

# Newsalert

## EU Direct Tax Group

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### EU Direct Tax Group

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#### **Advocate General Leger's opinion in the Cadbury Schweppes plc and Cadbury Schweppes Overseas Limited v CIR UK Controlled Foreign Company (CFC) case**

AG Leger today released his opinion in the Cadbury Schweppes plc (CS plc) CFC case.

CS plc had set up two Irish subsidiaries, CS Treasury Services (CSTS) and CS Treasury International (CSTI) benefiting from the 10% Irish IFSC rate to carry out sterling and dollar treasury activity, including raising additional third party funds for group use.

The UK Special Commissioners (SCs) referred to the ECJ the question: "Do Articles 43 and 48 (Freedom of Establishment), 49 (Services) and 56 (Free Movement of Capital) of the EC Treaty preclude national tax legislation such as that at issue in the main proceedings, which provides in specified circumstances for the imposition of a charge upon a company resident in that member state (the UK) in respect of the profits of a subsidiary company resident in another member state (Ireland) subject to a lower level of taxation?"

The AG has opined that first, the establishment by an EU parent company of a subsidiary in another Member State for the purpose of enjoying a more favourable tax regime in that other Member State does not, in itself, constitute an abuse of freedom of establishment, preventing access to freedom of establishment.

Secondly, the AG considers that the UK CFC legislation does hinder the freedom of establishment, notwithstanding that the overall tax rate (10% Irish tax plus 20% incremental UK tax) is the same as the 30% UK corporation tax rate, had CS plc set up the relevant treasury subsidiaries in the UK. In so doing, he focuses not only on the absence of UK tax on dividends from UK subsidiaries paid to CS plc, but also on the fact that the UK CFC regime only applies where the foreign subsidiary is subject to a rate lower than  $\frac{3}{4}$  of the UK tax that such a subsidiary would have been subject to if in charge to UK corporation tax, which excludes some foreign subsidiaries with a rate lower than the UK, but not others.

Thirdly, he considers that whether or not a Member State can justify application of its CFC legislation to a particular tax payer should be evaluated by reference to whether or not the CFC regime only catches "wholly artificial arrangements". That in turn depends on whether the subsidiary is engaged in the actual pursuit of an economic activity in the Host State (here Ireland). If the subsidiary is actually carrying on such an activity in the Host State and, in that connection, provides genuine and actual services to the parent company, that situation cannot be regarded, in itself, as tax evasion or avoidance, even if payment for those services leads to a reduction in the taxable profits of the parent company. This remains the case even if the provision of the services is wholly intra-group.

He enunciates three sub-tests in relation to the above. First, does the subsidiary have premises, staff and equipment, necessary to carry out the services provided to the parent company which results in the reduction of origin state tax? Secondly, are those services of a genuine nature, having regard to the competence of the subsidiary staff and the level of decision-making in carrying out those activities? Thirdly, do the subsidiary's activities add economic value? This has to be evaluated in the light of the parent company's activity.

Lastly, he rejects motive as irrelevant in determining whether or not the subsidiary is engaged in the actual pursuit of an economic activity in the Host State.

In conclusion, he has recommended remitting back to the UK SCs the question as to whether the UK CFC regime applies only to "wholly artificial arrangements", having regard to the language of the UK motive test.

Given the UK SCs' ABTA decision, it appears reasonably clear that the UK motive test and therefore CFC regime is not confined to "wholly artificial arrangements". Accordingly, if the ECJ Grand Chamber judgment follows AG Leger's opinion in all material respects, the UK CFC regime will be found to operate disproportionately where the subsidiaries are engaged in actual economic activity locally, notwithstanding that this may result in a reduction of UK tax and/or diversion of profits from the UK. Accordingly, it is anticipated that UK law will have to be amended.

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