ORDER OF THE COURT (Fourth Chamber)

23 April 2008 *

In Case C-201/05,

REFERENCE for a preliminary ruling under Article 234 EC from the Chancery Division of the High Court of Justice of England and Wales (United Kingdom), made by decision of 18 March 2005, received at the Court on 6 May 2005, in the proceedings

The Test Claimants in the CFC and Dividend Group Litigation

v

Commissioners of Inland Revenue,

THE COURT (Fourth Chamber),

composed of K. Lenaerts (Rapporteur), President of the Chamber, R. Silva de Lapuerta, E. Juhász, J. Malenovský and T. von Danwitz, Judges,

* Language of the case: English.

Advocate General: V. Trstenjak,
Registrar: R. Grass,

the Court proposing to give its decision by reasoned order in accordance with the first subparagraph of Article 104(3) of its Rules of Procedure,

after hearing the Advocate General,

makes the following

Order

1 This reference for a preliminary ruling concerns the interpretation of Articles 43 EC, 49 EC and 56 EC to 58 EC.

2 The reference was made in the course of proceedings between several groups of international companies and the Commissioners of Inland Revenue (the tax authority in the United Kingdom) concerning the taxation of resident companies on the profits made by, and dividends received from, non-resident subsidiary companies.

Legal context

3 In the United Kingdom, corporation tax is governed by the Income and Corporation Taxes Act 1988 ('ICTA').

4 Under section 6 of ICTA, a resident company is subject to corporation tax on its worldwide profits. Those profits include the profits of branches or agencies through which the company carries on its activities in other States.

5 On the other hand, the resident company is not generally taxed on the profits of its subsidiaries, whether resident or non-resident, as those profits arise.

The taxation of dividends

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

7 When a United Kingdom-resident company receives dividends from a company resident outside the United Kingdom, it is liable to corporation tax on those dividends. In such a case, the company receiving those dividends is not entitled to a tax credit and the dividends paid do not qualify as franked investment income. However, under

sections 788 and 790 of ICTA, it is entitled to relief for tax paid by the company making the distribution in the State in which the latter is resident. Such relief is granted either under the legislation in force in the United Kingdom or under a double taxation convention ('DTC') concluded by the United Kingdom with the other State.

8 Thus, the national legislation allows withholding taxes paid on dividends from a non-resident company to be offset against the liability to corporation tax of a resident company receiving the dividends. Where a resident company receiving dividends either directly or indirectly controls, or is a subsidiary of, a company which directly or indirectly controls not less than 10% of the voting power in the company making the distribution, the relief extends to the underlying foreign corporation tax on the profits out of which the dividends are paid. Relief on that foreign tax is available only up to the amount due in the United Kingdom by way of corporation tax on the income concerned.

9 Certain specific provisions concern the taxation of investment income, particularly dividends, received by insurance companies on assets allocated to pensions business and life assurance business.

10 Section 208 of ICTA does not apply, as a rule, to either pensions business or overseas life assurance business, with the result that dividends from portfolio investments linked to such business are subject to United Kingdom tax calculated in accordance with the principles applicable to the computation of trading profits arising from underwriting. However, prior to 1 July 1997, a life insurance company could, as an exception to that principle, elect that that section should apply as regards dividends received from resident companies, as part of its pensions business. If it did so elect

it could not claim payment of the tax credits attached to those dividends. Such an election was not, on the other hand, possible as regards dividends received from non-resident companies, as part of such business.

The legislation on controlled foreign companies

11 The principle whereby a resident company is not taxed on the profits of its non-resident subsidiaries as they arise is subject to a scheme of exceptional arrangements, namely the legislation on controlled foreign companies ('CFCs'), contained in sections 747 to 756 and Schedules 24 to 26 to ICTA.

12 That legislation provides that the profits of a CFC — namely, under the version of that legislation applicable at the time of the facts in the main proceedings ('the legislation on CFCs'), a foreign company in which the resident company owns a holding of more than 50% — are attributed to the resident company and taxed in its hands, by means of a tax credit for the tax paid by the CFC in the State in which it is established. If those same profits are then distributed in the form of dividends to the resident company, the tax paid by the latter in the United Kingdom on the profits of the CFC is treated as additional tax paid by the latter abroad and gives rise to a tax credit payable in respect of the tax owed by the resident company on those dividends.

13 The legislation on CFCs is designed to apply when the CFC is subject, in the State in which it is established, to a 'lower level of taxation', which is the case, under that legislation, in respect of any accounting period in which the tax paid by the CFC is less than three quarters of the amount of tax which would have been paid in the United Kingdom on the taxable profits as they would have been calculated for the purposes of taxation in that Member State.

14 The charge to tax under the legislation on CFCs is subject to a number of exceptions.

15 According to the legislation on CFCs, that charge to tax does not apply in any of the following cases:

— the CFC pursues an 'acceptable distribution policy', which means that a specified percentage (90% in 1996) of its profits is distributed within 18 months of their arising and taxed in the hands of a resident company;

— the CFC is engaged in 'exempt activities' within the meaning of that legislation, such as certain trading activities carried out from a business establishment;

— the CFC satisfies the 'public quotation condition', which means that 35% of the voting power is held by the public, the subsidiary is quoted and its securities are dealt in on a recognised stock exchange, and

— the CFC's chargeable profits do not exceed an amount set at GBP 50 000 (the 'de minimis' exception).

16 The taxation provided for by the legislation on CFCs is also excluded when 'the motive test' is satisfied. The latter involves two cumulative conditions. First, where

the transactions which gave rise to the profits of the CFC for the accounting period in question produce a reduction in United Kingdom tax compared to that which would have been paid in the absence of those transactions and where the amount of that reduction exceeds a certain threshold, the resident company must show that such a reduction was not the main purpose, or one of the main purposes, of those transactions. Secondly, the resident company must show that it was not the main reason, or one of the main reasons, for the CFC's existence in the accounting period concerned to achieve a reduction in United Kingdom tax by means of a diversion of profits. According to that legislation, there is a diversion of profits if it is reasonable to suppose that, had the CFC or any related company established outside the United Kingdom not existed, the receipts would have been received by, and been taxable in the hands of, a United Kingdom resident.

17 The decision making the reference also states that in 1996 the United Kingdom tax authorities published a list of States within which, subject to specified conditions, a CFC could be established and carry on its activities and be regarded as meeting the requirements for exemption from the taxation provided for by the legislation on CFCs.

18 Until 1999, the legislation on CFCs applied only on the direction of the United Kingdom tax authority. There was no obligation, for parent companies, to make a tax return concerning CFCs. Since then, resident companies have been required to determine themselves whether that legislation applies and assess the charge to tax arising from any such application (the rule known as 'self-assessment').

19 A resident company's corporation tax return must contain information in respect of CFCs, including the names of the CFCs concerned, the country or countries in which they are resident, the size of the resident company's interests in each of the CFCs,

as well as details relating to any application for exemption. If none of the exceptions provided for by the legislation on CFCs is applicable, the resident company must state the details of the computation of the total tax.

20 The legislation on CFCs has been the subject of a series of amendments since December 1993.

21 First, 'self-assessment' was introduced, as regards CFCs, for accounting periods ending after 1 July 1999.

22 Secondly, the definition of control of a foreign company was altered with effect from 21 March 2000. A provision was also adopted in respect of joint ventures.

23 Thirdly, 'designer rate provisions' were introduced by the Finance Act 2000 and entered into effect from 6 October 1999. Under those provisions, a company which is resident in the territory of a State where the rate of tax is equal to or greater than three quarters of that of the United Kingdom may nevertheless come within the scope of the legislation on CFCs if, in the view of the United Kingdom tax authority, the provisions in force in the State of establishment of that company enable it to exercise influence over the amount of the tax to be paid.

24 Fourthly, a series of amendments made the conditions stricter for the application of the 'de minimis' exception, the exception based on an acceptable distribution policy, the exception connected with exempt activities and that relating to excluded countries.

The dispute in the main proceedings and the questions referred for a preliminary ruling

25 The main proceedings take the form of 'group litigation' relating to the provisions of the United Kingdom's tax legislation on dividends and CFCs. Those proceedings consist of claims brought by 21 groups of international companies against the tax authority of the United Kingdom in the Chancery Division of the High Court of Justice of England and Wales. The claims of three groups of companies, namely Anglo American, Cadbury Schweppes and Prudential, were selected as test cases.

26 Before the national court, Anglo American and Cadbury Schweppes claim that they complied with the United Kingdom's tax provisions on CFCs and dividends, whereas, had they been aware that those provisions were contrary to Community law, they would not have paid corporation tax on dividends received from, or profits made by, CFCs. Nor would they have deducted from their tax certain reliefs, which would thus have been available for other purposes or could have been carried forward, nor paid dividends for the purposes of obtaining the acceptable distribution policy exemption, since such payments were not in their commercial interest or since the timing of the payment required to meet the conditions laid down by the legislation on CFCs as regards that exemption exposed the group to less favourable tax treatment. They would not, finally, have undertaken the work or incurred the expenses necessary to comply with the legislation on CFCs and would not have restricted the business activities of the CFCs in compliance with that legislation.

27 In that regard, Anglo American and Cadbury Schweppes claim, before the national court, restitution of the sums wrongly paid and/or compensation for the losses resulting from the provisions of the legislation on CFCs and dividends, as well as the expenses incurred in complying with those provisions.

28 Before the national court, Prudential's claim deals with the taxation, in the hands of certain resident companies, of dividends received from non-resident companies, in which the former owned, for investment purposes, portfolio holdings representing less than 10% of the voting power, with the result that those resident companies were not subject to the legislation on CFCs.

29 In that regard, Prudential claims, before the national court, restitution of the sums wrongly paid and/or compensation for the loss resulting from the taxation, in application of the United Kingdom's tax legislation on dividends, of dividends received from companies established in other Member States and third countries.

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

'(1) Is it contrary to Articles 43 EC or 56 EC for a Member State to keep in force and apply measures which:

(a) exempt from corporation tax dividends received by a company resident in that Member State ("the resident company") from other resident companies; but which

(b) subject to corporation tax dividends received by the resident company from a company resident in another Member State and in particular a company controlled by it resident in another Member State and subject to a lower level of taxation there ("the controlled company"), after giving double taxation relief for any withholding tax payable on the dividend and for the underlying tax paid by the controlled company on its profits?

(2) Do Articles 43 EC, 49 EC or 56 EC preclude national tax legislation [in a Member State] such as that in issue in the main proceedings under which, prior to 1 July 1997:

(a) certain dividends received by an insurance company resident in a Member State from a company resident in another Member State ("the non-resident company") were chargeable to corporation tax; but

(b) the resident insurance company was allowed to elect that corresponding dividends received from a company resident in the same Member State should not be chargeable to corporation tax, with the further consequence that a company which had made the election was unable to claim payment of the tax credit to which it would otherwise have been entitled?

(3) Do Articles 43 EC, 49 EC or 56 EC preclude national tax legislation in a Member State such as that in issue in the main proceedings which:

(a) provides in specified circumstances for the imposition of a charge to tax upon the resident company in respect of the profits of a controlled company being a company resident in another Member State as defined in Question 1(b) above; and

(b) imposes certain compliance requirements where the resident company does not seek or is not able to claim any exemption and pays tax in respect of the profits of that controlled company; and

(c) imposes further compliance requirements where the resident company seeks to obtain exemption from that tax?

(4) Would the answer to Questions 1, 2 or 3 be different if the controlled company (in Questions 1 and 3) or the non-resident company (in Question 2) was resident in a third country?

(5) Where, prior to 31 December 1993, a Member State adopted the measures outlined in Questions 1, 2 and 3, and after that date amended those measures in the manner described in [the decision making the reference], and if those measures as amended constitute restrictions prohibited by Article 56 EC, are those restrictions to be taken to be restrictions which did not exist on the 31 December 1993 for the purposes of Article 57 EC?

(6) In the event that any of the measures referred to in Questions 1, 2 and 3 are contrary to the Community provisions referred to, then in circumstances where the resident company and/or the controlled company make any of the following claims:

(a) a claim for repayment of (or the loss of use of money paid as) corporation tax unlawfully levied on the resident company in the circumstances referred to in Questions 1, 2 or 3 above;

(b) a claim for restitution and/or compensation in respect of losses, reliefs and expenses that were used by the resident company (or surrendered to the resident company by other companies in the same group resident in the same Member State) to eliminate or reduce taxation charges incurred by virtue of the measures referred to in Questions 1, 2 and 3 above where such losses, reliefs and expenses would have been available for alternative use or could have been carried forward;

(c) a claim for compensation for costs, losses, expenses and liabilities incurred in complying with the domestic legislation referred to in Question 3 above;

(d) where a controlled company has distributed reserves to the resident company to meet the requirements of the national legislation as an alternative to the resident company incurring the charge referred to in Question 3, and the controlled company has incurred costs, expenses and liabilities in doing so which it could have avoided had it been able to put those reserves to alternative use, a claim for compensation for those costs, expenses and liabilities,

are such claims to be regarded as:

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

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

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

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

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

(b) must some or all of the conditions for recovery laid down in ... *Brasserie du Pêcheur and Factortame*[, cited above,] be satisfied; or

(c) must some other conditions be met?

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

(9) What guidance, if any, does the Court of Justice think it appropriate to provide in the present cases as to which circumstances the national court ought to take into consideration when it comes to determine whether there is a sufficiently serious breach within the meaning of the judgment in ... *Brasserie du Pêcheur*

and Factortame, in particular as to whether, given the state of the case-law on the interpretation of the relevant Community provisions, the breach was excusable?

(10) As a matter of principle, can there be a direct causal link (within the meaning of the judgment in … *Brasserie du Pêcheur and Factortame*) between any breach of Articles 43 EC, 49 EC and 56 EC and the losses falling into the categories identified in Question 6(a) to (d) above that are claimed to flow from it? If so, what guidance, if any, does the Court of Justice think it appropriate to provide as to the circumstances which the national court should take into account in determining whether such a direct causal link exists?

(11) In determining the loss or damage for which reparation may be granted, is it open to the national court to have regard to the question of whether injured persons showed reasonable diligence in order to avoid or limit their loss, in particular by availing themselves of legal remedies which could have established that the national provisions did not (by reason of the application of [DTCs]) have the effect of imposing the obligations set out in Questions 1, 2 and 3 above?

(12) Is the answer to Question 11 above affected by the beliefs of the parties at the relevant times as to the effect of the [DTCs]?'

31 Since, in the present case, questions of interpretation similar to those covered by the questions referred for a preliminary ruling in the cases which, in due course, gave rise to the judgments in Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995; Case C-374/04 *Test Claimants in Class IV of the ACT*

Group Litigation [2006] ECR I-11673; Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753; and Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, the proceedings were, by decision of the President of the Court of Justice of 13 December 2005, stayed pending the decision of the Court of Justice in those cases.

32 The above-cited judgments in *Cadbury Schweppes and Cadbury Schweppes Overseas*, *Test Claimants in Class IV of the ACT Group Litigation*, *Test Claimants in the FII Group Litigation* and *Test Claimants in the Thin Cap Group Litigation* were communicated to the referring court by letter of 3 April 2007, so that it could inform the Court whether, in the light of those judgments, it wished to maintain its reference for a preliminary ruling.

33 By letter of 12 June 2007, the referring court informed the Court that it was maintaining its reference.

The questions referred for a preliminary ruling

34 Under the first subparagraph of Article 104(3) of the Rules of Procedure, where a question referred to the Court for a preliminary ruling is identical to a question on which the Court has already ruled, or where the answer to such a question may be clearly deduced from existing case-law, the Court may, after hearing the Advocate General, at any time give its decision by reasoned order.

The first question

35 By its first question, the national court is asking, in essence, whether Articles 43 EC and 56 EC preclude legislation of a Member State which exempts from corporation tax dividends received by a resident company from a company which is also resident in that State ('nationally-sourced dividends'), when it imposes that tax on dividends received by a resident company from a company which is not resident in that State ('foreign-sourced dividends'), particularly if it is a non-resident company controlled by that resident company, while granting relief for all withholding tax levied in the State in which the company making the distribution is resident and, where the resident company receiving the dividends holds, directly or indirectly, not less than 10% of the voting power in the company making the distribution, relief against corporation tax paid by the company making the distribution on the profits underlying the dividends distributed.

36 The Court has already examined that question in *Test Claimants in the FII Group Litigation*, cited above. Consequently, the reply given by the Court in that judgment is fully applicable to the first question referred by the national court in this case.

37 In that judgment, the Court observed that Community law does not, in principle, prohibit a Member State from avoiding the imposition of a series of charges to tax on dividends received by a resident company by applying rules which exempt those dividends from tax when they are paid by a resident company, while preventing, through an imputation system, those dividends from being liable to a series of charges to tax when they are paid by a non-resident company (*Test Claimants in the FII Group Litigation*, paragraph 48).

38 As regards, in the first place, dividends received by a resident company from a non-resident company in which it has a shareholding enabling it to exercise a definite influence over the decisions of that non-resident company and to determine its activities, the Court held that the fact that nationally-sourced dividends are subject to an exemption system and foreign-sourced dividends are subject to an imputation system does not contravene the principle of freedom of establishment laid down under Article 43 EC, provided that the tax rate applied to foreign-sourced dividends is not higher than the rate applied to nationally-sourced dividends and that the tax credit is at least equal to the amount paid in the Member State of the company making the distribution, up to the limit of the tax charged in the Member State of the company receiving the dividends (*Test Claimants in the FII Group Litigation*, paragraph 57).

39 With respect, in the second place, to dividends paid to resident companies by a company in which they hold 10% or more of the voting rights, without that holding conferring on them a definite influence over the decisions of that company or allowing them to determine its activities, it follows from the Court's case-law that, in the case of the national legislation at issue in the main proceedings, the fact that nationally-sourced dividends are subject to an exemption system and foreign-sourced dividends are subject to an imputation system does not contravene the principle of free movement of capital laid down under Article 56 EC, provided that the tax rate applied to foreign-sourced dividends is not higher than the rate applied to nationally-sourced dividends and that the tax credit is at least equal to the amount paid in the Member State of the company making the distribution, up to the limit of the tax charged in the Member State of the company receiving the dividends (see, to that effect, *Test Claimants in the FII Group Litigation*, paragraph 60).

40 As regards, thirdly and lastly, resident companies which received dividends from companies in which they hold fewer than 10% of the voting rights, after noting that nationally-sourced dividends are exempt from corporation tax, whilst foreign-sourced dividends are subject to that tax and are entitled to relief only as regards any withholding tax charged on those dividends in the State in which the company

making the distribution is resident (*Test Claimants in the FII Group Litigation*, paragraph 61), the Court held that the difference in treatment arising from legislation such as that at issue in the main proceedings as regards dividends received by resident companies from non-resident companies in which they hold fewer than 10% of the voting rights constitutes a restriction on the free movement of capital which is, in principle, prohibited by Article 56 EC (*Test Claimants in the FII Group Litigation*, paragraph 65).

41 The Court went on to hold that the mere fact that it is for a Member State to determine for such holdings whether, and to what extent, the imposition of a series of charges to tax on distributed profits is to be avoided does not of itself mean that it may operate a system under which foreign-sourced dividends and nationally-sourced dividends are not treated in the same way (*Test Claimants in the FII Group Litigation*, paragraph 69), and that, irrespective of the fact that a Member State may, in any event, choose between a number of systems in order to prevent or mitigate the imposition of a series of charges to tax on distributed profits, the difficulties that may arise in determining the tax actually paid in another Member State cannot justify a restriction on the free movement of capital such as that which arises under the legislation at issue in the main proceedings (*Test Claimants in the FII Group Litigation*, paragraph 70).

42 Therefore, the Court held that Article 56 EC precludes legislation of a Member State which exempts from corporation tax dividends which a resident company receives from another resident company, where that State levies corporation tax on dividends which a resident company receives from a non-resident company in which it holds less than 10% of the voting rights, without granting the company receiving the dividends a tax credit for the tax actually paid by the company making the distribution in the State in which the latter is resident (*Test Claimants in the FII Group Litigation*, paragraph 74).

43 Having regard to the foregoing, the reply to the first question must be:

— Article 43 EC is to be interpreted as meaning that it does not preclude legislation of a Member State which exempts from corporation tax dividends which a resident company receives from another resident company, when that State imposes corporation tax on dividends which a resident company receives from a non-resident company in which the resident company has a shareholding enabling it to exercise a definite influence over the decisions of that non-resident company and to determine its activities, while at the same time granting a tax credit for the tax actually paid by the company making the distribution in the Member State in which it is resident, provided that the rate of tax applied to foreign-sourced dividends is no higher than the rate of tax applied to nationally-sourced dividends and that the tax credit is at least equal to the amount paid in the Member State of the company making the distribution, up to the limit of the amount of the tax charged in the Member State of the company receiving the distribution;

— Article 56 EC is to be interpreted as meaning that it does not preclude legislation of a Member State which exempts from corporation tax dividends which a resident company receives from another resident company, when that State imposes corporation tax on dividends which a resident company receives from a non-resident company in which the resident company holds at least 10% of the voting rights, while granting a tax credit for the tax actually paid by the company making the distribution in the Member State in which it is resident, provided that the rate of tax applied to foreign-sourced dividends is no higher than the rate of tax applied to nationally-sourced dividends and that the tax credit is at least equal to the amount paid in the Member State of the company making the distribution, up to the limit of the amount of the tax charged in the Member State of the company receiving the distribution;

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

The second question

44 By its second question, the national court is asking the Court, in essence, whether Articles 43 EC, 49 EC or 56 EC are to be interpreted as meaning that they preclude legislation of a Member State which allows an exemption from corporation tax for certain dividends received from resident companies by resident insurance companies but excludes such an exemption for similar dividends received from non-resident companies.

45 In that regard, it is clear from the case-law that freedom of establishment includes the right to set up and manage undertakings, in particular companies or firms, in a Member State by a national of another Member State. So, a national of a Member State who has a holding in the capital of a company established in another Member State which gives him definite influence over the company's decisions and allows him to determine its activities is exercising his right of establishment (Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 22; *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 31; and *Test Claimants in the Thin Cap Group Litigation*, paragraph 27).

46 In principle, the acquisition by one or more persons residing in a Member State of shares in a company incorporated and established in another Member State, where such a shareholding does not confer on those persons definite influence over the company's decisions or allow them to determine its activities, falls within the scope

of the provisions of the EC Treaty on the free movement of capital (see, to that effect, *Baars*, cited above, paragraph 22; *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 31; and *Test Claimants in the Thin Cap Group Litigation*, paragraph 27).

47 In this case, it is clear from the order making the reference that the claimants in the main proceedings who are subject to the legislation in question in connection with the second question referred did not own a controlling shareholding in the capital of the companies from which they received dividends, but only a portfolio holding, held for investment purposes, of less than 10%.

48 There is therefore no need to reply to the second question in so far as it refers to Article 43 EC.

49 The same applies in so far as that question refers to Article 49 EC.

50 Indeed, Article 50 EC provides that services are to be considered to be 'services' within the meaning of the Treaty where they are normally provided for remuneration, in so far as they are not governed by the provisions relating to the free movement of capital.

51 Consequently, since the receipt of dividends on shares in a company established in a Member State by a national of another Member State is indissociable from a capital movement (Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraphs 29 and 30), that transaction is not covered by Article 49 EC.

52 The questions referred should therefore be answered in the light of Article 56 EC alone.

53 In that respect, the measures prohibited by Article 56(1) EC, as restrictions on the movement of capital, include those which are likely to discourage non-residents from making investments in a Member State or to discourage that Member State's residents from doing so in other Member States (see Case C-513/03 *van Hilten-van der Heijden* [2006] ECR I-1957, paragraph 44; Case C-370/05 *Festersen* [2007] ECR I-1129, paragraph 24; and Case C-101/05 *A* [2007] ECR I-11531, paragraph 40).

54 For the purposes of the legislation applicable to the main proceedings, section 208 of ICTA does not apply, as a rule, either to pensions business or overseas life assurance business, with the result that dividends from portfolio investments linked to such business are subject to United Kingdom tax. While, prior to 1 July 1997, a life insurance company could, by way of exception, elect that that section would apply as regards dividends received from resident companies as part of its pensions business, such an election was not, on the other hand, possible as regards dividends received from non-resident companies as part of such business.

55 Such a system would be contrary to Article 56 EC, if dividends paid by companies established in another Member State to insurance companies established in the United Kingdom were treated, for tax purposes, less favourably than those paid by companies established in the United Kingdom (see, to that effect, *Verkooijen*, cited above, paragraphs 34 to 38, and *Test Claimants in the FII Group Litigation*, paragraph 64).

56 In that regard, it is not apparent from the decision making the reference whether, in light of the fact that the permitted election, as regards dividends of national origin, entailed the waiver of tax credits, a company receiving dividends of foreign origin, which could not exercise such an election, was treated less favourably because of that fact alone.

57 It is for the national court to establish whether such was the case.

58 On the other hand, since it is clear from the decision making the reference that companies with a less than 10% shareholding in the company making the distribution were not entitled to relief in respect of corporation tax paid by that company in the Member State in which it was resident, those companies were, contrary to Article 56 EC, subject to less favourable tax treatment.

59 According to the United Kingdom Government, it is legitimate and proportionate to restrict the availability of the corporation tax relief granted to resident companies to the amount of any withholding tax levied on the dividend. Practical obstacles would preclude a company with a less than 10% shareholding in the company making the distribution from benefiting from a tax credit corresponding to the tax actually paid by the latter. Unlike a tax credit given in respect of withholding tax, such a tax credit could be granted only after lengthy and complex checks had been carried out. It is therefore legitimate to set a threshold by reference to the size of the relevant shareholding.

60 It is true that, when introducing mechanisms designed to prevent or mitigate distributed profits being liable to a series of charges to tax, it is in principle for Member States to determine the category of taxpayers entitled to benefit from those mechanisms and, for that purpose, to set thresholds based on the shareholdings which

taxpayers have in the companies making the distributions in question. It is only in the case of Member State companies having a minimum shareholding of 25% in a company of another Member State that Article 4 of Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries in different Member States (OJ 1990 L 225, p. 6), read in conjunction with Article 3, in the version in force at the time of the events in the main proceedings, requires Member States, if they do not exempt profits received by a resident parent company from a subsidiary resident in another Member State, to authorise the parent company to deduct from the amount of tax due not only the amount of the withholding tax levied by the Member State in which the subsidiary is resident, but also the fraction of the tax paid by the subsidiary which relates to those profits (*Test Claimants in the FII Group Litigation*, paragraph 67).

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

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

63 Furthermore, irrespective of the fact that a Member State may, in any event, choose between a number of systems in order to prevent or mitigate the imposition of a

series of charges to tax on distributed profits, the difficulties that may arise in determining the tax actually paid in another Member State cannot justify a restriction on the free movement of capital such as that which arises under the legislation at issue in the main proceedings (*Test Claimants in the FII Group Litigation*, paragraph 70 and the case-law cited).

64 In this case, the United Kingdom Government contends, on the other hand, that such a difference in treatment is justified by the need to ensure the cohesion of the tax system.

65 Admittedly, it follows from the case-law that the need to safeguard the coherence of the tax system could justify a restriction on the exercise of the fundamental freedoms guaranteed by the Treaty (Case C-204/90 *Bachmann* [1992] ECR I-249, paragraph 28, and Case C-300/90 *Commission* v *Belgium* [1992] ECR I-305, paragraph 21).

66 However, it is also clear from the case-law that, for an argument based on such a justification to succeed, a direct link must be established between the tax concession concerned and the offsetting of that concession by a particular tax levy (see, to that effect, *Verkooijen*, paragraph 57; Case C-315/02 *Lenz* [2004] ECR I-7063, paragraph 35; Case C-386/04 *Centro di Musicologia Walter Stauffer* [2006] ECR I-8203, paragraph 53; and *Test Claimants in the FII Group Litigation*, paragraph 93).

67 While the tax legislation in question in the main proceedings rests on the basis of a link between the tax advantage and the corresponding levy by providing for a tax credit for dividends received from a non-resident company in which the resident

parent company holds not less than 10% of the voting power, the need for such a direct link must in fact lead to the same tax advantage being granted to companies receiving dividends from non-resident companies, in which the resident parent company holds less than 10% of the voting power, since those companies are also obliged to pay corporation tax on distributed profits in the State in which they are resident (see, to that effect, *Test Claimants in the FII Group Litigation*, paragraph 93).

68 Therefore, the restriction noted in paragraph 58 of the present order cannot be justified by the need to ensure the cohesion of the tax system.

69 Accordingly, the reply to the second question must be that Article 56 EC is to be interpreted as meaning that it precludes legislation of a Member State which allows an exemption from corporation tax for certain dividends received from resident companies by resident insurance companies but excludes such an exemption for similar dividends received from non-resident companies, in so far as it entails less favourable treatment of the latter dividends.

The third question

70 By its third question, the national court is asking the Court, in essence, whether Articles 43 EC, 49 EC or 56 EC are to be interpreted as precluding legislation of a Member State which provides for the inclusion in the tax base of a resident company established in a Member State of profits made by a CFC in another Member State, where those profits are subject in that State to a lower level of taxation than that applicable in the former State and which imposes certain compliance requirements where the resident company seeks exemption from taxes already paid on the profits of that controlled company in the State in which it is resident.

71 In the first place, in *Cadbury Schweppes and Cadbury Schweppes Overseas*, the Court has already had to consider the first part of that question, and, consequently, the reply given by the Court in that judgment is fully applicable in the present case.

72 In that judgment, the Court held that, since the legislation on CFCs concerns the taxation, under certain conditions, of the profits of subsidiary companies established outside the United Kingdom in which a resident company has a controlling holding, that legislation must be examined in the light of Articles 43 EC and 48 EC (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 32).

73 If it were to be accepted that that legislation has restrictive effects on the freedom to provide services and the free movement of capital, such effects must be seen as an unavoidable consequence of any restriction on freedom of establishment and do not, in any event, justify an independent examination of that legislation taking Articles 49 EC and 56 EC into account (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 33).

74 The Court then noted that the legislation on CFCs involves a difference in the treatment of resident companies on the basis of the level of taxation imposed on the company in which they have a controlling holding and that that difference in treatment creates a tax disadvantage for the resident company to which the legislation on CFCs is applicable (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraphs 43 and 45).

75 Therefore, the Court held that the separate tax treatment under the legislation on CFCs and the resulting disadvantage for resident companies which have a subsidiary subject, in another Member State, to a lower level of taxation are such as to hinder the exercise of freedom of establishment by such companies, dissuading them from

establishing, acquiring or maintaining a subsidiary in a Member State in which the latter is subject to such a level of taxation and that they therefore constitute a restriction on freedom of establishment within the meaning of Articles 43 EC and 48 EC (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 46).

76 However, a national measure restricting freedom of establishment may be justified where it specifically targets wholly artificial arrangements designed to circumvent the legislation of the Member State concerned (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 51 and the case-law cited).

77 It follows that, for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements, which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 55).

78 In order to find that there is such an arrangement there must be, in addition to a subjective element consisting in the intention to obtain a tax advantage, objective circumstances showing that, despite formal observance of the conditions laid down by Community law, the objective pursued by freedom of establishment has not been achieved (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 64 and the case-law cited).

79 In those circumstances, in order for the legislation on CFCs to comply with Community law, the taxation provided for by that legislation must be excluded where, despite the existence of tax motives, the incorporation of a CFC reflects economic reality.

That finding must be based on objective factors which are ascertainable by third parties with regard, in particular, to the extent to which the CFC physically exists in terms of premises, staff and equipment (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraphs 65 and 67).

80 In this case, it is for the national court to determine whether, as maintained by the United Kingdom Government, the motive test, as defined by the legislation on CFCs, lends itself to an interpretation which enables the taxation provided for by that legislation to be restricted to wholly artificial arrangements or whether, on the contrary, the criteria on which that test is based mean that, where none of the exceptions laid down by that legislation applies and the intention to obtain a reduction in United Kingdom tax is central to the reasons for incorporating the CFC, the resident parent company comes within the scope of application of that legislation, despite the absence of objective evidence which could indicate the existence of an arrangement of that nature. In the first case, the legislation on CFCs should be regarded as being compatible with Articles 43 EC and 48 EC. In the second case, on the other hand, the view should be taken that that legislation is contrary to Articles 43 EC and 48 EC (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraphs 72 to 74).

81 In the light of the preceding considerations, Articles 43 EC and 48 EC must be interpreted as precluding the inclusion in the tax base of a resident company established in a Member State of profits made by a CFC in another Member State, where those profits are subject in that State to a lower level of taxation than that applicable in the first State, unless such inclusion relates only to wholly artificial arrangements intended to escape the national tax normally payable. Accordingly, such a tax measure must not be applied where it is proven, on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives, that CFC is actually established in the host Member State and carries on genuine economic activities there (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 75).

82 As regards, secondly, compliance requirements to which the exemption for a CFC's profits in the hands of a resident company is subject, it is appropriate to point out, first, that in *Cadbury Schweppes and Cadbury Schweppes Overseas*, the Court held that the resident company is best placed to establish that it has not entered into wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory and that it must be given an opportunity to produce evidence that the CFC is actually established and that its activities are genuine (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 70).

83 In the present context, those compliance requirements are inherent in the assessment, referred to in paragraph 81 of the present order, on which the compatibility of the legislation on CFCs rests.

84 Secondly, in *Test Claimants in the Thin Cap Group Litigation*, the Court held that national legislation which provides for a consideration of objective and verifiable elements in order to determine whether a transaction represents a purely artificial arrangement, entered into for tax reasons alone, is to be considered as not going beyond what is necessary to prevent abusive practices where, on each occasion on which the existence of such an arrangement cannot be ruled out, the taxpayer is given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that arrangement (*Test Claimants in the Thin Cap Group Litigation*, paragraph 82).

85 Consequently, Articles 43 EC and 48 EC are to be interpreted as not precluding tax legislation of a Member State which imposes certain compliance requirements where the resident company seeks exemption from taxes already paid on the profits of that CFC in the State in which it is resident, provided that the aim of those requirements is to verify that the CFC is actually established and that its economic activities are genuine without that entailing undue administrative constraints.

86 The reply to the third question must therefore be:

— Articles 43 EC and 48 EC must be interpreted as precluding the inclusion in the tax base of a resident company established in a Member State of profits made by a CFC in another Member State, where those profits are subject in that State to a lower level of taxation than that applicable in the first State, unless such inclusion relates only to wholly artificial arrangements intended to escape the national tax normally payable;

— accordingly, such a tax measure must not be applied where it is proven, on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives, that CFC is actually established in the host Member State and carries on genuine economic activities there;

— however, Articles 43 EC and 48 EC are to be interpreted as not precluding national tax legislation which imposes certain compliance requirements where the resident company seeks exemption from taxes already paid on the profits of that CFC in the State in which it is resident, provided that the aim of those requirements is to verify that the CFC is actually established and that its activities are genuine without that entailing undue administrative constraints.

The fourth question

87 By its fourth question, the national court is asking the Court whether the answers to the first to third questions would be different were the non-resident company established in a non-member country.

88 In that regard, it should be noted, first, that the chapter of the Treaty concerning the freedom of establishment does not include any provision extending the application of its provisions to situations which involve the establishment of a company of a Member State in a non-member country (see, to that effect, Case C-102/05 *A and B* [2007] ECR I-3871, paragraph 29, and Case C-157/05 *Holböck* [2007] ECR I-4051, paragraph 28).

89 There is therefore no need, in the light of the answers given to the first to third questions, to reply to the fourth question, other than in respect of measures which Article 56 EC precludes.

90 In that regard, it should be noted that Article 56(1) EC gave effect to the liberalisation of capital movements between the Member States and between Member and non-member States. To that end, it provides, in the chapter of the Treaty entitled 'Capital and payments', that all restrictions on the movement of capital between Member States and between Member and non-member States are prohibited (Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera and Others* [1995] ECR I-4821, paragraph 19; *van Hilten-van der Heijden*, cited above, paragraph 37; and *A*, cited above, paragraph 20).

91 Furthermore, the Court has already held that, as regards the movement of capital between Member and non-member States, Article 56(1) EC, in conjunction with Articles 57 EC and 58 EC, may be relied on before national courts and may render national rules that are inconsistent with it inapplicable, irrespective of the category of capital movement in question (*A*, paragraph 27).

92 Admittedly, it is clear from the case-law of the Court that the extent to which the Member States are authorised to apply certain restrictive measures on the movement

of capital cannot be determined without taking account of the fact that movement of capital to or from third countries takes place in a different legal context from that which occurs within the Community. Accordingly, because of the degree of legal integration that exists between Community Member States, in particular by reason of the presence of Community legislation which seeks to ensure cooperation between national tax authorities, such as Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (OJ 1977 L 336, p. 15), the taxation by a Member State of economic activities having cross-border aspects which take place within the Community is not always comparable to that of economic activities involving relations between Member States and third countries (*Test Claimants in the FII Group Litigation*, paragraph 170).

93 It may also be that a Member State will be able to demonstrate that a restriction on the movement of capital to or from third countries is justified for a particular reason in circumstances where that reason would not constitute a valid justification for a restriction on capital movements between Member States (*A*, paragraphs 36 and 37).

94 As regards the grounds advanced by the United Kingdom Government to justify the national measures to which the first and second questions refer, particularly the need to ensure the cohesion of the tax system, that Government put forward no evidence explaining how those grounds justify those measures in relations between a Member State and non-member countries.

95 Moreover, as regards the difficulties associated with the verification of compliance with certain requirements by companies established in third countries, the Court decided, in the context of the free movement of capital, that, where the legislation of a Member State makes the grant of a tax advantage dependent on satisfying requirements, compliance with which can be verified only by obtaining information from the competent authorities of a third country, it is, in principle, legitimate for that Member State to refuse to grant that advantage if, in particular, because that third

country is not under any contractual obligation to provide information, it proves impossible to obtain such information from that country (*A*, paragraph 63).

96 Therefore, it follows from that judgment that Articles 56 EC to 58 EC are to be interpreted as not precluding the legislation of a Member State under which a tax concession in respect of dividends may be granted only if the distributing company is established in a State within the European Economic Area or a State with which a taxation convention providing for the exchange of information has been concluded by the Member State imposing the tax, where that concession is subject to conditions compliance with which can be verified by the competent authorities of that Member State only by obtaining information from the State of establishment of the distributing company (see, to that effect, *A*, paragraph 67).

97 Having regard to the foregoing considerations, the reply to the fourth question referred for a preliminary ruling must be that Articles 56 EC to 58 EC are to be interpreted as not precluding the legislation of a Member State which grants a corporation tax concession in respect of certain dividends received from resident companies by resident companies but excludes such a concession for dividends received from companies established in a non-member country particularly where the grant of that concession is subject to conditions compliance with which can be verified by the competent authorities of that Member State only by obtaining information from the non-member country where the distributing company is established.

The fifth question

98 By its fifth question, the national court is asking, in essence, whether, where a Member State adopted, prior to 31 December 1993, the measures outlined in the

first to third questions and, after that date, amended those measures in the manner described in the decision making the reference and, if those measures, as amended, constitute restrictions prohibited by Article 56 EC, are those restrictions to be taken to be restrictions which did not exist on 31 December 1993 for the purposes of Article 57 EC.

99 In that regard, first, pursuant to Article 57(1) EC, the provisions of Article 56 EC are without prejudice to the application to third countries of any restrictions which existed on 31 December 1993 under national or Community law adopted in respect of the movement of capital to or from third countries involving direct investment — including in real estate —, establishment, the provision of financial services or the admission of securities to capital markets.

100 There is therefore no need, in the light of the answers given to the first to third questions, to reply to the fifth question, other than in respect of measures which Article 56 EC precludes.

101 On the basis of the information provided by the national court as to the national legal provisions applicable in the main proceedings, the fifth question arises, as the Commission pointed out in the observations it submitted to the Court, only in relation to the third question.

102 As regards the national measures held to be contrary to Article 56 EC in the answers given to the first and second questions, the referring court provides no information enabling it to be established whether those measures were adopted before 31 December 1993 and amended after that date in a way that might be relevant for the purposes of applying Article 57(1) EC.

103 There is therefore no need to reply to the fifth question in so far as it refers to the first and second questions.

104 As regards, secondly, the fifth question in so far as it refers to the third question, it must be recalled that, in the answer given to the latter question in the present order, it was stated that since the legislation on CFCs concerns the taxation, under certain conditions, of the profits of subsidiary companies established outside the United Kingdom in which a resident company has a controlling holding, that legislation must be examined in the light of Articles 43 EC and 48 EC.

105 Thus, first, the answer given by the Court to the third question makes no reference whatsoever to Article 56 EC.

106 Secondly, should the national measures held to be contrary to Articles 43 EC and 48 EC, in the answer given by the Court to the third question, have restrictive effects on the free movement of capital, those effects should be regarded as the unavoidable consequence of such an obstacle to freedom of establishment as there might be, and do not therefore justify an examination of those measures from the point of view of Articles 56 EC to 58 EC (see, to that effect, *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 33; Case C-452/04 *Fidium Finanz* [2006] ECR I-9521, paragraphs 48 and 49; *Test Claimants in the Thin Cap Group Litigation*, paragraph 34; and *A and B*, cited above, paragraph 27).

107 Consequently, there is no need to reply to the fifth question in so far as it refers to the third question.

The sixth to twelfth questions

108 By its sixth to twelfth questions, which should be considered together, the national court is asking the Court, in essence, whether, in the event that the national measures referred to in the preceding questions are incompatible with Community law, claims such as those brought by the claimants in the main proceedings in order to remedy such an incompatibility must be classified as actions for restitution of sums unduly levied or advantages unduly refused or, conversely, as claims for compensation in respect of damage suffered. In the latter case, the national court asks whether it is necessary to satisfy the conditions laid down in paragraphs 51 and 66 of the judgment in *Brasserie du Pêcheur and Factortame*, and whether account must be taken, in that regard, of the form in which such claims must be brought under national law.

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

110 The national court also asks whether, in determining the losses which are to be reimbursed or in respect of which compensation is to be provided, it is appropriate to have regard to the question whether the injured parties showed reasonable diligence in order to avoid the alleged losses, in particular in bringing actions before the courts.

111 The Court has had the occasion to point out that it is not for it to assign a legal classification to the actions brought before the national court by the claimants in the main proceedings. It is for the latter to specify the nature and basis of their actions

(whether they are actions for restitution or actions for compensation for damage), subject to the supervision of the national court (*Test Claimants in the FII Group Litigation*, paragraph 201, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 109).

112 The Court has also noted that, according to well-established case-law, the right to a refund of charges levied in a Member State in breach of the rules of Community law is the consequence and complement of the rights conferred on individuals by Community provisions as interpreted by the Court and that the Member State is therefore required in principle to repay charges levied in breach of Community law (*Test Claimants in the FII Group Litigation*, paragraph 202, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 110).

113 Indeed, in the absence of Community rules on the refund of national charges levied though not due, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive from Community law, provided, first, that such rules are not less favourable than those governing similar domestic actions (principle of equivalence) and, secondly, that they do not render virtually impossible or excessively difficult the exercise of rights conferred by Community law (principle of effectiveness) (*Test Claimants in the FII Group Litigation*, paragraph 203, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 111).

114 In addition, where a Member State has levied charges in breach of the rules of Community law, individuals are entitled to reimbursement not only of the tax unduly levied but also of the amounts paid to that State or retained by it which relate directly to that tax. That also includes losses constituted by the unavailability of sums of money as a result of a tax being levied prematurely (*Test Claimants in the FII Group Litigation*, paragraph 205, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 112).

115 However, the Court stated that neither the reliefs or other tax advantages waived by a resident company in order to be able to offset in full a tax levied unlawfully against an amount due in respect of another tax, nor the expenses incurred by the companies in that group in order to comply with the national legislation at issue, can form the basis of an action under Community law for the reimbursement of the tax unlawfully levied or of sums paid to the Member State concerned or withheld by it directly against that tax (*Test Claimants in the Thin Cap Group Litigation*, paragraph 113).

116 In the circumstances of the present case, such expenditure is the result of decisions taken by the claimants in the main proceedings and cannot therefore constitute, on their part, an inevitable consequence of the application of the United Kingdom tax legislation on dividends and CFCs (see, to that effect, *Test Claimants in the FII Group Litigation*, paragraph 207, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 113).

117 It is therefore for the national court to determine whether the expenditure referred to in paragraph 114 of the present order represents, in the case of the companies concerned, financial losses suffered by reason of a breach of Community law for which the Member State in question is responsible (see, to that effect, *Test Claimants in the FII Group Litigation*, paragraph 208, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 114).

118 The Court has also observed that, while it has not gone so far as to rule out the possibility of a State being liable in less restrictive conditions on the basis of national law, there are three conditions under which a Member State will be liable to make reparation for loss and damage caused to individuals as a result of breaches of Community law for which it can be held responsible, namely that the rule of law infringed must be intended to confer rights on individuals, that the breach must be sufficiently

serious, and that there must be a direct causal link between the breach of the obligation resting on the State and the loss or damage sustained by the injured parties (*Test Claimants in the FII Group Litigation*, paragraph 209, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 115).

119 In that regard, it is, in principle, for the national courts to apply the criteria for establishing the liability of Member States for damage caused to individuals by breaches of Community law, in accordance with the guidelines laid down by the Court for the application of those criteria (*Test Claimants in the FII Group Litigation*, paragraph 210, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 116).

120 So far as concerns the legislation at issue in the main proceedings, the first condition is plainly satisfied as regards Articles 43 EC and 56 EC. Those provisions confer rights on individuals (*Test Claimants in the FII Group Litigation*, paragraph 211, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 117).

121 As regards the second condition laid down, the Court pointed out, first, that a breach of Community law will be sufficiently serious where, in the exercise of its legislative power, a Member State has manifestly and gravely disregarded the limits on its discretion. Secondly, where, at the time when it committed the infringement, the Member State in question had only considerably reduced, or even no, discretion, the mere infringement of Community law may be sufficient to establish the existence of a sufficiently serious breach (*Test Claimants in the FII Group Litigation*, paragraph 212, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 118).

122 In order to determine whether a breach of Community law is sufficiently serious, it is necessary to take account of all the factors which characterise the situation brought before the national court. Those factors include, in particular, the clarity and precision of the rule infringed, whether the infringement and the damage caused were intentional or involuntary, whether any error of law was excusable or inexcusable, and the fact that the position taken by a Community institution may have contributed to the adoption or maintenance of national measures or practices contrary to Community law (*Test Claimants in the FII Group Litigation*, paragraph 213, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 119).

123 On any view, the Court has already stated that a breach of Community law will clearly be sufficiently serious if it has persisted despite a judgment finding the infringement in question to be established, or a preliminary ruling or settled case-law of the Court on the matter, from which it is clear that the conduct in question constituted an infringement (*Test Claimants in the FII Group Litigation*, paragraph 214, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 120).

124 In the present case, in order to determine whether a breach of Article 43 EC or Article 56 EC committed by the Member State concerned is sufficiently serious, the national court must take into account the fact that, in a field such as direct taxation, the consequences arising from the freedoms of movement guaranteed by the Treaty have been only gradually made clear (*Test Claimants in the FII Group Litigation*, paragraph 215, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 121).

125 As regards the third condition, namely the requirement for a direct link between the breach of the obligation resting on the State and the loss or damage sustained by the injured parties, it is for the national court to assess whether the loss and damage

claimed flows sufficiently directly from the breach of Community law to render the State liable to make it good (*Test Claimants in the FII Group Litigation*, paragraph 218, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 122).

126 Indeed, subject to the right of reparation which flows directly from Community law where those conditions are satisfied, it is on the basis of the rules of national law on liability that the State must make reparation for the consequences of the loss and damage caused, provided that the conditions for reparation of loss and damage laid down by national law are not less favourable than those relating to similar domestic claims and are not so framed as to make it, in practice, impossible or excessively difficult to obtain reparation (*Test Claimants in the FII Group Litigation*, paragraph 219, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 123).

127 The Court also made clear 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 (*Test Claimants in the Thin Cap Group Litigation*, paragraph 124).

128 In that regard, the Court recalled that it had held, in paragraph 106 of the judgment in Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, with respect to tax legislation which did not afford the possibility of benefiting from the group taxation regime to resident subsidiaries of non-resident parent companies, that the exercise of rights conferred on private persons by directly applicable provisions of Community law would be rendered impossible or excessively difficult if their claims for restitution or compensation based on infringement of Community law were rejected or reduced solely 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 (*Test Claimants in the Thin Cap Group Litigation*, paragraph 125).

129 It is also clear from the Court's case-law that the application of the provisions relating to the freedoms of movement would be rendered impossible or excessively difficult if claims for restitution or compensation based on infringement of those provisions had to be rejected or reduced solely because the companies concerned had not applied to the tax authorities for the benefit of a tax regime which national law, combined, where appropriate, with the relevant provisions of the DTCs, denied them (see, to that effect, *Test Claimants in the Thin Cap Group Litigation*, paragraph 126).

130 Thus, it is for the national court to determine whether, should it be established that the national legislation at issue in the main proceedings, combined, where appropriate, with the relevant provisions of the DTCs, constitutes a restriction on the freedom of establishment prohibited by Article 43 EC, or a restriction on the free movement of capital prohibited by Article 56 EC, the application of that legislation would, on any basis, have led to the failure of the claims of the claimants in the main proceedings before the United Kingdom tax authorities (*Test Claimants in the Thin Cap Group Litigation*, paragraph 127).

131 In the light of the foregoing, the reply to the sixth to twelfth questions must be as follows:

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

— Where it is established that the legislation of a Member State constitutes a restriction on freedom of establishment prohibited by Article 43 EC or a restriction on the free movement of capital prohibited by Article 56 EC, the national court may, in order to establish the recoverable losses, determine whether the injured parties have shown reasonable diligence in order to avoid those losses or to limit their extent and whether, in particular, they availed themselves in time of all legal remedies available to them. However, in order to prevent the exercise of the rights which Articles 43 EC and 56 EC confer on individuals from being rendered impossible or excessively difficult, the national court may determine whether the application of that legislation, coupled, where appropriate, with the relevant provisions of DTCs, would, in any event, have led to the failure of the claims brought by the claimants in the main proceedings before the tax authorities of the Member State concerned.

Costs

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

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

1. **Article 43 EC is to be interpreted as meaning that it does not preclude legislation of a Member State which exempts from corporation tax dividends which a resident company receives from another resident company, when that State imposes corporation tax on dividends which a resident company receives from a non-resident company in which the resident company has a shareholding enabling it to exercise a definite influence over the decisions of that non-resident company and to determine its activities, while at the same time granting a tax credit for the tax actually paid by the company making the distribution in the Member State in which it is resident, provided that the rate of tax applied to foreign-sourced dividends is no higher than the rate of tax applied to nationally-sourced dividends and that the tax credit is at least equal to the amount paid in the Member State of the company making the distribution, up to the limit of the amount of the tax charged in the Member State of the company receiving the distribution.**

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

   Article 56 EC is, furthermore, to be interpreted as meaning that it precludes legislation of a Member State which exempts from corporation tax dividends

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

2. **Article 56 EC is to be interpreted as meaning that it precludes legislation of a Member State which allows an exemption from corporation tax for certain dividends received from resident companies by resident insurance companies but excludes such an exemption for similar dividends received from non-resident companies, in so far as it entails less favourable treatment of the latter dividends.**

3. **Articles 43 EC and 48 EC must be interpreted as precluding the inclusion in the tax base of a resident company established in a Member State of profits made by a controlled foreign company in another Member State, where those profits are subject in that State to a lower level of taxation than that applicable in the first State, unless such inclusion relates only to wholly artificial arrangements intended to escape the national tax normally payable.**

   Accordingly, such a tax measure must not be applied where it is proven, on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives, that controlled foreign company is actually established in the host Member State and carries on genuine economic activities there.

However, Articles 43 EC and 48 EC are to be interpreted as not precluding national tax legislation which imposes certain compliance requirements where the resident company seeks exemption from taxes already paid on the profits of that controlled foreign company in the State in which it is resident, provided that the aim of those requirements is to verify that the controlled foreign company is actually established and that its economic activities are genuine without that entailing undue administrative constraints.

4. **Articles 56 EC to 58 EC are to be interpreted as not precluding the legislation of a Member State which grants a corporation tax concession in respect of certain dividends received from resident companies by resident companies but excludes such a concession for dividends received from companies established in a non-member country particularly where the grant of that concession is subject to conditions compliance with which can be verified by the competent authorities of that Member State only by obtaining information from the non-member country where the distributing company is established.**

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

Where it is established that the legislation of a Member State constitutes a restriction on freedom of establishment prohibited by Article 43 EC or a restriction on the free movement of capital prohibited by Article 56 EC, the national court may, in order to establish the recoverable losses, determine whether the injured parties have shown reasonable diligence in order to avoid those losses or to limit their extent and whether, in particular, they availed themselves in time of all legal remedies available to them. However, in order to prevent the exercise of the rights which Articles 43 EC and 56 EC confer on individuals from being rendered impossible or excessively difficult, the national court may determine whether the application of that legislation, coupled, where appropriate, with the relevant provisions of Double Taxation Conventions, would, in any event, have led to the failure of the claims brought by the claimants in the main proceedings before the tax authorities of the Member State concerned.

[Signatures]