THE SPECIAL COMMISSIONERS

BRUNO SANTIAGO

O caso *sub judice* versa sobre o problema da compatibilidade da legislação inglesa sobre *Controlled Foreign Companies* (CFC) com o Direito Comunitário. Os *Special Commissioners* AVERY JONES e MALCOLM GAMMIE em virtude das dúvidas expressadas pelas Recorrentes *Cadbury Schweppes Plc* e *Cadbury Schweppes Overseas Limited* decidiram reenviar o caso para o TJCE a fim de que este Tribunal decida a título prejudicial sobre se a legislação inglesa de CFCs é compatível com o Tratado da Comunidade Europeia (em especial com as normas sobre liberdade de estabelecimento, liberdade de prestação de serviços e liberdade de circulação de capitais).

As normas inglesas sobre CFCs inserem-se num conjunto de normas especiais anti-abuso criadas nos anos 30 do século passado nos EUA (que constituem hoje a famosa "Subpart F" do IRC) com o objectivo de prevenir e reprimir a fraude e a evasão fiscais internacionais e encontram-se consagradas em muitas legislações europeias, designadamente, em Inglaterra, nas secções 747 a 756 e no Schedule 24 a 26 do Income and Corporation Taxes Act de 1988 e, em Portugal, no artigo 60.º do Código do IRC (com a epígrafe "Imputação de lucros de sociedades não residentes sujeitas a um regime fiscal privilegiado").

Se uma sociedade residente num determinado Estado tem uma subsidiária noutro Estado, de acordo com os princípios gerais de Direito Fiscal Internacional os lucros da subsidiária não serão tributados no Estado da sociedade-mãe enquanto não forem pagos ou distribuídos à sociedade-mãe como dividendos ou sob qualquer outra forma. Se ambas as sociedades estão sujeitas nos Estados da sua residência a níveis de imposto similares não deve haver uma distorção dos seus comportamentos por razões fiscais. Contudo, se a subsidiária estiver localizada num paraíso fiscal onde os lucros estão ou isentos de imposto ou sujeitos a uma taxa de imposto irrelevante, a sociedade-mãe fica efectivamente capaz de deferir no tempo a tributação que seria devida pelos lucros da subsidiária, enquanto estes aí ficarem retidos. É com o objectivo de combater o abuso criado por este deferimento na tributação que foi implementado este regime especial.

O problema do eventual conflito entre este tipo de legislação e as convenções para evitar a dupla tributação tem vindo a ser alvo de várias decisões judiciais das instâncias superiores dos tribunais de diversos Estados (veja-se, a título exemplificativo, o Caso *Bricom Holdings* julgado pelo *Court of Appeals* inglês em 1997, e o Caso *Schneider* julgado, em 2002, pelo *Conseil d'Etat* francês). Os argumentos avançados a favor da incompatibilidade baseiam-se, sobretudo, no artigo 7.º, n.º 1 e no artigo 10.º, n.º 5, da Convenção Modelo. A posição da OCDE plasmada no Comentário à Convenção Modelo (veja-se o parágrafo 10.1 do Comentário ao artigo 7.º e os parágrafos 37 a 39 do Comentário ao artigo 10.º) é favorável à compatibilidade desta legislação com as disposições da Convenção.

Mas se é esta a tendência ao nível da OCDE, surgem as maiores dúvidas relativamente à posição que vai ser tomada pelo TJCE em virtude da interpretação que tem vindo a ser feita das liberdades fundamentais consagradas no Tratado. Pelas mãos dos tribunais ingleses surgiu finalmente a possibilidade de o Tribunal de Justiça se debruçar sobre este assunto. Ainda assim este reenvio prejudicial poderia ter sido evitado se o Tribunal de Justiça, na sua decisão sobre o Caso *Lasteyrie du Saillant* (Caso C-9/02), não tivesse fugido a tomar posição sobre as normas anti-evitação como razão justificativa da limitação da liberdade de estabelecimento.

Na verdade desde que abandonou as posições confusas tomadas nos acórdãos *Daily Mail* (Caso 81/87) e *Bachmann* (Caso C-204/90) o Tribunal de Justiça não conseguiu ainda definir as suas posições sobre a evitação fiscal. Aguarda-se pois que, face à clareza das questões colocadas, o TJCE se possa pronunciar abertamente sobre uma série de tópicos que se mantêm controvertidos e têm alimentado a discussão doutrinal (veja-se os cinco pontos do parágrafo décimo da decisão).

Daí a importância deste reenvio prejudicial.

Bruno Santiago

THE SPECIAL COMMISSIONERS

**CADBURY SCHWEPPES PLC AND
CADBURY SCHWEPPES OVERSEAS LIMITED** **Appellants**

- and -

THE COMMISSIONERS OF INLAND REVENUE **Respondent**

ORDER FOR REFERENCE TO THE EUROPEAN COURT OF JUSTICE

**Special Commissioners: DR JOHN F AVERY JONES CBE
MALCOLM GAMMIE QC**

Julian Ghosh and James Henderson instructed by Gordon Slater, Group Tax Adviser of the Appellant

David Anderson QC and David Ewart instructed by the Solicitor of Inland Revenue for the Respondent

NOTE. Although not a final decision the Presiding Special Commissioner has authorised publication of this Schedule to the formal Order making the Reference to the European Court of Justice.

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SCHEDULE

1. The sole issue in this appeal is the compatibility with European law of the United Kingdom's controlled foreign companies' legislation. Under this legislation a company resident in the United Kingdom may be taxed on the profits of a subsidiary resident in another state if those profits have borne a lower rate of tax than they would have done in the United Kingdom. It is accepted that, subject only to the compatibility with Community law, the controlled foreign companies' legislation applies to the Appellants.

2. The facts are contained in a statement of agreed facts and a witness statement of Gordon Trevor Slater, Group Tax Adviser of PLC, which is not disputed. The salient facts can be summarised as follows:

(1) Cadbury Schweppes plc (PLC) is incorporated and resident in the United Kingdom. It is the parent company of a group of companies comprising subsidiaries established in the UK, in other member States of the European Union and in many other countries of the world. As concerns the controlled foreign companies' legislation, the group includes two indirect 100 per cent subsidiaries incorporated with unlimited liability in Ireland and agreed (for the purposes of this appeal only) to be resident in Ireland, Cadbury Schweppes Treasury Services (CSTS) and Cadbury Schweppes Treasury International (CSTI). A group structure is attached as an Appendix.

(2) CSTS and CSTI are subject to a tax rate of 10 per cent within the International Financial Services Centre in Dublin in accordance with certificates issued by the Ministry of Finance for Ireland under section 39B(2) of the Irish Finance Act 1980.

(3) The business of CSTS and CSTI is to raise finance and to provide that finance to subsidiaries in the PLC worldwide group.

(4) CSTS was established by PLC for three purposes to replace a previous structure that involved a Jersey company:

(i) to remedy a Canadian tax problem for Canadian resident preference shareholders of PLC,

(ii) to avoid the need to obtain consents of the UK Treasury for overseas lending, and

(iii) to reduce the withholding tax on dividends paid within the group structure by benefiting from the Parent-Subsidiary Directive (Council Directive of 23 July 1990 90/435/EEC).

These three purposes would equally well have been achieved if CSTS had been incorporated and tax resident in the UK rather than tax resident in Ireland.

(5) CSTI was incorporated as a subsidiary of CSTS with shares denominated in US dollars. It accounted in US dollars and acquired the benefit of loans in US dollars made by CSTS to a US and an Argentinean subsidiary of PLC. The reason for incorporating CSTI was to avoid the application to CSTS of certain foreign exchange provisions under United Kingdom tax law in the event that the controlled foreign companies' legislation in issue in this appeal was applied to CSTS.

(6) PLC established CSTS and CSTI as tax resident indirect subsidiaries in Ireland solely in order that the profits arising from their intra-group lending treasury activities could benefit from the International Financial Services Centre regime for group treasury companies in Ireland and would not be taxed in the United Kingdom.

3. A United Kingdom resident company is subject to corporation tax on its worldwide profits. This includes the profits of a permanent establishment outside the United Kingdom. It does not include the profits of its subsidiary companies (see below). Unlike many European countries, the United Kingdom adopts a tax credit system of relieving double taxation. It is not the United Kingdom's policy to exempt United Kingdom residents from tax (whether through domestic provision or by agreement under a treaty) in respect of their foreign profits. A United Kingdom resident parent company is not taxed on the profits of its subsidiary companies (as opposed to its own establishments) as they arise. In the case of its United Kingdom subsidiaries, a United Kingdom resident parent company is also exempt from tax on any dividends that its United Kingdom subsidiaries pay. In the case of its foreign subsidiaries, tax is charged, subject to credit for the foreign tax on the relevant profits of the subsidiary, when those profits are received as dividends by a United Kingdom resident company.

4. By way of exception to the rule that profits of a foreign subsidiary are not taxed by the United Kingdom as they arise, where the United Kingdom controlled foreign companies' legislation applies, the income of the foreign subsidiary is attributed to the United Kingdom parent (although that income has not been received by the parent) and taxed with credit for foreign tax paid by the subsidiary. Where a dividend is paid out of profits subjected to the controlled foreign companies provisions, the United Kingdom tax paid by the parent on the foreign subsidiary's profits is treated as if it were additional foreign tax paid by the foreign subsidiary and is available for credit against further United Kingdom tax payable by the parent on the dividend. Controlled foreign companies' legislation is common and it is understood to exist in the EU also in Denmark, Spain, Italy, Norway, France, Finland, Germany, Sweden and Portugal, and is proposed in Austria.

5. The United Kingdom legislation is contained in sections 747 to 756 and Schedules 24 to 26 of the Income and Corporation Taxes Act 1988. It applies where the subsidiary is resident outside the UK and is subject to a 'lower level of taxation'. A lower level of taxation exists in any accounting period in which the tax paid by the foreign subsidiary in its country of residence is less than three-quarters of the amount of United Kingdom tax that would be paid on the profits of the subsidiary as computed for United Kingdom tax purposes. By definition, the legislation does not apply to a parent company's United Kingdom resident subsidiaries as their profits will be subject to United Kingdom tax. The rules under which the tax due on the profits of the foreign subsidiary is arrived at under the controlled foreign companies' legislation, however, differ in some respects from the ordinary rules that would apply to determine the tax liability of a UK resident subsidiary of PLC. In 1996 the legislation only applied if the Inland Revenue directed that it should.

6. The charge to tax under the controlled foreign companies' legislation has always been subject to a number of exceptions, the detailed terms of which have changed over time. The following is a broad summary of the exceptions:

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

(2) The foreign subsidiary is engaged in "exempt activities". This means activities of a type set out in detail in the legislation, such as certain trading activities carried out from a business establishment.

(3) The foreign subsidiary satisfies the "public quotation condition". This means that 35 per cent of the voting power is in the hands of the public and the subsidiary is quoted and dealt in on a recognised Stock Exchange.

(4) The foreign subsidiary's chargeable profits do not exceed £50,000.

(5) The establishment and operation of the foreign subsidiary satisfies what is generally known as "the motive test". The motive test contains two elements and the taxpayer must show that both are satisfied for the exemption to apply. Briefly, the two elements are as follows:

(i) First, it is necessary to discover whether the results of any transactions reflected in the subsidiary's profits for the accounting period achieved a "reduction in United Kingdom tax." This is a reduction as compared to what the tax would have been if the transactions had not been undertaken. If there is a reduction and that reduction is more than a minimal amount, the taxpayer must show that the reduction in UK tax was not the main purpose, or one of the main purposes, of those transactions.

(ii) Second, the taxpayer must show that it was not the main reason, or one of the main reasons, for the subsidiary's existence in that accounting period to achieve a reduction in United Kingdom tax by the diversion of profits from the United Kingdom. The legislation explains that there is a diversion of profits if it is reasonable to suppose that, had the subsidiary or any related non-United Kingdom resident company not existed, the receipts would have been received by, and been taxable in the hands of, a hypothetical United Kingdom resident.

A taxpayer must satisfy both elements of the test: one does not suffice. It is believed that the motive test is unique to the United Kingdom legislation.

The taxpayer's purposes in establishing a subsidiary outside the United Kingdom is irrelevant where any of the exceptions in (1) to (4) apply. If none of (1) to (4) apply, the motive test allows the Inland Revenue (and, on appeal, a court) to consider the particular circumstances of the taxpayer against the essential purpose of the legislation to tax profits that are either accumulated abroad or diverted abroad from the United Kingdom. To that end the Inland Revenue by 1996 had published a list of countries within which (subject to specified conditions) a subsidiary could be established and conduct its business and be regarded as meeting the requirements for exemption.

7. The effect of the 10 per cent rate of tax in Ireland is that the profits of CSTS and CSTI are subject to a lower level of taxation. None of the above exemptions applies to CSTS or CSTI. In particular

(1) insufficient profits were distributed to the United Kingdom by way of dividend in the requisite period to meet the acceptable distribution policy requirement,

(2) making loans to other group companies is not among the permitted exempt activities,

(3) the subsidiaries are not quoted,

(4) the profits exceed £50,000, and

(5) the main purpose of the transactions entered into by the subsidiaries was (within the terms of the motive test as set by the UK legislation) to achieve a reduction in United Kingdom tax, and if the two companies had not existed their receipts would have been taxable in the United Kingdom (see paragraph 2(6) above).

8. Accordingly, on 18 August 2000 the Inland Revenue directed that the controlled foreign companies' legislation applied. They assessed Cadbury Schweppes Overseas Limited (the first United Kingdom resident company in the chain of companies) to an amount equal to corporation tax of £8,638,633.54 (being tax at 33% on the profits of £34,684,038 equals £11,445,732.54 less credit for Irish tax of £2,807,099) in respect of the profits of CSTI for the period ended 28 December 1996 (CSTS made a loss in the same period that was surrendered for Irish tax purposes partly to CSTI and partly to another Irish company). The taxpayer appealed to the Special Commissioners on 21 August 2000.

9. The Appellants contend that the application of the United Kingdom controlled foreign companies' legislation in these circumstances constitutes a breach of the freedom of establishment contained in Article 43 of the EC Treaty, of the freedom to provide services under Article 49 and of the freedom of movement of capital and payments under Article 56.

10. Although the Special Commissioners have not heard argument from the parties expanding on these contentions it is clear to the Special Commissioners that there are a considerable number of uncertainties in the application of European law in these circumstances. They are unable to resolve these without the guidance of the European Court of Justice. The uncertainties include such questions as:

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

- If it is exercising the fundamental freedoms, whether the correct approach in the circumstances of this case is to consider whether the United Kingdom's controlled foreign companies' legislation may be viewed as a restriction on the exercise of those freedoms, or whether it involves discrimination;

- In relation to whether the legislation should be viewed as a restriction, whether the fact that PLC may pay no more tax than what CSTS and CSTI would have paid if they had been established in the United Kingdom means that there is no such restriction; and whether it is relevant that (a) the rules for calculating the tax liability in respect of CSTS and CSTI's income differ in some

respects from the ordinary rules applicable to UK subsidiaries of PLC and (b) there is no relief for losses of one subsidiary against the profits of the other or against the profits of plc and its United Kingdom subsidiaries (such relief for losses would have been available if CSTS and CSTI had been established in the United Kingdom rather than Ireland);

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

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

11. Accordingly the Special Commissioners refer the following question to the Court of Justice of the European Communities:

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