than those leasing from residents. The trade tax was calculated by adding back half the rental value of the assets for the purpose of calculating leasing income only if the lessor did not pay German trade tax. The cohesion argument was that the rules in question were designed to avoid only double payment of German tax, i e not the duplication of German tax and that of another member state. The court held, at pp 7475–7476, para 42, that there was merely an "indirect link" between a fiscal advantage accorded to a German lessee of a German-established lessor and the unfavourable tax treatment of such lessors in the form of their liability to pay tax on their rental income.

At issue in *Staatssecretaris van Financiën v Verkooijen* (Case C-35/98) [2000] ECR I-4071 was a partial exemption from personal income tax, conferred in respect of share dividends, provided the companies paying the

A dividends were established in the Netherlands. The Netherlands and other intervening member states supported the limitation of that advantage to the case of dividend income from resident companies. The double taxation which the rules were designed to avoid was corporation tax and income tax on the same profits or income, and that would not arise if the former were paid in another member state. The court held, at pp 4132–4133, para 58, that there was no "direct link" but, rather, "two separate taxes levied on B different taxpayers".

Baars v Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem (Case C-251/98) [2000] ECR I-2787 also concerned Netherlands tax law, in this case wealth tax. A taxpayer was entitled to certain exemptions in respect of "substantial holdings" in companies provided they were established in the Netherlands. The exclusion of C holdings of companies established in other member states raised very similar issues regarding the claimed objective of precluding double taxation as between the imposition of taxation on the company and a personal wealth tax on the holder of its shares as those which arose in *Verkooijen*. The court, rejecting the defence, held, at pp 2819–2820, para 40, that it was "irrelevant . . . that companies established in the Netherlands are subject to D corporation tax in the Netherlands and that companies established in another member state are not".

32 The cases on fiscal cohesion have arisen in the context of all of the Treaty freedoms: *Bachmann* and *Asscher* concerned the free movement of persons; *Imperial Chemical Industries* and *Baars* concerned the freedom of establishment; *Eurowings* concerned a recipient of services, and *Verkooijen* concerned the free movement of capital. In all cases, save *Bachmann*, the E court held that the national rules in question could not be justified by any notion of fiscal cohesion. The last three cases concerned the aim of avoiding double taxation, which was restricted to mean only two national taxes. The court stated on each occasion that there was either no "direct link" between the tax differentiation in question and the proclaimed object of the system, or that there was no or an insufficient correspondence between the different F taxpayers and the taxes at issue.

It is clear that a mere diminution in the tax revenues of the host member state cannot justify a refusal to extend a particular benefit to non-resident companies. That member state must take account of the liability of such non-residents to pay comparable taxes in their member state of residence. Thus, it would seem that the true scope for fiscal cohesion as a justification for the differential treatment of non-residents would concern only situations G in which there is a real and substantial risk that extending equal treatment in respect of a particular benefit would potentially facilitate tax evasion in both the host member state and the member state of residence of the claimant non-resident taxpayer. This may well have been the real concern underlying the now unique judgment in *Bachmann*. (Much of the academic criticism of *Bachmann* has centred on the fact that the court ignored Belgium's double H taxation convention with Germany, which might well have permitted Belgium to tax the capital payments made to migrant workers like Mr Bachmann, at least if they remained resident in Belgium, and the fact that there were probably less restrictive means by which the taxation of such payments could have been secured, such as by imposing obligations on insurers who wished to have their policies qualify for deduction: see,

inter alia, B Knobbe-Keuk, "Restrictions on the Fundamental Freedoms Enshrined in the EC Treaty by Discriminatory Tax Provisions—Ban and Justification" [1994] EC Tax Review 74; V Hatzopoulos, "Fiscalité directe des États membres et 'libertés personnelles' reconnues par le traité CE" [1995] 4 Revue du Marché Unique Européen 121, 143–152; M Quaghebeur, "A Bridge over Muddled Waters—Coherence in the case law of the Court of Justice of the European Communities relating to discrimination against non-resident taxpayers" [1995–96] The EC Tax Journal 109; P Farmer, "EC Law and Direct Taxation—Some Thoughts on Recent Issues" [1995–96] The EC Tax Journal 91; P J Wattel, "The EC Court's Attempts to Reconcile the Treaty Freedoms with International Tax Law" (1996) 33 Common Market Law Review 223; F Vanistendael, "The Consequences of *Schumacher* and *Wielockx*: Two Steps Forward in the Tax Procession of Echternach" 33 Common Market Law Review 255, and M Lang, "The Binding Effect of the EC Fundamental Freedoms on Tax Treaties" and J Schuch, "Will EC Law Transform Tax Treaties into Most-Favoured-Nation Clauses?", in *Gassner, Lang and Lechner (eds), Tax Treaties and EC Law* (1997), pp 15 and 87 respectively.)

33 What is clear, in any event, is that for the defence to succeed there must be a direct and, from the point of view of the application of the particular tax in question, fundamental organic link between the application of that tax and the exemption or relief therefrom, which, though made available to the resident taxpayer, is denied to his non-resident counterpart. In my view, such a strict correlation is lacking in the present case.

34 The argument advanced by the United Kingdom centres on the theory that an element of the recipient shareholder's income tax is imputed to the charge to corporation tax of the company paying the dividend. The United Kingdom contends that the element in question is reflected in that part of the dividend-paying company's corporation tax liability that was payable in advance by way of advance corporation tax. The United Kingdom revenue authorities maintain that they require the advance use of the revenues generated by way of advance corporation tax on the payment of dividends so as to compensate them for any later reimbursements of the income tax treated as imputed to those advance corporation tax payments which they have to make in favour of certain individual shareholders, who, although receiving such dividends, are not, for one reason or another, liable to pay any United Kingdom income tax. (As corporate shareholders are not liable to pay corporation tax on dividends, no element of tax otherwise due by the German parents in the present case may be imputed to the advance corporation tax payments made by their United Kingdom subsidiaries.)

35 I do not accept that this argument justifies the unfavourable treatment of non-resident taxpayers. It is based on the misconception that advance corporation tax may, somehow, be regarded as a separate tax from mainstream corporation tax. Since there is no question regarding the liability of the subsidiaries of both resident and non-resident parent companies to pay United Kingdom corporation tax, the grant to one but not to the other of a significant tax advantage cannot be justified by a difference in the corporation tax liability of the parent companies to which the dividends are paid. In other words, the objectively different corporation tax positions of resident and non-resident parents cannot justify the imposition

A of an effectively higher corporation tax burden only on the subsidiaries of the latter.

36 Moreover, in the case of individual shareholders of those parent companies who are resident in other member states and who are, thus, subject to the tax laws of those states, there is nothing on the case file to suggest that the United Kingdom authorities have ever been obliged to make B any income tax reimbursements. There would, in the case of non-resident parent companies who make downstream dividends to individual shareholders of profits distributed to them by their UK-resident subsidiaries, be at most a remote link between allowing a group income election regarding the subsidiaries' obligation to pay advance corporation tax and possible claims, by the parents' own shareholders, for the reimbursement of the (United Kingdom) income tax element imputed to the dividends paid by C those subsidiaries. This is a fortiori the case since dividends paid by non-resident parent companies do not carry a United Kingdom tax credit merely because they were themselves funded from dividends received from UK-resident subsidiaries. There is therefore no real and substantial risk to the cohesion of the United Kingdom tax system capable of justifying the differential treatment at issue.

D 37 If the court were to disagree with this recommendation, the outright refusal in the United Kingdom rules to extend the exemption from advance corporation tax to subsidiaries of non-resident companies would, at all events, appear to be disproportionate. I do not accept the United Kingdom's submission to the effect that, once legitimate concerns regarding fiscal cohesion underlie a differential fiscal treatment of non-residents, the E member state concerned is not obliged to take into account the fact that there may be less restrictive means of achieving the desired coherence. Thus, I do not agree with the contention that, in answer to a specific claim of discrimination contrary to article 52 of the Treaty made in respect of its rules, the United Kingdom was not obliged to consider the appropriateness of the less restrictive rules regarding non-resident parents applied by another member state (to wit Ireland) operating a very similar system of advance F corporation tax.

38 In any event, as the Commission submits, the objective underlying advance corporation tax could just as easily have been achieved by the imposition of a general requirement, on some or all companies, to pay a certain proportion of their corporation tax liability in advance. Indeed, as the claimants point out, this, indeed, is the system which has recently been G introduced in the United Kingdom, at least in respect of larger companies, by sections 30 and 31 of the Finance Act 1998. The refusal to permit subsidiaries of parent companies resident in other member states to make a group income election for advance corporation tax purposes thus clearly went beyond what might conceivably have been capable of justification on the ground of preserving the fiscal cohesion of the system established by the Income and Corporation Taxes Act 1988.

H 39 For all of the above reasons, I am satisfied that a restriction on the availability of a tax advantage, such as the exemption from the obligation to make advance payments of corporation tax inherent in a group income election of the sort at issue in the main proceedings, is incompatible with article 52 of the EC Treaty.

40 In the circumstances, I am of the view that it is not necessary to consider whether the unfavourable treatment of non-resident companies regarding advance corporation tax hindered direct investment in the United Kingdom by companies resident in other member states and so restricted the free movement of capital. As the court pointed out unequivocally in *Bachmann v Belgian State* (Case C-204/90) [1992] ECR I-249, 285, para 34, in respect of the former article 67 (later article 73b) of the EC Treaty (now article 56 EC), it "does not prohibit restrictions which do not relate to the movement of capital but which result indirectly from restrictions on other fundamental freedoms". (The court, thus, accepted the recommendation of Mr Advocate General Mischo that the transfer of capital necessary to pay contributions to non-Belgian insurers was not subject to any restraint and that any causal nexus between the non-deductibility of the premiums at issue and the free movement of capital was too remote to constitute a restriction on the latter.) I agree with the view expressed by Mr Advocate General Tesauro in his opinion in *Safir v Skattemyndigheten i Dalarnas Län* (Case C-118/96) [1999] QB 451, 461, para 17, that, where the free movement of capital and other fundamental freedom provisions of the Treaty are potentially infringed by a particular national rule, the Court of Justice should consider the former provision only "if the measure at issue *directly* restricts the *transfer* of capital, rendering it impossible or more difficult, for example by subjecting it to mandatory authorisation . . ." (emphasis in original). That view was implicitly endorsed by the court, which, having found that the impugned tax on life assurance contracts entered into with non-Swedish established providers of such insurance was incompatible with article 59 of the EC Treaty (now, after amendment, article 49 EC), held, at p 476, para 35, that "it is not necessary to determine whether such legislation is also incompatible with articles 6, 73b and 73d of the Treaty".

In my opinion, as a restriction like that at issue in the main proceedings is incompatible with the freedom of establishment, it is unnecessary to consider whether it also constitutes a restriction on direct foreign investment in the United Kingdom.

Question (2) and appropriate remedy

41 The second question referred by the national court raises two distinct issues, the first of which itself contains two alternatives. It asks first what remedy should be available to taxpayers like the claimants if they are correct in contending that subsidiaries of non-resident parent companies were discriminated against in being denied the advantage involved in making a group income election: are they entitled to a restitutionary claim or only to a compensatory claim for damages for breach of Community law? Secondly, on the assumption that such taxpayers are, in principle, entitled to a remedy, is that remedy affected by the fact their claim extends only to a claim for loss of a cashflow advantage, namely for interest, in circumstances where the monies of whose use they were deprived were later set off against their proper mainstream corporation tax liabilities and, in particular, does such a matter depend on the applicable national procedural rules?

42 The claimants contend principally that their claim amounts to a restitutionary claim. They rely on the court's well-established case law that member states which have levied taxes in contravention of directly effective provisions of Community law must repay them; in their view, that is an

A adjunct of the directly effective nature of the Community-law rights which have thereby been infringed. (*Amministrazione delle Finanze dello Stato v SpA San Giorgio* (Case 199/82) [1983] ECR 3595, 3612, para 12, and *Société Comateb v Directeur Général des Douanes et Droits Indirects* (Joined Cases C-192–218/95) [1997] ECR I-165, 188, para 20 are cited by Metallgesellschaft and others, while Hoechst also cites *GT-Link A/S v De Danske Statsbaner* (Case C-242/95) [1997] ECR I-4449, 4471, paras 58–60,
B and *Ministero delle Finanze v IN CO GE '90 Srl* (Joined Cases C-10–22/97) [1998] ECR I-6307, 6333–6335, paras 23, 24 and 29.) Although they recognise that the court has not yet had to consider a claim based entirely on interest, to allow such a claim would constitute a logical extension of that case law: it would be futile to recognise the validity of their right to rely directly on the right of establishment but not then to accord them any
C remedy. If their claim cannot be classified as a restitutionary claim, they assert, in the alternative, that they have a right to bring a compensatory claim for breach of Community law based on the principles laid down in the *Francovich* line of case law, notwithstanding that they are seeking interest for the temporary loss of the use of moneys paid by way of advance corporation tax: reference is made to *Francovich v Italian Republic* (Joined Cases C-6/90 and C-9/90) [1995] ICR 722 and *Brasserie du Pêcheur SA v*
D *Federal Republic of Germany; R v Secretary of State for Transport, Ex p Factortame Ltd (No 4)* (Joined Cases C-46 and 48/93) [1996] QB 404. They maintain, in this respect, that the court recognised in *Marshall v Southampton and South West Hampshire Area Health Authority (Teaching) (No 2)* (Case C-271/91) [1994] QB 126 that full compensation for the loss and damage sustained as a result of an infringement of Community law
E could not leave out of account the effect of factors such as the effluxion of time, and that the award of interest might, in some cases, be an essential component of compensation. They seek to distinguish *R v Secretary of State for Social Security, Ex p Sutton* (Case C-66/95) [1997] ICR 961, where, in the context of a claim for interest on arrears of social security benefit, it was held that there was no right under Community law to interest in connection with a claim for restitution, on the basis that the payment of interest was
F found not to be an essential component of the right in issue.

43 The United Kingdom, supported in substance by Finland, submits that the claimants' claim is in substance that its revenue authorities have incurred non-contractual liability to them. The claim has therefore no connection with restitutionary claims for recovery of sums paid but not due or with related claims to interest on such sums. While the right to reparation
G is founded directly on Community law, it is for the state concerned to make good the consequences of the damage caused in accordance with the relevant national law of liability. In particular, the United Kingdom relies on *Fromme v Bundesanstalt für landwirtschaftliche Marktordnung* (Case 54/81) [1982] ECR 1449 in support of the view that the question whether interest is payable in connection with charges levied contrary to Community
H law is a matter for national law. It also relies on *Sutton*—there are similarities between a claim for interest on money paid late, allegedly contrary to Community law, as in that case, and a claim to interest on money levied early, again allegedly contrary to Community law, as in the present case, since both actions turn on the consequences of the claimant's being deprived of the use of a sum of money for a certain period. The United

Kingdom refers, in particular, to para 31 of the judgment in *Sutton* [1997] ICR 961, 993.

44 The Commission submits that a claim such as that brought by the claimants is restitutionary in nature. The early use of the money constituted a financial benefit obtained unlawfully by the member state, whose value may be quantified. The precise manner in which it is to be quantified is a matter for the national court alone but any national rules applied may not render ineffective the claimants' right under Community law. In the alternative, the Commission submits that the same result should be available through the application of the *Francovich* and *Brasserie du Pêcheur and Factortame* case law.

45 The court has consistently held that member states must reimburse taxes levied in breach of Community law and that the right to such a reimbursement is a consequence of, and a complement to, the rights conferred on individuals by the directly effective provisions of Community law: see, inter alia, *Amministrazione delle Finanze dello Stato v SpA San Giorgio* (Case 199/82) [1983] ECR 3595. In its more recent case law, the court has added that member states are "in principle required to repay charges levied in breach of Community law": *Société Comateb v Directeur Général des Douanes et Droits Indirects* (Joined Cases C-192–218/95) [1997] ECR I-165, 188, para 20; also *Dilexport Srl v Amministrazione delle Finanze dello Stato* (Case C-343/96) [1999] ECR I-579, 611, para 23. The notion underlying this principle is that a member state must not profit and an individual who has been required to pay the unlawful charge must not suffer loss as a result of the imposition of the charge.

However, the court has also recognised that, in the absence of harmonised Community law rules governing actions for recovery of sums unduly paid,

> "it is for the domestic legal system of each member state to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive from Community law, provided, first, that such rules are not less favourable than those governing similar domestic actions (principle of equivalence) and, second, that they do not render virtually impossible or excessively difficult the exercise of rights conferred by Community law (principle of effectiveness)": *Dilexport*, paragraph 25.

46 The United Kingdom submits that among the procedural matters governed by national law is the question of interest. In its view, since in English law no action for interest in respect of the loss of the use of monies which were ultimately later set off against the paying company's corporation tax liability would lie, to deny a remedy in the main proceedings would not infringe the principle of non-discrimination.

However, if the national court agreed with the United Kingdom's interpretation of the applicability of the rule upheld by the House of Lords in *President of India v La Pintada Cia Navigacion SA* [1985] AC 104 to the claimants' claim, the effect of applying the principle of national procedural autonomy in respect of interest would be to deny a remedy to taxpayers like the claimants who suffered a cashflow disadvantage by virtue of being obliged to pay advance corporation tax (see paragraph 12 above). In my view, such a result would run counter to the principle of effectiveness that

A lies at the heart of the court's case law in respect of the recovery of unduly paid taxes.

47 While the court has not yet had occasion to consider a claim consisting entirely of the loss of the benefit of certain monies, I am satisfied that, in principle, the mere fact that such a loss is the only loss suffered as a result of a temporary violation of Community law is not in itself a reason for refusing to recognise the legitimacy of the claim. It would be anomalous if a B claim, valued by the claimants at the oral hearing as possibly amounting to some £8m, could not be made merely because the loss at issue concerned the temporary use of money whose payment was later properly demanded by the member state concerned. In my view, since it is without question that a member state may, in principle, be required to pay interest on a capital sum unlawfully levied in contravention of Community law, albeit in accordance C with the applicable national legal provisions, it follows, as a logical extension, that where the entire claim at issue concerns the payment of interest, such interest must in principle be payable. Any other view would, quite simply, entail denying to the taxpayer concerned the opportunity of exercising the rights enjoyed under the directly effective provisions of Community law.

48 I would draw support for this view from *Marshall v Southampton* D *and South West Hampshire Area Health Authority (Teaching) (No 2)* (Case C-271/91) [1994] QB 126 and *Brasserie du Pêcheur SA v Federal Republic of Germany; R v Secretary of State for Transport, Ex p Factortame Ltd (No 4)* (Joined Cases C-46 and 48/93) [1996] QB 404. In *Marshall (No 2)*, while the court was interpreting a provision of a Community Directive, its application of the principle of effectiveness in respect of financial compensation is E nevertheless instructive. It held [1994] QB 126, 165, para 26:

> "Where financial compensation is the measure adopted in order to achieve [an effective remedy for wrongful sex discrimination], it must be adequate, in that it must enable the loss and damage actually sustained . . . to be made good in full in accordance with the applicable national rules."

F Moreover, it is also noteworthy that in *Brasserie du Pêcheur and Factortame* [1996] QB 404, 503, para 87, the court specifically observed:

> "Total exclusion of loss of profit as a head of damage for which reparation may be awarded in the case of a breach of Community law cannot be accepted. Especially in the context of economic or commercial litigation, such a total exclusion of loss of profit would be such as to make G reparation of damage practically impossible."

The same principle, to my mind, applies in respect of a claim to interest based on the loss of the use of money.

49 I do not think that this view is undermined by the court's case law concerning interest. The court first considered the question of interest in *Société Roquette Frères v Commission of the European Communities* (Case H 26/74) [1976] ECR 677. In that case, the applicant claimed interest on certain payments (monetary compensatory amounts) it had been obliged to make to the relevant national authority acting, as agent for the Commission, under a Commission Regulation that was subsequently found to be invalid. (The applicant had obtained, in parallel proceedings brought before the

national courts, an order for the reimbursement of the capital sum of the amounts actually paid: see paragraphs 3–7 of the judgment, at p 685, for an account of those proceedings.) Mr Advocate General Trabucchi advised the court, at p 691:

> "Payment of the interest on a capital sum unduly paid is strictly dependent upon the right to repayment of the principal itself . . . an application for interest is subject to the same criteria as those laid down by the case law of the court in respect of the claim for repayment of the capital on which the interest is based. An application for interest must, therefore, be made in accordance with the same procedure as that applicable to recovery of the capital sum."

The court accepted that advice. It ruled, at p 686, para 12:

> "In the absence of provisions of Community law on this point, it is currently for the national authorities, in the case of reimbursement of dues improperly collected, to settle all ancillary questions relating to such reimbursement, such as the payment of interest."

In *Express Dairy Foods Ltd v Intervention Board for Agricultural Produce* (Case 130/79) [1980] ECR 1887, which also concerned an action for the recovery of monetary compensatory amounts paid pursuant to a Community Regulation which had been declared invalid, the court, at p 1901, para 17, held that, in the absence of harmonised Community rules, it was for national courts

> "to settle all ancillary questions relating to such reimbursement, such as the payment of interest, by applying their domestic rules regarding the rate of interest and the date from which interest must be calculated."

That case law concerned capital sums paid pursuant to invalid Community measures but which had been reimbursed to the claimants. The question of whether interest should also be paid was, as the court made clear, "ancillary". In the present case, as the claimants stressed at the hearing, the claim for interest represents the entirety of the claim. Although in *Fromme v Bundesanstalt für landwirtschaftliche Marktordnung* (Case 54/81) [1982] ECR 1449, cited by the United Kingdom, the court also classified as ancillary the nature of claims to interest, that case may also be distinguished from the present case. It concerned a claim by the German authorities for interest to be paid by the undertaking Fromme in respect of certain premiums for the denaturing of cereals which, it was common ground, had been wrongly paid to it by those authorities. The court held that the member states' obligation under the relevant Community legislation was "to take the measures necessary to recover sums lost as a result of irregularities or negligence": p 1463, para 5; it was therefore for national law to regulate "ancillary questions" such as that concerning the payment of interest (paragraph 4), subject to the requirement that the obligations imposed on undertakings having received payments based on Community law "not be more stringent" than those imposed on undertakings having received payments based on national law: pp 1463–1464, para 7.

In my view, this case law provides no support for the view defended by the United Kingdom, that, even in a case which only concerns interest, the

A matter falls to be regulated by national law alone, regardless of whether the relevant rules preclude such purely interest-based claims.

50 Nor do I consider *R v Secretary of State for Social Security, Ex p Sutton* (Case C-66/95) [1997] ICR 961 to be of assistance to the United Kingdom. That case concerned a claim for the payment of interest on an amount awarded by way of arrears of a particular social security benefit B which had initially been denied for reasons which amounted to sex discrimination contrary to Council Directive 79/7/EEC of 19 December 1978 on the progressive implementation of the principle of equal treatment for men and women in matters of social security (OJ 1979 L6, p 24). The court held, at p 992, para 25, that the right provided by article 6 of the Directive for victims of such discrimination was "to obtain the benefits to which they would have been entitled in the absence of discrimination", but C that "the payment of interest on arrears" did not constitute "an essential component of the right as so defined". The court thus followed the advice of Mr Advocate General Léger, who, noting that the benefit claimed had been paid to Ms Sutton, observed, at p 985, para 62: "the discrimination has *already* been removed in conformity with the rules of national law and the national system can be regarded as having ensured the effectiveness of the D principle *in practice*." (Emphasis in original.) Thus, in the absence of Community rules, he was satisfied that the question whether the claimant also had a right to interest should be left to national law. The situation is different, in my view, in a case such as the present. Not only is the claim for interest essential, it is the only claim made by the claimants. This arises from the fact that the breach of Community law consists entirely in the temporary removal of sums of money from the resources of certain companies. If E Community law were not to require that national legal provisions which would preclude such claims be set aside, the result would be wholly to negate the exercise of a right based on a fundamental principle of Community law. Such a consequence would undermine the effectiveness of the right of establishment by rendering "impossible in practice" the exercise of the right: see paragraph 172 of the opinion of Mr Advocate General Jacobs in *Haahr Petroleum Ltd v Åbenrå Havn* (Case C-90/94) [1997] ECR I-4085, 4137.

F 51 I would reject the submission of the United Kingdom that the claimants' claims in the main proceedings cannot be regarded as restitutionary in nature, solely because, not having sought to exercise a group income election, their action should, at best, be treated as akin to an action for damages against the United Kingdom for the loss they suffered as a result of being left in uncertainty as to their Community law rights. The G advance corporation tax payments made by the claimants were made on the basis of national legislation which allowed them no choice. Since such legislation is not compatible, in my view, with Community law, they should, in principle, be entitled to seek restitution for those payments.

52 I believe that it is more correct and more logical to treat the claimants' claim as restitutionary rather than as a compensatory claim for H damages. Advance corporation tax was, on the basis of my foregoing analysis, exacted from them in contravention of Community law and, therefore, unlawfully. In the period between payment of advance corporation tax and its being taken into account in respect of the corporation tax liability of the subsidiaries, it should have been repaid to the claimants by the United Kingdom. If it had been possible to bring legal

proceedings during that period, the claimants would, in my view, have been entitled to interest. It is neither logical nor just to deprive them of that entitlement merely because, in the meantime, the liability of the United Kingdom to repay the principal sum has been discharged. In a practical sense, also, the claim for interest is closer to a restitutionary rather than a compensatory claim. The underlying sums are known and indisputable. All that is necessary is for the national court to establish an appropriate interest rate for the relevant period.

53 If, however, the court were to disagree with my view that a restitutionary claim to interest for the loss of the use of money should be available in circumstances such as those involved in the main proceedings, it would have to consider the claimants' alternative claim that there should be a right of action for compensatory damages for such a loss. While it is true that in the case law the damages allegedly suffered by the claimants have normally been unliquidated in amount, I see no reason, in principle, why it should not be possible to claim compensatory damages for a loss that is quantifiable, as in the present case, provided the relevant conditions are satisfied. The United Kingdom relies on the fact that, while the three basic conditions for potential member state liability are set out in the relevant case law, "the national law on liability provides the framework within which the state must make reparation for the consequences of the loss and damage": *R v Secretary of State for Social Security, Ex p Sutton* (Case C-66/95) [1997] ICR 961, 993, para 33; see also *Francovich v Italian Republic* (Joined Cases C-6/90 and C-9/90) [1995] ICR 722, 772, para 42 and *Brasserie du Pêcheur SA v Federal Republic of Germany; R v Secretary of State for Transport, Ex p Factortame Ltd (No 4)* (Joined Cases C-46 and 48/93) [1996] QB 404, 503, para 83. That framework, in its view, includes the question of interest. However, the court has been equally clear that the rules in question must be non-discriminatory and "must not be so framed as to make it virtually impossible or excessively difficult to obtain reparation": *Ex p Sutton*, paragraph 33; see also *Francovich*, paragraph 43 and *Brasserie du Pêcheur and Factortame*, para 83. This latter principle requires, in my view, that an action seeking compensation in the form of interest in respect of the cashflow disadvantage occasioned by the loss of the use of money be, in principle, permissible where that is the only loss suffered as a result of a member state's breach of Community law.

54 The three conditions which must be satisfied before a state may be held liable for a breach of Community law have been confirmed consistently by the court since its initial decision in *Francovich*. They are (see for example *Ex p Sutton*, para 32):

> "the rule of law infringed must be intended to confer rights on individuals; the breach must be sufficiently serious, and there must be a direct causal link between the breach of the obligation resting on the state and the damage sustained by the injured parties."

As no questions have been referred in respect of the interpretation of those conditions, and as it is for the national court in each concrete case ultimately to determine whether they are satisfied, I do not propose to consider them in detail. However, as it may be of some assistance to the national court, I shall briefly consider the Commission's submission that the three conditions are met in the present case.

A 55 First, it is beyond doubt that article 52 of the Treaty creates rights for individuals and that a breach of that provision would therefore satisfy the first condition: see *Brasserie du Pêcheur and Factortame* [1996] QB 404, 499, para 54. Secondly, it seems to me manifest that, in principle, there is a direct causal link between the statutory exclusion of the group income election to subsidiaries whose parents were not resident in the United B Kingdom and the loss suffered by the claimants. As regards the nature of the breach, I agree with the Commission that the national court may have some doubts as to whether the breach of Community law by the United Kingdom constituted such a sufficiently serious breach of Community law as to justify imposing liability on it. The United Kingdom submits that any breach of Community law was excusable and that any damage caused was involuntary. (It relies particularly on *Brasserie du Pêcheur and Factortame*, para 56.)

C 56 Since there can be no question in the present case of the Community institutions having contributed to the infringement of Community law at issue, the question for the national court would be whether, in the exercise of its legislative powers, the United Kingdom "manifestly and gravely disregarded the limits on the exercise of its powers": *R v HM Treasury, Ex p British Telecommunications plc* (Case C-392/93) [1996] QB 615, 655, D para 42. (That test was confirmed recently in *Rechberger v Austrian Republic* (Case C-140/97) [1999] ECR I-3499, 3540, para 50; see also in this respect *Brasserie du Pêcheur and Factortame*, para 56.) The issue is whether the clarity and precision of article 52 of the EC Treaty are such that the breach may be regarded as sufficiently serious. That has to be viewed in the light of the widespread use of residence as a criterion for direct taxation purposes coupled with the state of development of the relevant case law (in E *Brasserie du Pêcheur and Factortame*, para 57, the court held that a breach of Community law would be "sufficiently serious" if it continued "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") at the material time (for Metallgesellschaft and others, it comprises developments F up to 26 April 1994, while for Hoechst it extends to 13 October 1995: see paragraph 9 above. It is, therefore, only in respect of Hoechst's claim that the court's post-*Bachmann* [1992] ECR I-249 case law, beginning with *Wielockx v Inspecteur der Directe Belastingen* (Case C-80/94) [1996] 1 WLR 84, which was decided on 1 August 1995, would be relevant.) It will concern the limits which affect the use by member states of that criterion where it is detrimental to the interests of residents from other member states. G In short, was the refusal to allow the group income election, viewed objectively, "excusable or inexcusable" (*Brasserie du Pêcheur and Factortame*, para 56)? Although it is clear that measures which discriminate directly on grounds of nationality and which are not justified on the basis of one of the exceptions set out in the Treaty itself would fall to be considered as "sufficiently serious" (*Brasserie du Pêcheur and Factortame* [1996] H QB 404, 500, para 62), the present case concerns indirect discrimination. (Since *Commission of the European Communities v French Republic* (Case 270/83) [1986] ECR 273 in 1986, the court has consistently held that the seat of a company, in the sense of its registered office, central administration or principal place of business, serves the function of nationality for natural persons and that to treat non-resident corporate taxpayers less favourably

because of their foreign places of residence may, in the absence of objective justification, constitute indirect discrimination on grounds of nationality: see *Commission v France*, at p 304, para 18. That view has been confirmed in, inter alia, *R v Inland Revenue Comrs, Ex p Commerzbank AG* (Case C-330/91) [1994] QB 219, 240, para 15 and *Imperial Chemical Industries plc v Colmer* (Case C-264/96) [1999] 1 WLR 108, 126, para 23.)

Indirect discrimination should, in general, be regarded as "sufficiently serious". As the court declared as long ago as 1986 in respect of direct taxation,

> "Acceptance of the proposition that the member state in which a company seeks to establish itself may freely apply to it a different treatment solely by reason of the fact that its seat* is situated in another member state would thus deprive [articles 52 and 58 of the EC Treaty] of all meaning": *Commission v France* [1986] ECR 273, 304, para 18.

(See also *Ex p Commerzbank*, paras 18–19 and *Imperial Chemical Industries*, paras 23–24.) As regards the possible defence of fiscal cohesion, the court's recognition in *Bachmann v Belgian State* (Case C-204/90) [1992] ECR I-249 that such indirect discrimination may be capable of justification on grounds connected with preserving fiscal cohesion does not, in itself, render "excusable" the breach of Community law. To classify a breach of article 52 of the Treaty such as that involved in the present case as "excusable", the national court must be satisfied not only that the United Kingdom authorities genuinely believed that refusing to extend the benefit of the group exemption in question to groups whose parent company was non-resident was strictly necessary, but also, viewed objectively in the light of *Bachmann* and the principle of strict interpretation of exceptions to fundamental Treaty rules like the freedom of establishment, that that belief was reasonable. The national court should also bear in mind the importance of ensuring the effectiveness of rights derived from Community law, particularly fundamental Treaty-based rights.

Questions (3) and (4) concerning tax credits

57 In view of the recommendation that I have made in respect of the principal claim brought in the main proceedings, I do not consider it necessary to consider the extremely complex issues raised by the alternative claim in respect of the possible entitlement of the German parent companies, by analogy with the double taxation convention applicable between the United Kingdom and the Netherlands, to a partial tax credit in respect of advance corporation tax paid by United Kingdom subsidiaries.

Question (5) and the alleged laches of the claimants

58 Since I consider that the court should rule that the denial of the option to make a group income election to subsidiaries whose parent companies were resident in other member states constituted unlawful discrimination contrary to article 52 of the EC Treaty, and that the mere fact that the alleged resulting loss suffered by such subsidiaries concerned the

* *Reporter's note.* The text reads "registered office", at this point as well as earlier in paragraph 18, but it is generally accepted that in this instance "registered office" is a mistranslation of the French "siège" and is incorrect.

A time value of the use of the monies paid by way of advance corporation tax does not preclude their claim, it is necessary to consider briefly whether the alleged omission of the claimants, over an extended period of time, to challenge that denial, on the basis of the relevant national statutory appeal mechanism, or, indeed, by way of an earlier direct judicial review application than that actually brought in the main proceedings, may be invoked by the defendant member state to defeat or reduce the damages B sought subsequently by them in a claim based on its incompatibility with Community law. It is true that it has been accepted by the court that a failure to show "reasonable diligence" in order to avoid loss or damage or to reduce its extent and particularly to avail "in time of all the legal remedies available", may, if similar rules would be applied in purely national-law cases, be taken into account by the national court to reduce, and perhaps in C extreme cases, eliminate member state liability: *Brasserie du Pêcheur and Factortame* [1996] QB 404, 503, para 84; see also para 104, in particular, of the opinion of Mr Advocate General Tesauro in those cases, at p 482. In my opinion, it should not be permissible, save in the most extreme of cases, for a member state, whose legislation created a difference in treatment to the detriment of non-residents that admitted of no exceptions and which would have required them, on pain of penalties, to continue paying the tax in D question even if its compatibility with Community law had been called into question, to rely on a taxpayer's failure to use a statutory remedy—one which, moreover, was not, in its own terms, applicable to it—for the purpose of making such a Community-law claim, or to rely on the direct effect and supremacy of article 52 of the EC Treaty as an excuse for seeking to limit a subsequent claim for damages based on the incompatibility of that E legislation with Community law.

59 This conclusion reflects the important principle that a member state must not be allowed to profit from its own wrong. It may not, therefore, insist on the application of its rules against taxpayers and then, when those rules are found to be contrary to Community law, deny an obligation to make reparation for the loss it caused on the basis that those rules were not immediately challenged. In my view, in cases such as the present case, where F claimants are essentially faced with an unambiguous national legislative rule, on the one hand, and the possible right to oppose the application against them of that rule on the basis of Community law, on the other hand, and where neither the rule in question nor any similar rule of another member state has previously been considered by this court, a delay on the part of the claimant in challenging the national rule in question should only G be taken into account by the competent national court when considering the possible limits affecting the claim before it flowing from national limitation periods or from other comparable rules regarding laches that would also apply to similar claims based purely on national law.

Conclusion

H 60 In the light of the foregoing, I propose that the court answer the first, second and fifth questions referred by the High Court of Justice (England and Wales), Chancery Division, as follows.

(1) It is contrary to article 52 of the EC Treaty for the legislation of a member state to permit a tax advantage such as a group income election (allowing distributions to be paid by a subsidiary to its parent without the

subsidiary being required to make advance payments of corporation tax in respect of the profits it has earned in that member state) only when both the subsidiary and parent are resident in that member state.

(2) Where a subsidiary whose parent is not resident in such a member state has been required to make advance payments of its corporation tax, while in similar circumstances subsidiaries of resident parents were permitted to avoid that requirement by making a group income election, the directly effective right granted by article 52 of the EC Treaty requires that an effective remedy be available, in principle, to such companies to seek restitution to it of the financial benefit acquired by the member state authorities concerned as a result of receiving early payment of the taxes of such subsidiaries. The mere fact that any such claim would only be for interest in respect of the financial loss incurred on the loss of the use of the moneys paid cannot, in itself, constitute a reason for precluding the taxpayer's right to pursue such a claim. It is for national law to regulate all ancillary matters, such as the limitation period and applicable rates of interest applying to such claims. However, such rules must be no more restrictive than those applicable to similar or comparable claims based purely on national law and must not operate to render virtually impossible the exercise of the right conferred by Community law.

(3) A member state may not plead, in answer to a claim for such restitutionary damages, that it should be disallowed or reduced on the grounds that, despite the national legal rules which prevented them from doing so as a matter of national law, the taxpayers concerned ought to have claimed the relevant tax advantage by making use of any statutory remedies available to them and/or relying on the primacy and direct effect of the relevant provisions of Community law.

8 March 2001. The following judgment was delivered in open court in Luxembourg.

1 By two orders of 2 October 1998, received at the Court Registry on 6 November 1998 (Case C-397/98) and 17 November 1998 (Case C-410/98) respectively, the High Court of Justice of England and Wales, Chancery Division, referred to the Court of Justice for a preliminary ruling under article 177 of the EC Treaty five questions on the interpretation of articles 6, 52, 58 and/or 73b of the EC Treaty.

2 Those questions have been raised in proceedings between the claimants, Metallgesellschaft Ltd, Metallgesellschaft AG, Metallgesellschaft Handel & Beteiligungen AG and The Metal and Commodity Co Ltd ("Metallgesellschaft and others") in Case C-397/98, and Hoechst AG and Hoechst UK Ltd ("Hoechst") in Case C-410/98, and the Inland Revenue Commissioners, concerning the obligation imposed on companies resident in the United Kingdom to pay advance corporation tax in respect of dividends paid to their parent companies.

The relevant national provisions

3 Under the provisions of Part I of the Income and Corporation Taxes Act 1988, profits made during an accounting period by a company resident in the United Kingdom or by a company not so resident which is trading in the United Kingdom through a branch or agency are chargeable to corporation tax.

A 4 In accordance with section 12 of the 1988 Act, an accounting period is generally 12 months. For accounting periods ending before 1 October 1993, corporation tax was payable either nine months after the end of the accounting period or one month after the issue of the notice of assessment relating to that accounting period, at the taxpayer's choice. For accounting periods ending after 1 October 1993, corporation tax is due and payable nine months and a day after the end of the accounting period.

B

Advance corporation tax

5 Section 14 of the 1988 Act provides that a company resident in the United Kingdom which makes certain distributions, such as the payment of dividends to its shareholders, is liable to pay advance corporation tax calculated on an amount equal to the amount or value of the distribution C made.

6 It is important to bear in mind that advance corporation tax is not a sum withheld on a dividend, which is paid in full, but is rather corporation tax borne by the company distributing dividends, paid in advance and set off against the mainstream corporation tax payable in respect of each accounting period.

D 7 A company is obliged to make a return, in principle every quarter, showing the amount of any distribution made during that period and the amount of advance corporation tax payable. Advance corporation tax due in respect of a distribution must be paid within 14 days of the end of the quarter in which the distribution was made.

8 Under sections 239 and 240 of the 1988 Act, the advance corporation tax paid by a company in respect of a distribution made during a given E accounting period must, in principle, subject to that company's right of surrender, either be set off against the amount which that company must pay by way of mainstream corporation tax for that accounting period or be transferred to that company's subsidiaries, which can set it off against the amount of mainstream corporation tax for which they themselves are liable. If the company is not liable for any corporation tax for the accounting F period in question (because, for example, its profits are insufficient), it may either set off the advance corporation tax against the corporation tax payable for subsequent accounting periods or claim to carry the set-off back to preceding accounting periods.

9 Whereas mainstream corporation tax becomes payable nine months or nine months and a day after the end of the accounting period, depending on whether that period ended before or after 1 October 1993, advance G corporation tax must be paid within 14 days of the end of the quarter during which the distribution was made. Consequently, advance corporation tax is always paid before the time at which mainstream corporation tax—against which it can generally be set off—becomes payable. The national court points out that the effect for a company distributing dividends is therefore to advance, by a period of from $8\frac{1}{2}$ months (in the case of a distribution made H on the last day of an accounting period) to one year, $5\frac{1}{2}$ months (where the distribution was made on the first day of the accounting period), the date for payment of corporation tax due in respect of dividends paid.

10 Since, where no mainstream corporation tax is payable for the period in question, it is even possible to set off advance corporation tax against profits of subsequent accounting periods, the national court observes

that in that case the advance will have been made for a longer period and even, in certain circumstances, for an indefinite period. A

Tax credit

11 A company resident in the United Kingdom is not liable to pay corporation tax in respect of dividends which it receives from another company resident in the United Kingdom: section 208 of the 1988 Act. Accordingly, any distribution of dividends subject to advance corporation tax made by one resident company to another gives rise to a tax credit for the company receiving the dividends: section 231(1). B

12 That tax credit is equal to the amount of advance corporation tax paid by the distributing company on that distribution of dividends: section 231(1).

13 Where a company resident in the United Kingdom receives from its resident subsidiary a distribution entitling it to a tax credit, the parent company may deduct the amount of advance corporation tax paid by its subsidiary from the amount of advance corporation tax which it must itself pay when making distributions to its own shareholders, with the result that it pays advance corporation tax only on the excess. C

14 Where a company resident in the United Kingdom, but wholly exempt from mainstream corporation tax, receives a dividend from its resident subsidiary on which advance corporation tax has been paid, it is entitled to payment of an amount equal to the tax credit: section 231(2). D

15 Companies that are not resident in the United Kingdom and do not trade there through a branch or agency are not subject to corporation tax in the United Kingdom. They are, however, in principle subject to United Kingdom income tax in respect of income having its source in that member state, including dividends paid to them by their resident subsidiaries. E

16 However, under section 233(1) of the 1988 Act, where a non-resident parent company is not in principle entitled to a tax credit in the absence of a double taxation convention to that effect concluded between the United Kingdom and its state of residence, it is not subject to United Kingdom income tax on dividends paid by its resident subsidiary.

17 Conversely, where a non-resident parent company is entitled to a tax credit under a double taxation convention concluded between the United Kingdom and its state of residence, it is subject to United Kingdom income tax on dividends received from its resident subsidiary. F

18 The double taxation convention concluded between the United Kingdom and the Federal Republic of Germany on 26 November 1964, as amended on 23 March 1970, does not grant a right to a tax credit to companies resident in Germany which hold shares in and receive dividends from companies resident in the United Kingdom. G

19 Consequently, a parent company with its seat in Germany and receiving a distribution subject to advance corporation tax from a subsidiary resident in the United Kingdom is not entitled in the United Kingdom to a tax credit corresponding to the advance corporation tax paid and, under United Kingdom tax law, is not taxable in the United Kingdom in respect of the dividends received from its resident subsidiary. H

20 Where a non-resident parent company is entitled to a tax credit pursuant to a double taxation convention concluded between the United Kingdom and its state of residence, that company may claim to set off that

A credit against the income tax for which it is then liable in the United Kingdom in respect of dividends received from its resident subsidiary and, where the amount of the tax credit exceeds the amount of the tax, to be repaid the difference. If the claim is rejected, the company which made it may appeal to the special or general commissioners and, if necessary, from them to the High Court.

B

Group income election

21 Under section 247 of the 1988 Act, two companies resident in the United Kingdom, one of which holds at least 51% of the other, may make a group income election.

22 The result of such election is that the subsidiary does not pay advance corporation tax on the dividends which it pays to its parent C company, unless it gives notice that it does not wish the election to apply to a particular distribution of dividends.

23 A request for group income election must be made to an inspector of taxes. If the request is rejected, the requesting company may appeal against that decision to the special or general commissioners and, as the case may be, may appeal from them on a point of law to the High Court.

D 24 Where a dividend is paid under a group income election by a subsidiary resident in the United Kingdom to its parent company which is also resident in the United Kingdom, no advance corporation tax is payable by the subsidiary and the parent company is not entitled to a tax credit. A group of companies may not simultaneously benefit from a group income election and from a tax credit in respect of the same dividend.

E 25 Advance corporation tax was abolished by section 31 of the Finance Act 1998 with effect from 6 April 1999. The legal provisions described above in paragraphs 5–24 are those which were in force prior to that date.

The facts of the main proceedings

26 In Case C-397/98, Metallgesellschaft Ltd and The Metal and Commodity Co Ltd, companies resident in the United Kingdom, paid F dividends to their respective parent companies, Metallgesellschaft AG and Metallgesellschaft Handel & Beteiligungen AG, companies having their seat in Germany, and were therefore required to pay advance corporation tax. The two subsidiaries were subsequently able to set off that advance corporation tax against the mainstream corporation tax for which they were liable.

G 27 Metallgesellschaft and others instituted proceedings before the High Court of Justice of England and Wales, Chancery Division, against the Inland Revenue Commissioners in which they sought a ruling that they had suffered loss by virtue of the fact that the distribution of dividends by the subsidiaries to their parent companies had been subject to advance corporation tax. The dispute in the main proceedings concerns the amounts of advance corporation tax paid between 16 April 1974 and 1 November H 1995 by Metallgesellschaft Ltd and between 11 April 1991 and 13 October 1995 by The Metal and Commodity Co Ltd.

28 In Case C-410/98, Hoechst UK Ltd, a company resident in the United Kingdom, distributed dividends to its parent company, Hoechst AG, which has its seat in Germany, and paid the advance corporation tax due on

those dividends in the United Kingdom. It was subsequently able to set off that advance corporation tax against the mainstream corporation tax for which it was liable.

29 Hoechst also brought proceedings before the High Court against the Inland Revenue Commissioners in which they sought a ruling that they had suffered loss by virtue of the fact that the dividends distributed by Hoechst UK Ltd to Hoechst AG between 16 January 1989 and 26 April 1994 had been subject to advance corporation tax. The dispute in the main proceedings concerns the amounts of advance corporation tax paid between 14 April 1989 and 13 July 1994.

30 In each of the cases in the main proceedings, the parent companies maintain that, because it was impossible for them and their subsidiaries to make a group income election, which would have enabled the subsidiaries to avoid payment of advance corporation tax, those subsidiaries suffered a cashflow disadvantage which subsidiaries of parent companies resident in the United Kingdom did not incur. By making a group income election, the latter were able to retain, until the date when the mainstream corporation tax to which they were liable fell due, the sums which they would otherwise have had to pay as advance corporation tax on the distribution of dividends to their parent companies. In their view, that disadvantage amounts to indirect discrimination on grounds of nationality contrary to the EC Treaty.

31 In the alternative, Metallgesellschaft AG and Metallgesellschaft Handel & Beteiligungen AG maintain, in Case C-397/98, that they ought to receive a tax credit corresponding, at least in part, to the advance corporation tax paid by their resident subsidiaries, similar to that afforded to a parent company resident in the United Kingdom or to a parent company not resident in the United Kingdom but entitled to a tax credit under a double taxation convention.

32 In Case C-410/98, if the court were to find that Hoechst UK Ltd is not entitled to repayment of interest due in respect of the advance corporation tax paid, Hoechst AG claims, in the alternative, payment of tax credits corresponding to that advance corporation tax or a sum equivalent to the credits which a parent company resident in the Netherlands would have received. According to Hoechst AG, the fact that United Kingdom tax legislation authorises the grant of tax credits to parent companies which are not resident in the United Kingdom in respect of the advance corporation tax paid by their resident subsidiaries only where a double taxation convention so provides, which is the case with the convention concluded between the United Kingdom and the Kingdom of the Netherlands but not the case with the convention concluded between the United Kingdom and the Federal Republic of Germany, amounts to unjustified discrimination between parent companies resident in different member states, contrary to the Treaty.

The questions submitted for preliminary ruling

33 As it took the view that the outcome of the cases pending before it depended on an interpretation of Community law, the High Court of Justice of England and Wales, Chancery Division, decided to stay proceedings and to refer the following questions, identically worded in each case, to the Court of Justice for a preliminary ruling:

A "(1) In the circumstances set out in the order for reference, is it consistent with Community law and, in particular, with articles 6, 52, 58 and/or 73b of the EC Treaty for the legislation of a member state to permit a group income election (allowing distributions to be paid by a subsidiary to its parent without accounting for advance corporation tax) only where both the subsidiary and parent are resident in that member state?

B "(2) If the answer to question (1) is 'no', do the above-mentioned provisions of the EC Treaty give rise to a restitutionary right for a resident subsidiary of a parent company resident in another member state and/or the said parent to claim a sum of money by way of interest on the advance corporation tax which the subsidiary paid on the basis that the national laws did not allow it to make a group income election, or can such a sum C only be claimed, if at all, by way of an action for damages pursuant to the principles laid down by the Court of Justice in *Brasserie du Pêcheur SA v Federal Republic of Germany; R v Secretary of State for Transport, Ex p Factortame Ltd (No 4)* (Joined Cases C-46 and 48/93) [1996] QB 404 and *R v Secretary of State for Social Security, Ex p Sutton* (Case C-66/95) [1997] ICR 961, and in either case is the national court obliged to grant a D remedy even if under national law interest cannot be awarded (whether directly or by way of restitution or damages) on principal sums which are no longer owing to the claimants?

"(3) In the circumstances set out in the order for reference, is it consistent with the above-mentioned provisions of the EC Treaty for the authorities of one member state to deny any tax credit to a company resident in another member state when it grants such credit to resident E companies and to companies resident in certain other member states by virtue of the terms of its double taxation conventions with those other member states?

"(4) If the answer to question (3) above is 'no', is and was the first member state at all material times obliged to make a tax credit available to such company on the same terms as to resident companies or as to F companies resident in member states with provision for such credits in their double taxation conventions?

"(5) Is a member state entitled to plead in answer to such a claim for restitution, tax credit or damages, that the claimants are not entitled to recover, or that the claimants' claim should be reduced, on the grounds that, despite the terms of the national statute which prevented them from doing so, as a matter of national law they ought to have made a group G income election, or claimed a tax credit and have appealed to the commissioners and, if necessary, the courts, against the decision of the inspector of taxes refusing the election or claim, relying on the primacy and direct effect of the provisions of Community law?"

34 By order of the President of the Court of Justice of 14 December 1998, Cases C-397/98 and C-410/98 were joined for the purposes of the H written procedure, the oral procedure and the judgment.

The first question

35 By its first question, the national court is in substance asking whether it is contrary to articles 6, 52, 58 and/or 73b of the Treaty for the tax

legislation of a member state, such as that in issue in the main proceedings, to afford companies resident in that member state the possibility of benefiting from a taxation regime allowing them to pay dividends to their parent company without having to pay advance corporation tax where their parent company is also resident in that member state but to deny them that possibility where their parent company has its seat in another member state. A

36 According to the claimants, the national legislation in question tends to discourage companies resident in another member state from establishing subsidiaries in the United Kingdom and therefore constitutes an unjustified restriction on freedom of establishment. Their subsidiary submission is that that legislation is likewise incompatible with the Treaty provisions on the free movement of capital. B

37 It should be remembered that, according to settled case law, although direct taxation falls within their competence, member states must none the less exercise that competence consistently with Community law and avoid any discrimination on grounds of nationality: *Wielockx v Inspecteur der Directe Belastingen* (Case C-80/94) [1996] 1 WLR 84, 96, para 16; *Asscher v Staatssecretaris van Financiën* (Case C-107/94) [1996] ECR I-3089, 3124, para 36; *Royal Bank of Scotland plc v Elliniko Dimosio* (Case C-311/97) [1999] ECR I-2651, 2671, para 19, and *Baars v Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem* (Case C-251/98) [2000] ECR I-2787, 2813, para 17. C D

38 It follows from the court's case law that the general prohibition of all discrimination on grounds of nationality laid down by article 6 of the Treaty applies independently only to situations governed by Community law for which the Treaty lays down no specific non-discrimination rules: *Commission of the European Communities v Hellenic Republic* (Case 305/87) [1989] ECR 1461, 1476–1477, paras 12 and 13; *Halliburton Services BV v Staatssecretaris van Financiën* (Case C-1/93) [1994] ECR I-1137, 1155, para 12; *Royal Bank of Scotland* [1999] ECR I-2651, 2672, para 20, and *Baars* [2000] ECR I-2787, 2815, para 23. E

39 It is common ground that, in relation to the right of establishment, the principle of non-discrimination was implemented and specifically laid down by article 52 of the Treaty: *Halliburton Services*, para 12; *Criminal proceedings against Skanavi* (Case C-193/94) [1996] ECR I-929, 951, para 21 and *Baars*, para 24. F

40 Consequently, article 6 of the Treaty is not applicable to the cases in the main proceedings. The question whether legislation such as that in question imposes an unwarranted restriction on freedom of establishment must therefore first of all be determined in the light of article 52 of the Treaty. G

41 Article 52 of the Treaty constitutes one of the fundamental provisions of Community law and has been directly applicable in the member states since the end of the transitional period. Under that provision, freedom of establishment for nationals of one member state within the territory of another member state 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 country where such establishment is effected. The abolition of restrictions on freedom of establishment also applies to restrictions on the setting up of agencies, branches or subsidiaries by nationals of any member state established in the H

A territory of another member state: *Commission of the European Communities v French Republic* (Case 270/83) [1986] ECR 273, 302–303, para 13 and *Royal Bank of Scotland* [1999] ECR I-2651, 2672, para 22.

42 Freedom of establishment thus defined includes, pursuant to article 58 of the Treaty, the right of companies or firms formed in accordance with the law of a member state and having their registered office, central B administration or principal place of business within the Community, to pursue their activities in the member state concerned through a branch or agency: *Imperial Chemical Industries plc v Colmer* (Case C-264/96) [1999] 1 WLR 108, 125, para 20, and the case law cited therein, and *Cie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt* (Case C-307/97) [1999] ECR I-6161, 6195, para 35. With regard to companies, it should be noted in this context that it is their corporate seat in C the above sense that serves as the connecting factor with the legal system of a particular state, like nationality in the case of natural persons: *Imperial Chemical Industries*, para 20, and the case law cited therein, and *Saint-Gobain*, para 35. Acceptance of the proposition that the member state in which a company seeks to establish itself may freely apply to it a different treatment solely by reason of the fact that its seat is situated in another D member state would thus deprive article 52 of all meaning: *Commission of the European Communities v French Republic* (Case 270/83) [1986] ECR 273, 304, para 18.

43 With regard to the right to make a group income election, the legislation in question creates a difference in treatment between subsidiaries resident in the United Kingdom depending on whether or not their parent company has its seat in the United Kingdom. Resident subsidiaries of E companies having their seat in the United Kingdom may, subject to certain conditions, avail themselves of the group income election regime and thus be relieved of the obligation to pay advance corporation tax when distributing dividends to their parent companies. By contrast, that advantage is denied to the resident subsidiaries of companies not having their seat in the United Kingdom and which are therefore obliged to pay advance corporation tax F whenever they distribute dividends to their parent companies.

44 It is not disputed that this gives the subsidiary of a parent company resident in the United Kingdom a cashflow advantage inasmuch as it retains the sums which it would otherwise have had to pay by way of advance corporation tax until such time as mainstream corporation tax becomes payable, that is to say, for a period of between 8½ months, at the least, and 17½ months, at the most, depending on the date of distribution. Where G mainstream corporation tax is not payable at all for the accounting period in question, this entails an even longer period, since advance corporation tax can be set off against corporation tax due in respect of subsequent accounting periods.

45 According to the United Kingdom, Finnish and Netherlands Governments, the difference in treatment for tax purposes between H subsidiaries resident in the United Kingdom depending on whether or not their parent company is resident in that member state is objectively justified.

46 The first submission of the United Kingdom Government is that the situation of resident subsidiaries of resident parent companies is not comparable to that of resident subsidiaries of non-resident parent companies.

47 So far as resident subsidiaries of resident parent companies are concerned, the United Kingdom Government claims that, even though making a group income election relieves the subsidiary of the obligation to pay advance corporation tax when paying dividends to its parent company, that payment is merely deferred, in that the parent company, being resident, is itself required to pay advance corporation tax when it makes distributions subject to that tax. The obligation to pay advance corporation tax when paying dividends is therefore transferred from the subsidiary to the parent company and the subsidiary's exemption from advance corporation tax is offset by the parent company's liability to advance corporation tax.

48 By contrast, according to the United Kingdom Government, if resident subsidiaries and their non-resident parent companies were able to benefit from the group election regime, no advance corporation tax at all would be paid in the United Kingdom. The subsidiary would be exempt from payment of advance corporation tax when paying dividends to its parent company, but that exemption would not be offset by any subsequent payment of advance corporation tax by the non-resident parent company when it made distributions, in that it is not subject to United Kingdom corporation tax or, therefore, to advance corporation tax.

49 The Netherlands Government maintains that the principle of territoriality allows a member state to reserve to resident parent companies the possibility of opting for a regime such as group income election since even though, under such a regime, the state waives levying the tax on the subsidiary, it does not renounce its right to that tax, since the effect of that regime is simply to put back the charging of advance corporation tax to another level within the same group of companies. By contrast, if the exemption from advance corporation tax under a group income election were granted to subsidiaries of parent companies not resident in the United Kingdom, no advance corporation tax would be charged in the United Kingdom on transactions within the group since the other group companies are in another member state and are not subject to corporation tax in the United Kingdom. That would be tantamount to tax avoidance.

50 The Finnish Government also submits that affording subsidiaries of parent companies not resident in the United Kingdom the possibility of making a group income election would allow those subsidiaries to avoid taxation in the United Kingdom since their parent companies are not subject to tax in that member state.

51 Those arguments cannot be upheld.

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

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

A 54 Consequently, to afford resident subsidiaries of non-resident companies the possibility of making a group income election would do no more than allow them to retain the sums which would otherwise be payable by way of advance corporation tax until such time as mainstream corporation tax falls due. They would thus enjoy the same cashflow advantage as resident subsidiaries of resident parent companies, there being no other difference—assuming equal bases of assessment—between the B amounts of mainstream corporation tax for which the two types of subsidiary are liable in respect of the same accounting period.

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

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

D 57 Thirdly, as regards the risk of tax avoidance, the court has already held that the establishment of a company outside the United Kingdom does not, of itself, necessarily entail tax avoidance, since that company will in any event be subject to the tax legislation of the state of establishment: *Imperial Chemical Industries plc v Colmer* (Case C-264/96) [1999] 1 WLR 108, 126, para 26.

58 Moreover, it would seem that it is acceptable to the tax law of the E United Kingdom, so far as resident parent companies are concerned, for no advance corporation tax to be paid ultimately by companies which have made a group income election. In certain cases, the parent company to which dividends have been distributed under such a taxation regime will not itself pay any advance corporation tax. In particular, it may make no distribution liable to advance corporation tax or it may make distributions under the group income election which would otherwise have been liable to F advance corporation tax. The liability of a resident parent of a resident subsidiary to pay advance corporation tax does not, therefore, even necessarily offset the release, arising from the group income election, of its subsidiary from the obligation to pay advance corporation tax.

59 Fourthly and finally, as regards the loss of revenue for the United Kingdom tax authorities which would result from affording resident G subsidiaries of non-resident parent companies the possibility of making a group income election and thus to be exempted from paying advance corporation tax, suffice it to point out that it is settled case law that diminution of tax revenue cannot be regarded as a matter of overriding general interest which may be relied on in order to justify a measure which is, in principle, contrary to a fundamental freedom: see, in relation to article 52 of the Treaty, *Imperial Chemical Industries*, para 28.

H 60 Consequently, as the Advocate General has pointed out in paragraph 25 of his opinion, the difference in the tax treatment of parent companies depending on whether or not they are resident cannot justify denial of a tax advantage to subsidiaries, resident in the United Kingdom, of parent companies having their seat in another member state where that

advantage is available to subsidiaries, resident in the United Kingdom, of parent companies also resident in the United Kingdom, since all those subsidiaries are liable to mainstream corporation tax on their profits irrespective of the place of residence of their parent companies.

61 The second submission of the United Kingdom Government is that the refusal to grant resident subsidiaries of non-resident parent companies the right to make a group income election is justified by the need to preserve the cohesion of the United Kingdom's tax system.

62 The Government contends that the principle on which the United Kingdom's tax system is based is that companies should be liable to tax in respect of their profits and that their members should at the same time be liable to tax in respect of their share of those profits which the companies, in certain cases, pay out in the form of dividends. In order to mitigate that double taxation in economic terms, corporate shareholders resident in the United Kingdom are exempt from corporation tax on the dividends which they receive from their resident subsidiaries, as that exemption is offset by the advance corporation tax charge on the payment of dividends by subsidiaries to their parent companies.

63 The United Kingdom Government submits that there is therefore a direct link between the exemption from corporation tax accorded to a parent company in respect of dividends received from its resident subsidiary and the liability of that subsidiary to advance corporation tax when it pays those dividends. The requirement that advance corporation tax be paid by the company distributing dividends is essential in order to ensure that, before the company receiving dividends is granted any exemption, the distributing company is taxed on those dividends, whether or not it is subject to corporation tax in respect of profits made during the accounting period in the course of which the dividends are paid.

64 Where a resident subsidiary is not required to pay advance corporation tax when it distributes dividends, on the ground that it has, with its resident parent company, made a group income election, it is the advance corporation tax to be paid by the parent company when it in turn distributes dividends that will offset the exemption of the parent company from corporation tax in respect of the dividends which it has received.

65 According to the United Kingdom Government, to authorise exemption from advance corporation tax where a resident subsidiary pays dividends to its non-resident parent company would mean that the tax exemption afforded to the parent company in respect of the dividends received would not be offset by any tax charged on the payment of those dividends, which would be incompatible with the cohesion of the United Kingdom tax system.

66 That line of argument cannot be upheld.

67 The Court of Justice has, it is true, held that the need to safeguard the cohesion of a tax system may justify rules that are liable to restrict fundamental freedoms: *Bachmann v Belgian State* (Case C-204/90) [1992] ECR I-249 and *Commission of the European Communities v Kingdom of Belgium* (Case C-300/90) [1992] ECR I-305.

68 That is not, however, the case here.

69 Whereas in *Bachmann* and *Commission v Belgium* there was a direct link between the deductibility of contributions paid for old-age and life assurance contracts and the taxation of the sums paid out under those

A contracts, a link which had to be maintained in order to safeguard the cohesion of the tax system in question, there is no such direct link in the present cases between, on the one hand, the refusal to exempt subsidiaries in the United Kingdom of non-resident parent companies from payment of advance corporation tax under a group income election and, on the other, the fact that parent companies having their seat in another member state and B receiving dividends from their subsidiaries in the United Kingdom are not liable to corporation tax in the United Kingdom.

70 Parent companies, whether resident or not, are exempt from corporation tax in the United Kingdom in respect of dividends received from their resident subsidiaries. It is irrelevant for the purposes of granting a tax advantage such as exemption from advance corporation tax under the group income election regime that, for resident parent companies, such exemption C is intended to prevent double taxation of the profits of subsidiaries in the United Kingdom and that, for non-resident parent companies, that exemption simply results from the fact that they are not in any event subject to corporation tax in that member state, being subject to a comparable tax in the member state in which they are established.

71 Furthermore, the only tax to which a non-resident parent company is D liable in the United Kingdom in respect of dividends received from its resident subsidiary is income tax, but that liability is linked to the grant, if any, of tax credits provided for by a double taxation convention concluded between the United Kingdom and the state of residence of the parent company.

72 With regard to the claimants in the main proceedings, parent E companies resident in Germany are not liable to income tax in the United Kingdom on dividends received from their subsidiaries resident in the United Kingdom since the double taxation convention concluded between the United Kingdom and the Federal Republic of Germany does not provide for the grant of tax credits corresponding to the advance corporation tax paid by subsidiaries.

73 Consequently, the refusal to allow subsidiaries, resident in the F United Kingdom, of parent companies resident in another member state to make a group income election cannot be justified on grounds relating to the need to preserve the cohesion of the United Kingdom's tax system.

74 Moreover, the fact that advance corporation tax has in the meantime been abolished suggests that its payment was not essential to the proper functioning of the corporation tax system in the United Kingdom.

G 75 Since legislation such as that in question runs counter to the Treaty provisions on freedom of establishment, it is unnecessary to consider whether it also runs counter to the Treaty provisions on the free movement of capital.

76 The answer to the first question must therefore be that it is contrary to article 52 of the Treaty for the tax legislation of a member state, such as that in issue in the main proceedings, to afford companies resident in that H member state the possibility of benefiting from a taxation regime allowing them to pay dividends to their parent company without having to pay advance corporation tax where their parent company is also resident in that member state, but to deny them that possibility where their parent company has its seat in another member state.

The second question A

77 Having regard to the answer given to the first question, the second question seeks in substance to ascertain whether, on a proper construction of article 52 of the Treaty, where a subsidiary resident in the member state concerned and its parent company having its seat in another member state have been wrongfully deprived of the benefit of a taxation regime which would have enabled the subsidiary to pay dividends to its parent company B without having to pay advance corporation tax, that subsidiary and/or its parent company are/is entitled to obtain a sum equal to the interest accrued on the advance payments made by the subsidiary from the date of those payments until the date on which the tax became chargeable, even when national law prohibits the payment of interest on a principal sum which is not due. The national court frames that question in two hypotheses: in the first alternative, where the claim by the subsidiary and/or parent company is C made in an action for restitution of taxes levied in breach of Community law and, in the second, where the claim is made in an action for compensation for damage resulting from the breach of Community law.

78 The United Kingdom Government maintains, first, that if it should be held that it was contrary to Community law to deny resident subsidiaries of parent companies not resident in the United Kingdom the benefit of the D group income election regime, Community law would require that breach to be remedied, not through an action for restitution but through an action brought against the state for damages for loss occasioned by its breach of Community law. In its view, advance corporation tax is not a tax levied contrary to Community law, since subsidiaries are in any event bound to pay by way of mainstream corporation tax the sums paid by way of advance corporation tax. It is the fact that the United Kingdom legislature failed to E provide for the possibility of a resident subsidiary and its non-resident parent making a group income election that is at the origin of the disputes in the main proceedings and that might cause the United Kingdom to incur non-contractual liability. In *R v Secretary of State for Social Security, Ex p Sutton* (Case C-66/95) [1997] ICR 961, the court held, in particular, that in the case of damage arising out of breach of a Directive, Community law does F not require a member state to pay a sum equivalent to the interest on a sum paid late, in that case arrears of social security benefits. From this the United Kingdom Government concludes that Community law does not require interest to be paid in respect of the loss of use of a sum of money for a certain period on account of the advance levying of a tax contrary to Community law.

79 Secondly, the United Kingdom Government argues that, even if the G claimants' claims were to be treated as claims for recovery of sums paid in breach of Community law, such claims cannot be upheld inasmuch as settled case law states that it is for national law to determine whether interest is payable in connection with reimbursement of charges improperly levied in the light of Community law. Under English law, entitlement to interest depends on whether or not proceedings were commenced before payment of H the sum on which interest is claimed.

80 In consequence, the United Kingdom Government submits that the claimants in the main proceedings cannot claim interest under a claim for restitution or for damages inasmuch as the principal sums claimed were repaid by set-off of advance corporation tax against the amounts due by way

A of mainstream corporation tax payable by the subsidiaries before the proceedings were brought.

81 It must be stressed that it is not for the Court of Justice to assign a legal classification to the actions brought by the claimants before the national court. In the circumstances, it is for the claimants to specify the nature and basis of their actions (whether they are actions for restitution or B actions for compensation for damage), subject to the supervision of the national court.

82 First, on the assumption that the actions brought by the claimants in the main proceedings are to be treated as claims for restitution of a charge levied in breach of Community law, the question is whether, in circumstances such as those in the main proceedings, a breach of article 52 of the Treaty by a member state entitles taxpayers to reimbursement of interest C accrued on the tax they have paid from the date of its premature payment until the date on which it properly fell due.

83 It is important to bear in mind in this regard that what is contrary to Community law, in the disputes in the main proceedings, is not the levying of a tax in the United Kingdom on the payment of dividends by a subsidiary to its parent company but the fact that subsidiaries, resident in the United D Kingdom, of parent companies having their seat in another member state were required to pay that tax in advance whereas resident subsidiaries of resident parent companies were able to avoid that requirement.

84 According to well-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: *Amministrazione delle* E *Finanze dello Stato v SpA San Giorgio* (Case 199/82) [1983] ECR 3595, 3612, para 12; *Barra v Belgian State* (Case 309/85) [1988] ECR 355, 376, para 17; *BP Supergas Anonimos Etairia Geniki Emporiki-Viomichaniki kai Antiprossopeion v Greek State* (Case C-62/93) [1995] ECR I-1883, 1919, para 40; *Dilexport Srl v Amministrazione delle Finanze dello Stato* (Case C-343/96) [1999] ECR I-579, 610–611, para 23 and *Kapniki Mikhailidis* F *AE v Idrima Kinonikon Asphaliseon* (Joined Cases C-441 and 442/98) [2000] ECR I-7145, 7176, para 30. The member state is therefore required in principle to repay charges levied in breach of Community law: *Société Comateb v Directeur Général des Douanes et Droits Indirects* (Joined Cases C-192–218/95) [1997] ECR I-165, 188, para 20; *Dilexport*, para 23 and *Mikhailidis*, para 30.

85 In the absence of Community rules on the restitution of national G charges that have been improperly levied, 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 H do not render practically impossible or excessively difficult the exercise of rights conferred by Community law (principle of effectiveness): see, in particular, *Edilizia Industriale Siderurgica Srl v Ministero delle Finanze* (Case C-231/96) [1998] ECR I-4951, 4986, 4990, paras 19 and 34; *Ministero delle Finanze v SPAC SpA* (Case C-260/96) [1998] ECR I-4997, 5019, para 18; *Aprile Srl v Amministrazione delle Finanze dello Stato (No 2)*

(Case C-228/96) [2000] 1 WLR 126, 148, para 18 and *Dilexport* [1999] ECR I-579, 611, para 25.

86 It is likewise for national law to settle all ancillary questions relating to the reimbursement of charges improperly levied, such as the payment of interest, including the rate of interest and the date from which it must be calculated: *Société Roquette Frères v Commission of the European Communities* (Case 26/74) [1976] ECR 677, 686, paras 11 and 12 and *Express Dairy Foods Ltd v Intervention Board for Agricultural Produce* (Case 130/79) [1980] ECR 1887, 1901, paras 16 and 17.

87 In the main proceedings, however, the claim for payment of interest covering the cost of loss of the use of the sums paid by way of advance corporation tax is not ancillary, but is the very objective sought by the claimants' actions in the main proceedings. In such circumstances, where the breach of Community law arises, not from the payment of the tax itself but from its being levied prematurely, the award of interest represents the "reimbursement" of that which was improperly paid and would appear to be essential in restoring the equal treatment guaranteed by article 52 of the Treaty.

88 The national court has said that it is in dispute whether English law provides for restitution in respect of damage arising from loss of the use of sums of money where no principal sum is due. It must be stressed that in an action for restitution the principal sum due is none other than the amount of interest which would have been generated by the sum, use of which was lost as a result of the premature levy of the tax.

89 Consequently, article 52 of the Treaty entitles a subsidiary resident in the United Kingdom and/or its parent company having its seat in another member state to obtain interest accrued on the advance corporation tax paid by the subsidiary during the period between the payment of advance corporation tax and the date on which mainstream corporation tax became payable, and that sum may be claimed by way of restitution.

90 Secondly, assuming that the claimants' claims are to be treated as claims for compensation for damage caused by breach of Community law, the question is whether, in circumstances such as those in the main proceedings, breach of article 52 of the Treaty by a member state entitles the taxpayer to payment of damages in a sum equal to the interest accrued on the tax which they have paid from the date of premature payment until the date on which it properly fell due.

91 In that regard, as the court has already held in paragraph 87 of its judgment in *Brasserie du Pêcheur SA v Federal Republic of Germany; R v Secretary of State for Transport, Ex p Factortame Ltd (No 4)* (Joined Cases C-46 and 48/93) [1996] QB 404, 503, total exclusion of loss of profit as a head of damage for which reparation may be awarded cannot be accepted in the case of a breach of Community law since, especially in the context of economic or commercial litigation, such a total exclusion of loss of profit would be such as to make reparation of damage practically impossible.

92 In this regard, the United Kingdom Government's argument that the claimants could not be awarded interest if they sought compensation in a claim for damages cannot be accepted.

93 Admittedly, the court ruled in *R v Secretary of State for Social Security, Ex p Sutton* (Case C-66/95) [1997] ICR 961 that the Community Directive at issue in that case conferred only the right to obtain the benefits

A to which the person concerned would have been entitled in the absence of discrimination and that the payment of interest on arrears of benefits could not be regarded as an essential component of the right as so defined. However, in the present cases, it is precisely the interest itself which represents what would have been available to the claimants, had it not been for the inequality of treatment, and which constitutes the essential B component of the right conferred on them.

94 Moreover, in *Ex p Sutton*, at pp 991–992, paras 23–25, the court distinguished the circumstances of that case from those of *Marshall v Southampton and South West Hampshire Area Health Authority (Teaching) (No 2)* (Case C-271/91) [1994] QB 126. In the latter case, which concerned the award of interest on amounts payable by way of reparation for loss and damage sustained as a result of discriminatory dismissal, the court ruled that C full compensation for the loss and damage sustained cannot leave out of account factors, such as the effluxion of time, which may in fact reduce its value, and that the award of interest is an essential component of compensation for the purposes of restoring real equality of treatment: *Marshall (No 2)*, pp 164–165, paras 24–32. The award of interest was held in that case to be an essential component of the compensation which D Community law required to be paid in the event of discriminatory dismissal.

95 In circumstances such as those in the cases in the main proceedings, the award of interest would therefore seem to be essential if the damage caused by the breach of article 52 of the Treaty is to be repaired.

96 The answer to the second question referred must therefore be: where a subsidiary resident in one member state has been obliged to pay advance corporation tax in respect of dividends paid to its parent company having its E seat in another member state even though, in similar circumstances, the subsidiaries of parent companies resident in the first member state were entitled to opt for a taxation regime that allowed them to avoid that obligation, article 52 of the Treaty requires that resident subsidiaries and their non-resident parent companies should have an effective legal remedy in order to obtain reimbursement or reparation of the financial loss which they F have sustained and from which the authorities of the member state concerned have benefited as a result of the advance payment of tax by the subsidiaries. The mere fact that the sole object of such an action is the payment of interest equivalent to the financial loss suffered as a result of the loss of use of the sums paid prematurely does not constitute a ground for dismissing such an action. While, in the absence of Community rules, it is for the domestic legal system of the member state concerned to lay down the detailed procedural G rules governing such actions, including ancillary questions such as the payment of interest, those rules must not render practically impossible or excessively difficult the exercise of rights conferred by Community law.

The third and fourth questions

97 In light of the answer given to the first question, it is unnecessary to H reply to the third and fourth questions.

The fifth question

98 By its fifth question, the national court is seeking in substance to ascertain whether it is contrary to Community law for a national court to

refuse or reduce a claim brought before it by a resident subsidiary and its non-resident parent company for reimbursement or reparation of the financial loss which they have suffered as a consequence of the advance payment of corporation tax by the subsidiary, on the sole ground that they did not apply to the tax authorities in order to benefit from the taxation regime which would have exempted the subsidiary from making payments in advance and did not therefore make use of the legal remedies available to them to challenge the refusals of the tax authorities, by invoking the primacy and direct effect of the provisions of Community law, where on any view national law denied resident subsidiaries and their non-resident parent companies the benefit of that taxation regime.

99 According to the United Kingdom Government, were refusal to allow resident subsidiaries of non-resident parent companies the benefit of a group income election to be held to be contrary to Community law, the appropriate legal recourse would be an action to establish state liability in accordance with the conditions laid down by the court in *Brasserie du Pêcheur and Factortame* [1996] QB 404. It claims that it can plead, by way of defence to such actions for damages, that the claimants failed to act diligently, in that they did not at the outset apply to make a group income election, which would have enabled them to challenge the refusal of the tax authorities and to invoke the primacy and direct effect of Community law in order to obtain, in particular, a reference for a preliminary ruling at the earliest opportunity.

100 That argument is not based on the existence in national law of any rule of limitation or time bar.

101 The United Kingdom Government considers its position to be well-founded, having regard in particular to paragraphs 84 and 85 of *Brasserie du Pêcheur and Factortame*, at p 503, where the court ruled that, in accordance with a general principle common to the legal systems of the member states, the injured party must show reasonable diligence in limiting the extent of the loss or damage, or risk having to bear the damage himself, and, therefore, that in order to determine the loss or damage for which reparation may be granted, the national court may inquire whether the injured person showed reasonable diligence in order to avoid the loss or damage or limit its extent and whether, in particular, he availed himself in time of all the legal remedies available to him.

102 First of all, it must be borne in mind that actions such as those in the main proceedings are subject to national rules of procedure, which may in particular require claimants to act with reasonable diligence in order to avoid loss or damage or to limit its extent.

103 Next, it is not disputed that in the cases in the main proceedings the tax legislation of the United Kingdom clearly denied resident subsidiaries of non-resident parent companies the benefit of the group income election, with the result that the claimants cannot be faulted for failure to indicate their intention to apply to make a group income election. According to the orders for reference, it is not disputed that, had the claimants applied for that taxation regime, their application would have been refused by the inspector of taxes because the parent companies were not resident in the United Kingdom.

104 Finally, the orders for reference make it clear that an appeal against such a refusal by the tax authorities could have been brought before the

A special or general commissioners and then, if necessary, before the High Court. According to the national court, before judgment could be given in such an appeal, the subsidiaries would still have had to pay advance corporation tax in respect of all the dividends which they had paid out and, furthermore, if the appeal had succeeded, they would not have obtained reimbursement of the advance corporation tax, since no such right to reimbursement exists under English law. If the subsidiaries had chosen not B to pay advance corporation tax in respect of dividends paid before the determination of their appeals, they would nevertheless have been assessed to advance corporation tax, would have had to pay interest on those sums and would have laid themselves open to statutory penalties if they had been judged to have acted negligently and without reasonable cause.

105 It therefore appears that, in the cases in the main proceedings, the C United Kingdom Government is blaming the claimants for lack of diligence and for not availing themselves earlier of legal remedies other than those which they took to challenge the compatibility with Community law of the national provisions denying a tax advantage to subsidiaries of non-resident parent companies. It is thus criticising the claimants for complying with national legislation and for paying advance corporation tax without applying for the group income election regime or using the available legal D remedies to challenge the refusal with which the tax authorities would inevitably have met their application.

106 The exercise of rights conferred on private persons by directly applicable provisions of Community law would, however, be rendered impossible or excessively difficult if their claims for restitution or compensation based on Community law were rejected or reduced solely E because the persons concerned had not applied for a tax advantage which national law denied them, with a view to challenging the refusal of the tax authorities by means of the legal remedies provided for that purpose, invoking the primacy and direct effect of Community law.

107 The answer to the fifth question must therefore be that it is contrary to Community law for a national court to refuse or reduce a claim brought before it by a resident subsidiary and its non-resident parent company for F reimbursement or reparation of the financial loss which they have suffered as a consequence of the advance payment of corporation tax by the subsidiary, on the sole ground that they did not apply to the tax authorities in order to benefit from the taxation regime which would have exempted the subsidiary from making payments in advance and that they therefore did not make use of the legal remedies available to them to challenge the refusals of the tax G authorities, by invoking the primacy and direct effect of the provisions of Community law, where on any view national law denied resident subsidiaries and their non-resident parent companies the benefit of that taxation regime.

Costs

H 108 The costs incurred by the United Kingdom, German, French, Netherlands and Finnish Governments and by the Commission, which have submitted observations to the court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

On those grounds, the court (fifth chamber), in answer to the questions referred to it by the Court of Justice of England and Wales, Chancery Division, by orders of 2 October 1998, hereby rules: A

1 It is contrary to article 52 of the EC Treaty for the tax legislation of a member state, such as that in issue in the main proceedings, to afford companies resident in that member state the possibility of benefiting from a taxation regime allowing them to pay dividends to their parent company without having to pay advance corporation tax where their parent company is also resident in that member state but to deny them that possibility where their parent company has its seat in another member state. B

2 Where a subsidiary resident in one member state has been obliged to pay advance corporation tax in respect of dividends paid to its parent company having its seat in another member state even though, in similar circumstances, the subsidiaries of parent companies resident in the first member state were entitled to opt for a taxation regime that allowed them to avoid that obligation, article 52 of the Treaty requires that resident subsidiaries and their non-resident parent companies should have an effective legal remedy in order to obtain reimbursement or reparation of the financial loss which they have sustained and from which the authorities of the member state concerned have benefited as a result of the advance payment of tax by the subsidiaries. The mere fact that the sole object of such an action is the payment of interest equivalent to the financial loss suffered as a result of the loss of use of the sums paid prematurely does not constitute a ground for dismissing such an action. While, in the absence of Community rules, it is for the domestic legal system of the member state concerned to lay down the detailed procedural rules governing such actions, including ancillary questions such as the payment of interest, those rules must not render practically impossible or excessively difficult the exercise of rights conferred by Community law. C D E

3 It is contrary to Community law for a national court to refuse or reduce a claim brought before it by a resident subsidiary and its non-resident parent company for reimbursement or reparation of the financial loss which they have suffered as a consequence of the advance payment of corporation tax by the subsidiary, on the sole ground that they did not apply to the tax authorities in order to benefit from the taxation regime which would have exempted the subsidiary from making payments in advance and that they therefore did not make use of the legal remedies available to them to challenge the refusals of the tax authorities, by invoking the primacy and direct effect of the provisions of Community law, where on any view national law denied resident subsidiaries and their non-resident parent companies the benefit of that taxation regime. F G

Solicitors: Slaughter & May; Treasury Solicitor.

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