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EU/UK Cases

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Subcontractors Withholding Tax

I mention the case of Mundial Invest SA v Moore only to warn you from it. It concerns relevant contract tax or subcontractors withholding tax, in the UK. The UK legislation differs from the Irish legislation in one critical respect. It does not appear to have the equivalent of s531(2) which excludes from the operation of the tax, the erection of buildings for the use and occupation of the "contractor" or his employees. If you are not conscious of this difference between the UK legislation and the Irish legislation, the Mundial case reads very oddly, as it concerned an assessment to relevant contracts tax on a company whose sole connection with the construction industry seemed to be, that in having engaged contractors to carry out work on its own premises.

Having Irish Construction Workers Abroad!

The ECJ Judgement indicates that Herbosch Kiere NV concerns a set of facts you would not expect to encounter. It concerns an Irish construction company entering into a subcontract with a Belgium company, under which its workers are posted to Belgium. Given the major role played by Eastern European immigrants in the Irish construction industry, you do not expect to find paddies on construction sites in Belgium. Neither, it seems, do the Belgian tax authorities, who turned their noses up at it.

The Irish workers dispatched to Belgium remained in the Irish PRSI and social welfare system. Form E101 was duly issued by the Irish authorities certifying this fact. The Belgian authorities however, decided that the interaction between the main contractors in Belgium and the Irish workers was such that they were working under the orders and directions of the Belgian authorities and were, in effect, employed by the Belgian contractor, rather than the Irish subcontractor. They applied an element of Belgian domestic law which would have imputed an employment relationship (or so they claimed) in the circumstances. They sought to charge PRSI (or its Belgian equivalent) on the Belgian contractor which duly paid up, but appealed. The Appeal Court referred the matter to the ECJ.

The ECJ held that under Regulation 1408/71 and Regulation 574/72 of the EU, a system was laid out to ensure that a worker would be liable to social welfare in one Member State only at any one time. Where a Member State issued Form E101 in relation to a worker, the validity of that form could not be queried by the Courts or administrative authorities of another state, under the domestic law of the other state. If they thought that the form was inappropriately issued, they should raise their concerns with the issuing state, which could then reconsider the matter and act accordingly. If this does not resolve the doubts of the host State, they could take the matter to arbitration, or ultimately to the ECJ.

However, they could not take action under their domestic law to overturn the Form E101, and to attempt to levy their PRSI equivalent charges. If the host country were entitled to activate its domestic laws to ask its domestic Courts to consider that a Form E101 had been wrongly issued by another state, workers could find themselves subject to social welfare rules of two states simultaneously, while the two authorities bickered over the worker's head. The regulations were designed to ensure that couldn't occur, and the only way of ensuring it was to render the existence of a Form E101 decisive in the matter.

The Judgement is potentially quite important, given the mobility of construction workers in particular within the community, and given the very considerable differences in social welfare rates between Member States. Ireland has amongst the lowest social welfare rates in the EU and prima facie that would give a certain advantage to Irish contractors. However, high Irish labour costs probably counteract this.

Hypothetical Question

The UK VAT Tribunal, in the case of the Ford Motor Company Limited, held that it was entitled to hear an appeal from a tax payer on a decision given by the Revenue as to the VAT treatment of a transaction which had not at the time occurred, but which was planned to occur. In other words, it held that it was entitled to rule on the VAT treatment of a future, as opposed to a past transaction.

The tribunal made the point that such a jurisdiction on the part of the tribunal made sense in the context of a self-assessment tax. I would agree with them that it makes a great deal of sense in that context, but I do not believe that the law provides for it.

The proposed transaction is not described in the case, unfortunately. It would have been of interest to anyone advising the motor industry, since it was stated to be an arrangement designed to minimise output tax on the sale of cars by credit.

Is it a Car?

For VAT purposes, in the UK "motor car" means any motor vehicle normally used on public roads with three or more wheels which is either (a) constructed or adapted solely or mainly for the carriage of passengers or (b) has to the rear of the driver's seat roofed accommodation fitted with side windows. There are various exclusions. In Ireland "motor vehicles" in s12 means a motor vehicle designed and constructed for the conveyance of persons by road, and certain specific types of cars, wagons, etc, whether or not so designed or constructed.

The UK VAT tribunal in the case of Vauxhall Motors Limited had to consider whether or not a "crew van" sold by Vauxhall was a motor car for VAT input credit purposes. If it were, there was no recoverable input credit. If it were not, the VAT on its acquisition could be recovered.

The critical feature of a "crew van" was that whereas like many vans it had an area at the rear for the carriage of goods, and suitable for no other purposes, part of that area was fitted with fold-down seats. When these seats were folded up for use by passengers, more than half of the total floor space was given over to passenger use. When the seats were folded down so that the space could be used for the carriage of goods, less than half of the car was in use for the purpose of carrying passengers. The decision turned on how much significance should be attached to the presence of the fold-down seats. To cut a long story short, the Appeal Commissioners, having driven in the van (in the fold-down seats, with counsel for the Revenue occupying the passenger seat) concluded that they would not wish to travel very far in the fold-down seats and that the van was not constructed or adapted mainly for the carriage of passengers, but rather for the carriage of goods. The crew van did not have any side windows to the rear of the driver's seat. That excluded another basis upon which the van could have been held to be a "motor car". Good news for the owner of the "crew van" in the UK. But what of Ireland?

The Irish definition of "motor vehicles" is less clearly set out than in the UK. On the face of it, in Ireland "motor vehicles" for VAT purposes could include any road vehicle having two or more seats since such would have surely been designed and constructed for the conveyance of "persons"(in the plural). Apart from tractors and diggers, I am not aware of any vehicles that do not have at least two seats and therefore the capacity to carry more than one person. Even the ubiquitous "white van" would seem capable of meeting one interpretation of those words. What is missing in the Irish definition is the word "mainly". In other words, is the primary purpose of the vehicle the conveyance of persons by road, or is it mainly some other purpose? To give any sensible interpretation you have to read that word in.

That difference in wording between the UK and Ireland makes it difficult to know what significance the UK case would have in Ireland. The crew van was undoubtedly constructed with the intent that it would be used interalia for transporting persons by road, even though the primary purpose for which it was constructed was the transport of goods. So what is the answer?

Residence of Offshore Company: CGT

The UK Court of Appeal have upheld a High Court decision (on which I commented on in an earlier issue) to the effect that central management and control, and therefore residence of a company was within the Netherlands. The context was that the company, as part of what was admitted to be a tax planning scheme to avoid CGT, acquired certain shares and subsequently sold them. The decision to acquire the shares, and the decision to sell them, was influenced by the wishes of persons in the UK. The Courts held that the decision to purchase and the decision to sell was nonetheless made in the Netherlands by the managing director of the Netherlands Company and amounted to the exercise of central management and control. I will not go further into the case, since I commented on the High Court Judgement in detail, and the Court of Appeal has approved every aspect of the High Court's decision.

The case is important in that it goes to the heart of the question of whether Irish resident persons can own a company which is effectively managed abroad by professional directors.

The question of the place of "effective management" – which is a concept in the tiebreaker clause under double tax agreement for the residents of companies – was also discussed. The Judge expressed the view that it would be difficult to see how the central management of control test could lead to a different result to the effective management test. However, this was in the context of the particular facts of this company where only two decisions were made in the entire lifetime of the company – to buy and to sell. I would not take it to be a comment of general application.

EU Treaty Freedoms

The UK High Court has given a decision in the case of Foulser –v- MacDougall. The case has an Irish connection. The Isle of Man subsidiary of Irish Life had provided services in the course of what was accepted to be a tax avoidance scheme in the UK. The tax avoidance scheme was based on "holdover relief" which enables gifts to be made in the UK in certain circumstances free of CGT. Such a gift cannot be to a non-resident company connected with the donor of the gift. It had been held that the UK resident donor and Irish Life had acted together to control the company which was the recipient of the gift, and that accordingly as company and UK donor were connected, so that the relief was not available in relation to the gift. The appeal to the High Court was not on that particular point (unfortunately). Rather, it was on an EU Law point. It was claimed that the exclusion of holdover relief on the occasion of a transfer to a non-resident company inhibited Irish Life's right of establishment across border.

The problem with that argument of course was that Irish Life had not sought to establish itself in the UK, nor did it carry on the transaction in question through any branch or establishment in the UK. It did enter into a contract with a person resident in the UK, but it did so from outside the UK. The Judge summarised the conclusion as follows;

> *"The only relevant consequence of s167 is that companies in the position of Irish Life will no longer have the opportunity to earn a modest fee from schemes of this kind. Taxation provisions may have any number of incidental effects on the ability of financial institutions and professionals established in other Member States to charge fees, but that cannot of itself engage the right of freedom of establishment. In this case, Irish Life's right to freedom of establishment is not engaged".*

I am rather inclined to think that on the EU Law point, the Court got it right. But I think it unfortunate that there was no appeal on the "acting together to control the company point about which I would be less certain that the Special Commissioners got it right. I have already expressed my views on that in a previous issue.

Interest Relief

The UK Special Commissioner decision in the case of Dixon –v- Revenue is a cautionary tale about mixing business and pleasure. The tax payer, as a single deal, purchased a dwelling house, a business premises, and various items of equipment and stock. He financed this by selling his principal private residence, and by taking out a loan, which was secured on the business premises and on the dwelling house.

The proceeds of sale of his principal private residence exceeded the cost of the new dwelling house. The tax payer claimed to have all of the interest on the borrowings set against his business profits on the basis that the loan was used solely to finance the business premises, equipment and stock.

The documentation with the financial institution had indicated that it was a loan advanced for the purchase both of the business, and of the private residence. As previously mentioned, it was secured on both assets.

The Special Commissioner held that the loan was employed as indicated in the application to the building society, i.e. to finance both purchases, and that accordingly only part of the interest was a business expense.

One aspect of this apparently straightforward case, that is rather surprising, is that there is an express finding to the effect that on the completion statement for the transaction, the purchase price was specifically apportioned as between the dwelling house, the shop premises, the goodwill, the fittings, and the stock. Therefore, no difficult valuation issues arise in the case. The amount of money expended on each element of the purchase is known and it did not seem to me that the allocation was being challenged in the case.

The fact that the loan application stated that the loan was for the purpose both of purchase of the dwelling house and the purchase of the business, while relevant evidence, seems to me to be evidence of little importance. What one says to one's financial institution when seeking money from them is not to be taken too seriously. It is certainly not strong evidence of facts.

It was the view of the tax payer that he had allocated his resources so that the proceeds of his house sale paid for his new house purchase, and left some over to help with the purchase of the business. However, the Special Commissioners appear to have been influenced by the fact that the business and the house were purchased under a single contract (albeit with separate prices specified), and that the loan had been requested on the basis of being for the purchase of all of the assets, and not only the business.

But is not the real issue, what role is the borrowing playing in the taxpayer's finances in each year in which the interest payments arise? The claim, after all, was under Case 1 and not under Case 5. Had it been under Case 5, the entitlement to an interest deduction would be determined at the time the borrowings were applied in purchase of a premises, or otherwise. Subsequent events (other than the cessation of the source or sale of the premises) would not affect the matter. But in Case 1, the correct question seems to be to ask whether the interest cost was on borrowings that were employed during that particular year for business purposes.

I find it very hard to believe that the tax payer's decision as to his arrangement of his resources, i.e. his allocation of house sale proceeds against house purchase, and his borrowings against his business, can be overturned by somebody else's view of how the allocation should have been made. The taxpayer started with a house, and he ended up with a house plus some spare cash. That being so, how can it be said that any part of the borrowings are plugging a hole created by his house purchase? Surely the opposite was the case – the sale of one house and the purchase of a cheaper house freed up cash for the business, it did not absorb part of his borrowings.

None of these issues would have arisen if the loan application had not referred to the house purchase as well as to the business purchase, or so I would suspect. The purpose you State to a financial institution is but weak evidence of the function later served by the borrowings.

Domicile

The case of Cygnik v Agulian is a case about whether a man with a domicile of origin in Cyprus had acquired a domicile of choice in the UK (where he died). It is a very good read in a colourful sense involving a Greek Cypriot stated to be accustomed to having girlfriends, and having had two relatively long-term relationships. There is evidence of flaming family rows, allegations of missing money and, in the background, an Inland Revenue investigation into matters concerned with suitcases of cash, which sounds ominous and may cause all to regret those rows.

However, the case is largely one of a recycle of evidence, and of the Judge's evaluation of the truthfulness and reliability of that evidence rather than an exploration of the rules of law relating to domicile and I will not therefore further comment on it.

VAT & Fraud

The ECJ, in his Judgement on the Optigen Ltd case, dealt with a Revenue claim that innocent participants in a carousel fraud were to be denied input credit in respect of purchases by them.

The carousel fraud essentially involves goods passing along a line of buyers and sellers, from hand to hand, each seller charging the buyer with VAT, and each buyer entitled to claim input credit on the VAT charged to them. The peculiar point however is that one of the parties in this chain of transactions, having invoiced out goods and charged VAT, disappears and does not account for the VAT to the Revenue. In a classic carousel fraud the goods, having started with Company A, are passed through the hands of innocent third parties will ultimately be re-purchased by Company A from somebody in the chain while an associate of Company A further on in the chain will have disappeared having charged VAT.

Optigen was an innocent party which purchased goods and was charged VAT on them, and on-sold the goods in the normal way. It was not aware that it was participating in a chain of transactions involving a fraudulent trader. Nonetheless, the Revenue contended that because those who originated the chain of buying and selling had done so with fraudulent intent, that there was no economic activity such as was understand for the purposes of VAT and that accordingly nobody should be entitled to input credit.

The ECJ rejected this argument and not surprising. It is a most extraordinary argument and gives you some flavour of the arrogance of the Revenue authorities in the UK. The Court said,

> *"As the Advocate General observed, each transaction must therefore be regarded on its own merits and the character of a particular transaction in the chain cannot be altered by earlier or subsequent events."*

The decision is not concerned with tax avoidance, but was concerned with a series of transactions tainted at one part in the series with fraud. It is not therefore concerned with the same issues as were decided in the Halifax case, but nonetheless the two cases can well be read together. In the Halifax case the Courts emphasised that the only transactions that could be set aside on the grounds of abuse were those without economic consequences. In the Optigen case the Court held that the VAT position of an innocent trader cannot be affected by the fact that those with whom he dealt were, unknown to him, fraudsters.

Double Tax Agreements

The ECJ Judgement of last July 2005 in the case of Ondermemingen was concerned interalia with whether a Member State was entitled to treat a resident of another Member State differently than it would treat a resident of a third Member State, by reason of having entered into double tax agreements with other Member States which leads to the different treatments of their residents as between the different states. In other words, can Ireland have a double tax agreement that will treat a French person differently than its double tax agreement with Germany results in a German being treated?

The line taken by the Court was that direct taxation was a matter for the Member States subject to the treaties. Double tax agreements are bilateral means by which the sovereign states allocate taxing rights as between each other. Since they have the right to levy direct tax in the first place, they also have the right to allocate the privilege between themselves. The Court went on to say,

> *"The fact that these reciprocal rights and obligations apply only to persons resident in one of the two contracting Member States is an inherent consequence of bilateral double taxation conventions. It follows that a taxable person resident in Belgium is not in the same situation as the taxable person resident outside Belgium so far as concerns wealth tax on real property situated in the Netherlands. Articles 56 and 58 do not preclude a rule laid down by a bilateral convention for the avoidance of double taxation such as the rule at issue in the main proceedings, not being extended, in a situation and in circumstances such as those in the main proceedings, to the residents of a Member State which is not party to that convention."*

There is no point in saying that you don't agree with a Judgement of the ECJ, because a Judgement of the ECJ is, to all intents and purposes, final and represents what the law actually is. But I don't agree with the Judgement. Direct taxes can only be levied subject to the treaties. They cannot be levied in a manner that conflicts with the treaties. It follows that bilateral agreements allocating the right to impose direct taxation as between two contracting states, must themselves be subject to the treaties and must not conflict with the treaties. It seems to me to be a conflict with the treaties if a double tax agreement gives to a resident of (say) Belgium a more favourable treatment when they invest in the Netherlands, than is the treatment accorded to a resident of (say) Germany. That is at least discrimination on the grounds of nationality and it is probably an interference with the freedom of movement of capital. I would have expected the Court to say that any resident of the EU is entitled to the most favourable treatment accorded in a Member State under any double tax agreement with any other Member State of the EU. Nothing else would prevent discrimination and interference with the free marketplace for capital. But I'm not in the Court and the Judges are, so I'm wrong and they're right.

IDT Card Services, Ireland Limited

The Court of Appeal Judgement in the UK case of IDT Card Services, Ireland Ltd shook up the UK tax world. I suspect it will disappear without trace very quickly, once it reaches the House of Lords. What was remarkable about the decision was that the Court of Appeal held that it was entitled to rewrite tax law by inserting a charge to tax where none existed, but where the fundamental principles of EU VAT would have suggested that Parliament ought to have imposed a tax charge. In some respects, this is the Ramsey & Furnace v Dawson approach to 'make up the law as you go along' dressed up in new clothes, or as I said, I don't expect the House of Lords, having just managed to get rid of Furnace v Dawson, et cetera, to allow it to be resurrected in this fashion. The background to the dispute lays in the fact that certain provisions of the sixth directive relating to prepaid vouchers, and telecommunications services, have been implemented in a different fashion in Ireland, compared to that in UK. It is not suggested that the manner in which Ireland has implemented the sixth directive is any way incorrect.

Ireland charges VAT on the supply, within Ireland, of the prepaid vouchers but does not charge VAT on the subsequent supply of telecommunication services on redemption of the vouchers. The UK charges VAT on the supply within the UK of telecommunication services, but not the supply of the prepaid vouchers. An Irish telecommunication company provides telecommunication services in Ireland in return for vouchers which are sold on and supplied in the UK. The result is that neither Ireland nor the UK charges any VAT on the transaction as a whole, taking the issue of vouchers and supply of services as a whole.

It doesn't matter greatly, but the general view is that the UK has failed to properly implement EU Law in their domestic legislation and the confusion arises primarily from that.

The response of the Revenue in the UK to the "non-taxation" situation was to attempt to assess on IDT Card Services, the VAT on the supply of telecommunication services from Ireland.

The argument put forward was that amongst the fundamental principles of VAT is that a transaction which is a supply of services should be taxed somewhere in the community. While Article 9 of the sixth directive lays down the territorial principles that decide which State should tax any particular transaction, it can be overridden where it is found that a transaction is entirely escaping VAT. In other words, since Ireland was not taxing the supply of telecommunications, the UK had the right (and indeed the duty) to step in and remedy that by charging it themselves. It is, of course, true that UK law doesn't do that and nobody suggested that the words used were capable of doing it.

Firstly, the Courts concluded that the Revenue were right in saying that it is a basic principle of VAT that a supply of service should be taxed somewhere. That said, the Courts have to face the practical difficulties as UK law did not appear to impose any charge.

The Court, at this point, noted that it was a general principle that legislation had to be interpreted, insofar as possible, in compliance with EU directives that are relevant. That raises the question of how far "interpretation" could go in making good gaps in legislation. The Court noted that the UK Human Rights Act of 1998 imposed a similar obligation on the Courts, to interpret legislation, insofar as possible, in a manner which is compatible with Convention rights. In the case of Ghaidan v Godin-Mendoza, the House of Lords had held that Human Rights Act "*is also apt to require a Court to read in words which change the meaning of the enacted legislation so as to make it convention-compliant."* What the House of Lords here decided was that words can be read into a Statute and the unambiguous and clear meaning of a Statute can be varied, where it is necessary to do this to render them compatible with the Convention on Human Rights. However, there were some limits to how far the Courts could go in effectively changing the law. It said, "*The meaning imported by application of (Section 3 of the Human Rights Act 2998) must be compatible with the underlying thrust of the legislation being construed. Words implied must go with the grain of the legislation*."

The Court of Appeal decided that it could follow similar principles in interpreting legislation in a fashion compatible with EU directives. It could change the unambiguous meaning of the legislation, and it could read in words that were not there, so as to change the meaning of the legislation. One could do all of this, provided it was following the general thrust of the legislation. According, the Court concluded that it was permissible for it to read in a charge to VAT where no charge to VAT had been enacted by Parliament, because to do so met one of the fundamental principles of EU VAT law, i.e., that a supply must be taxed somewhere.

In my view, the Judgement was wrong on a number of grounds. Firstly, while EU Law may indeed favour the view that a supply should be taxed somewhere, it is for Parliament and not the Courts to impose the charge of tax. It has been a long established principle both in the UK and in Ireland that the citizen or tax payer is entitled to rely on domestic law against the State, where the State has failed to properly implement EU provisions; but that where there are EU provisions that have direct effect in Member States, the citizens may nonetheless rely on EU Law against the State.

The Court also did not take note of the distinction between a taxing Statute and any other Statute. It is one thing to say that in relation to a non-taxing Statute, the Courts can flex the law very considerably, to the extent of writing law that doesn't exist, to make it compatible with the Human Rights Convention. But taxation has traditionally been the specific preserve of the House of the Commons in the UK, and of the Dáil in Ireland. It is a very different matter to say that in relation to a taxation Statute, the Courts may presume to write tax law that does not exist. Even if it could do so in a non-tax context, I would dispute that it has the right to do so under either Irish constitutional principles, or even under the UK Act of Settlement of 1689, which is the closest the UK has to a Constitution.

The UK Court of Appeal judgment on a VAT Issue

Much the same point of principle came up in another case before the Court of Appeal. This was the case of Fleming (trading as Bodycraft). The issue here concerned the decision by the UK to reduce from six years to three years the time limit in which people could make claims for repayment of input credits in VAT. The restriction was introduced in response to an ECJ judgment in the case of Mark's & Spencer's, and was designed in part to defeat it. In a subsequent case the ECJ held that while it was lawful, in the interests of legal certainty, to have a time limit on the right to make claims and initiate actions, the limit must not be of such a nature as to render impossible the exercise of rights under Community Law. The reduction from six years to three years was done overnight, and therefore persons who immediately before the restriction had a right to make a claim due to events more than three years old, found that overnight they had lost that right. The Court held that in the ordinary way a restrictive change in the law in this way should have a transitional provision of at least six months, so that those potentially affected had a reasonable time in which to exercise their rights.

Mr Fleming dealt in motorcars. He had bought some expensive cars for which he had difficulty in obtaining VAT invoices. He had been chasing the invoices for some years, and when he had last got them and made his claim for input credit, he found that the reduction in the time period allowed for making claims for repayment of input credit, to three years, meant that he had lost his right to input credit. He challenged the denial of input credit on the grounds that there ought to have been a transitional provision in the law.

I had never before considered that the time limits for making claims, and in particular the UK's reduction of those time limits, had any relevance outside of major retrospective claims arising out of ECJ cases. It had never previously occurred to me that a delay in claiming input credit because one couldn't get an invoice for a purchase, could lead to the claim for input credit being entirely time-barred.

The issue before the Court was whether the Revenue could rely on the reduction from six years to three years in the time limit for making claims, or whether the reduction was entirely ineffective to defeat Mr Fleming, because it did not contain any transitional provision as European Law would have required. That in turn led to the issue of whether it was possible for the Court to 'read in' a transitional provision of six months, where no such provision appeared in the Act.

The argument returned to the familiar ground of the obligation to construe domestic law, insofar as possible, in accordance with EU Law. There was the usual reference to the Gaidan v Godin-Mendoza case which concerned the Human Rights Act 1998 in the UK. That Act, as noted above, had a similar requirement, that domestic law be construed, insofar as it is possible to do so, in accordance with the Human Rights Convention. That case has been quoted from above and discussed above, so I won't repeat it here.

Interestingly, Lady Justice Arden, who is also a member of the Court which heard the IDT Cards case, decided that the Court of Appeal could not read in a six month transitional period into the provision reducing the time limit from six years to three years. Had there been some attempt to make provision for a transitional period, then it might have been open to the Courts to see if they could construe that provision "purposively" so as to comply with EU Law. However, no attempt whatever had been made to put in a transitional provision and the Judge felt that it would go outside the bounds of legitimate judicial interpretation of statutes, to read in an entire provision which did not exist.

I find myself unable to reconcile the view expressed in this case with the view expressed in the IDT Cards case. In IDT Cards, the Court felt able to read in a charge to tax where none existed. In the Fleming case, the Court felt unable to read in a six month transitional period, so as to provide taxpayers with additional time to make their claims, before the time period for making claims was reduced. Surely, if anything is outside the bounds of the powers of the Court, it is to impose tax where Parliament has not done so. If anything might be within the bounds of the powers of a Court, surely it is to give a form of relief from a taxation measure, where European Law requires the relief to be given.

I can't reconcile these two cases, which came from the same Court, within a short period of each other. Something very odd is going on.

VAT & Branches

The ECJ Judgement in the case of FCE Bank plc held that for VAT purposes, the head office of FCE Bank, plc in the UK could not be considered to render services to a branch of the bank in Italy. The branch was not separately incorporated and had no legal personality and was just a branch office of the UK company. Italy sought to charge VAT as if the branch was capable of contracting with its head office for services. The Court held that a provision of services was taxable only if there exists between the service provider and the recipient a legal relationship in which there is a reciprocal performance. That made it necessary to determine whether the branch could be regarded as being an independent bank and in particular whether it bore the economic risks arising from its business. The branch had no separate capital. Any loss that suffered was a loss suffered by the bank. Any risk incurred by the branch was a risk incurred by the bank. Accordingly, the branch was dependent on the company of which it was part and therefore constituted with it a single taxable person.

The case helps dispose of a long running controversy but it still leaves some untidy loose ends. In particular, the status of a branch operation which is in a VAT group with other resident companies remains a bit ambiguous. Is the entire company of which the branch was a branch a member of the VAT group? If so, what are the implications?

Boat Shows

The ECJ Judgement in the case of Gillian Beach Ltd indicates some of the complexities of interpreting VAT legislation. Gillian Beach Ltd organised two boat shows in the South of France. It provided mooring services, stands, customer greeting services, communication services, promotional activities, et cetera. These were provided as a package. Gillian Beach was not established in France. The French VAT authorities took the view that the place of supply of the services in question was France, notwithstanding that Gillian Beach was not established there. It relied on Article 9(2)(c) of the sixth directive. That is the article that lays down the place of supply of services rules. The relevant words are "*the place of supply of services in relation to: cultural, artistic, sporting, scientific, educational, entertainment or similar activities, including the activities of the organisers of such activities – will be the place where those services are physically carried out.*"

The point at issue was whether "similar activities" in relation to the long list of cultural et cetera activities, could be stretched to include the boat show.

In answering the question, the Court didn't focus on how entertaining the boat show was, or how educational it was, or whether the poseurs who go along to stare at the boats, wearing yachting gear while doing so, might be considered to be sporting. Instead, they asked what was it about all of the long list of activities that caused them to be treated as being supplied in the location at which they were supplied, rather than in the place of establishment of the supplier. The Court said,

> *"The features under the various categories of services referred to – originating in the complex nature of the services concerned, which are various services, and in the fact that those services are generally provided for a number of different recipients, that is to say, all the people taking part, in a variety of capacities, in cultural, artistic, sporting, scientific, educational or entertainment activities. Those various categories of services also have the common feature that they are usually provided for specific events, and the place where those complex services are physically carried out is easy to identify."*

What all of that added up to was that the cultural, educational, et cetera list of activities usually involved a complex package of services rather than a single distinct service; usually involved buying in inputs from a wide range of persons; were usually supplied not on a one-at-a-time basis to a specific person, but to a wide group of persons simultaneously; and usually were held in a well identified place. The boat show had all of these features. So, Article 9(2)(c) did apply to the boat show and the place of supply of the service of the organisers was in France, and not where they were established.

The only trouble I find with that approach to interpretation (which is strongly purposive) is that the type of criteria that were identified for determining that the boat show was similar to a cultural, or educational, or scientific event, could, conceivably, be found in a wide range of activities which clearly would have nothing to do with culture, sports, et cetera. Words surely have to mean something even if they don't mean a lot in the area of VAT compared to basic principles underlying VAT. Therefore, one would have thought that the Court should have paused to consider whether the boat show in any way did resemble a cultural, sporting or educational event, when viewed from the perspective of the recipient of the supply. But that feature is totally ignored in the Judgement. For all the difference it made, the supply of services could have been that of baggage handling at an airport – something supplied to a large group of people at one time, in a well defined location, involving the buy-in of complex varieties of inputs and services to achieve delivery. I would have preferred it if Court had decided that a boat show is essentially an entertainment event, if those were the grounds on which it fell within Article 9(2)(c). Undoubtedly, it is pure entertainment for the majority of the people who go along to stare at the boats. For a minority, it probably is an opportunity to help make a decision when buying or leasing a boat. But that sort of analysis was ignored.

Get Your Claims in Early

The Advocate General's opinion in the case of Banca Popolare di Cremona (also known as the IRAP case), if confirmed by the full ECJ, has major implications for all future tax cases before the ECJ. The main point of significance is not the actual point in issue in the case – whether a form of tax in Italy introduced in 1997 to finance local government, was illegal by virtue of the sixth VAT directive – but rather the Advocate General's decision as to the time from which the tax should be considered to be illegal. In other words, it is his decision as to which tax payer should benefit from the tax being struck down, and then becoming entitled to a refund, and which tax payers should not benefit, that matters.

The actual point at issue was whether or not IRAP was illegal. IRAP was a form of sales tax. No new principles were established in the case in deciding that it was illegal. In the case of Dansk Denkavit, the ECJ defined the essential features of a tax which would render it similar to VAT, and therefore illegal under EU law. About the only point added in the current case was a ruling by the Advocate General that it was not only indirect taxes which could be illegal if they possessed the four features outlined in the Dansk Denkavit case but even a direct tax.

The key point was, the ruling on when a decision of the ECJ that IRAP was illegal should take effect. Traditionally, rulings of the ECJ saying that a tax is unlawful mean that it is unlawful from the day it was enacted. Typically, that means that anybody charged the tax is entitled to a refund. However, there have been cases in the past when, for various reasons, the ECJ ruled that the illegality of a tax should take effect, not from the day on which it was enacted, but from some other date – typically the date which the Advocate General's opinion holding it to be illegal was published. There have even been cases where laws held to be illegal were nonetheless permitted to remain in place for a period of time, in order to enable the National Parliament to devise a new (and compatible with EU Law) law. Past Court rulings, therefore, did not make it inevitable that because a law was struck down as being illegal, everybody who had been charged tax in foot of that law would get a refund.

The Advocate General said, "*An essential criteria must be met, namely that those concerned should have acted in good faith and that there should be a risk of serious difficulties in the absence of a limitation.*" In other words, if refunds were not to be due from day one of the law, the tax law must have been introduced by a State which believed it to be compatible with EU Law when it introduced it. Secondly, the prospect of refunding all of the tax must be such as would seriously undermine the finances of the State in question. In the IRAP case, both of those criteria were met. The Italian government had received a ruling from the EU Commission that IRAP was compatible with EU Law. If it had to refund all of the tax, the amount involved would be approximately 120 billion euro, something that would make a noticeable impact even on finances as disastrous as those of Italy.

Having decided that it was appropriate to limit the effect of the judgment, and therefore to cut off many tax payers from prospect of repayment, the Advocate General had to decide from what date his ruling would take effect (if confirmed by the Court). What the Advocate General had to balance was the interest of the State in not being bankrupted, and yet at the same time the need to provide an incentive to tax payers to challenge unlawful taxes. He also had to take account of the fact that IRAP were cancelled overnight, the Italian regions would go bankrupt. They needed an immediate replacement tax and it would inevitably take a certain amount of time to legislate for that. The Advocate General said,

> *"The Italian authorities cannot be expected to change overnight their whole system of financing regional expenditure, nor can they be expected to have changed it in anticipation of the Court's Judgement. If all tax payers could rely immediately on that Judgement in order to reclaim sums levied in IRAP as from the date of its delivery that would be tantamount to abolishing the tax, and a means of financing the Italian regions, with immediate effect. On the other hand, a date should not be set too far in the future. If it would be unreasonable to expect the immediate replacement of one tax by another, it is not unreasonable to*

> *suppose that the Italian authorities have now made contingency plans for such replacement."*

Accordingly, he gave them until 31st December 2006 to replace IRAP with an alternative lawful tax. In the meantime the tax, although unlawful, may continue to be levied. The Advocate General then went on to consider what to do about refunds. He said,

> *"An exception is to be made (from the rule permitting Italy to continue to levy IRAP until the end of 2006) for claims brought before a particular date and that date is to be chosen in the light of the considerations outlined in the previous paragraph, it should meet the following conditions: It should be as objective as possible; it should be likely to distinguish as far as possible between earlier claims brought in the belief that they were well founded, but nonetheless at some risk in view of the certainty of their outcome, and those brought at a later date in the light of a perceived probability of success; and it should be such as to dispose substantially of the problem posed by the extremely large number of claims."*

The Advocate General decided that the date of the publication of his opinion met these tests. If this approach is followed in the future in the case of a ruling which would result in huge tax refunds in any State, the result would be to permit those who make early claims to get their refunds, but to deny refunds who 'jump on the bandwagon' when it becomes pretty safe to assume that the taxpayer is going to win the case. Such an approach will certainly favour those who keep a close watch on what taxation issues are being referred to the ECJ, no matter from what Member State they are referred, and to get protective claims submitted as quickly as possible. Of course, it is not the case that the Advocate General in this case is saying that in all cases in the future there will be a cut-off on refunds. This is applying only where tax was levied in good faith, in the belief that it was lawful, and where the consequences of full refunds would be disastrous for the State in question. Nonetheless, it is important to take note.

Goodwill

The UK Special Commissioner's decision in the case of Balloon Promotions Limited involves examination of the nature of goodwill. Several franchisees of Pizza Express sold their restaurants to Pizza Express under contracts that allocated consideration to the premises, to the cancellation of the franchise agreement, and to goodwill. The Revenue challenged the allocation and claimed that the franchisees possessed no goodwill in their businesses, since all goodwill belonged to Pizza Express.

The point at issue is not of great relevance in Ireland as it turns on the availability of roll-over relief, which we no longer have. However, the Special Commissioner's Judgement is the most extensive examination of case law and accounting material on the nature of goodwill that I have ever read. It should be an invaluable resource to anybody having to tackle the matter of whether goodwill exists, and how one determines it.

The O'Flynn Case

The High Court has given Judgement in the case of Revenue Commissioners v O'Flynn Construction & John and Michael O'Flynn. This was an eagerly awaited Judgement. It was expected to clarify many of the ambiguities of s811. In the event, it is a disappointment. General Anti-Avoidance Provisions exist in several countries, and their format tends to be closely related. For that reason, Judgements on the topic of general anti-avoidance provisions tend to circulate internationally. I wonder what Judges in other countries would make of this Judgement?

The first issue one would expect to be addressed is whether or not s811 is contrary to the constitution. The issue was not referred to. It has been suggested to me that perhaps it is an issue that would be raised in separate proceedings. I cannot see the point of determining a tax appeal if the question of whether or not the relevant legislation is unconstitutional remains undecided. It seems to me to be the prior issue that has to be decided first. S811 permits the Revenue Commissioners to exercise their discretion and Judgement to impose tax on the taxpayer otherwise than in accordance with Statute Law imposing taxation (apart from s811). The power to impose taxation in Ireland is reserved to Dáil Éireann. There is therefore a prima facie case that s811 is unconstitutional. That is not a matter that can be raised before the Appeal Commissioners but it is a matter that can and should be raised before the Superior Courts.

The first matter that had to be addressed in the application of s811 is to be found in subsection 2, where the key issue is whether or not "the transaction" was undertaken primarily for purposes other than to give rise to a tax advantage, when the matter is viewed objectively in terms of the results of the transaction, its use as a means of achieving those results, and any other means by which the results could have been achieved. The Judge, quite rightly, said that the subjective motives of any of the parties to the transaction were not an issue in the case and that the matter had to be viewed objectively. That, however, was about the last useful comment I could determine in the Judgement, in relation to this matter.

The taxpayer argued that the primary purpose of "the transaction" was to transfer monies from the companies to the individual shareholders by way of dividend.

"The transaction" has to be defined by the Revenue Commissioners and can include several separate steps. Once defined, the Revenue Commissioners have to demonstrate that the defined steps give rise to a tax advantage, and it is by reference to an objective evaluation of the defined steps, that the question of whether or not there was primarily a non-tax purpose, has to be determined. It is not enough that one or more of the steps, in a grouping of several steps, may be entirely tax driven. Once, “the transaction” has been defined as including several steps, it is the group of steps as defined, in total, which must be evaluated on an objective basis. One would therefore expect a consideration in the Judgement of what the objective results of “the transaction” were, e.g. how much money left to the companies, and to whom the money went, what impact on reserves resulted, etc.

One will look in vain for any discussion of the objective results of “the transaction.” It might be presumed that had a dividend been paid by the O’Flynn Group to its shareholders without any steps being first taken to secure export sales relief reserves from another group, that ACT liability would have arisen within the construction companies, and that as the total tax cost resulting from the payment of the dividend, would this be increased a lesser sum would have reached the shareholders. The shareholders would have been liable to income tax but with a tax credit in an amount equal to the ACT. However, on the basis of the transaction that did occur, no ACT liability arose, no taxation liability arose on the individual shareholders, and the total cash flow may have been greater or less (we are not told) that would otherwise have been the case. We are given no measure of the amount of the tax advantage, to enable us to compare it with the other objective consequences of the transactions, e.g. the dividend paid, and received. We are supplied with no basis whatever for examining how the Judge reached his conclusion (which I presume he did, although I cannot clearly find it expressed) that objectively, the primary purpose is not commercial.

Where the conclusion is arrived at that the transaction was a tax avoidance transaction and its purpose was not primarily commercial, it is then necessary to consider whether or not it was undertaken with a view to realising business profits, or, not undertaken primarily to give rise to a tax advantage. In arriving at this decision, it would seem that the Court is not constrained to ignore the subjective motivations of parties, as they were in the first decision discussed above. Once again, however, we must focus on “the transaction” as defined, i.e. a transaction of several separate steps. The fact that any single step, taken in isolation, might be primarily tax driven, does not provide an answer as to whether the several steps, taken together, are primarily tax driven. Unfortunately, I can detect no discussion of this matter (at any rate, in any form that I can recognise or understand) in the Judgement.

The third matter the Court should then have addressed was whether or not “the transaction” was undertaken for the purpose of obtaining the benefit of any relief, etc. and would not result directly or indirectly of the misuse of the provision or abuse of the provision of regard to the purposes for which it was provided.

One would have expected at this point that each of the reliefs availed of would be identified, and that there would be, in relation to each one, a discussion of the purpose of the statutory provision relating to that relief. One would hope in vain. The following quotations are the only ones I can discover with relevance to these issues:

> *"In the Instant case, the company was a construction company who were not in anyway carrying on business of either providing for or manufacturing or otherwise dealing in goods for export. The acquisition of the export sales relief in the manner earlier referred to in my Judgement was considerably outside the ambit of their business. – The export sales relief purchased in the Instant case was relief granted and intended by the Legislature for a particular purpose and not as a commercially available product, as occurred in the Instant case – In my Judgement, the transaction the subject to these proceedings – whereby export sales relief reserves from the Dairygold Group were transferred to a company that was not engaged in the manufacture of goods for export and thereby enabled fully tax relieved dividends to be paid to the shareholders of the construction company, is completely at odds with the purpose for which sales relief was provided."*

The Judge may or may not be right, but it would have been nice to know what the purpose was for which export sales relief was provided, in his opinion. Because unless one can identify that purpose, and explain how one has identified it, how can one determine whether or not an abuse or a misuse has occurred? The purpose behind export sales relief was considered by the Supreme Court in the banana manufacturing case – Charles McCann Ltd – and that case is referred to in the Judgement in this case, but without extracting from it a statement of the purpose of export sales relief.

My recollection is that the Court found that the purpose was to encourage investment in productive enterprises requiring large scale plant and machinery, and employment of people to use the plant and machinery. This purpose was to be served by exempting export profits from tax; and by permitting the company the privilege of paying dividends which themselves would be exempt from tax in the hands of other shareholders, whether corporate or individual.

In the present case, we were very concerned with the payment of dividends out of export sales relief reserves. Therefore, we have expected some focus on why export sales relief was not confined to an exemption from tax on trading profits, but was also provided in relation to dividends out of those profits. One might infer (reasonably) that it was to encourage the investment of monies in manufacturing companies, and to assist manufacturing companies in raising capital. It is difficult to see what other possible purpose this particular aspect of the relief could have. The legislation clearly envisaged that a manufacturing company might be within a group and have corporate shareholders. The legislation clearly envisaged that those corporate shareholders could avail of the benefit of export sales relief when they themselves paid dividends out of reserves obtained from dividends from the exporting company. Where, therefore, was the abuse in the present case? There may well have been abuse but it would have been nice to have it explained as to where it lay.

The Judge went on to say,

> *"I am unable to accept that the determination of the Appeal Commissioners that the scheme and purposes disclosed for the statute of the export sales relief attributable to or derived from manufacture can be equated to or embraced by what was essentially a building or construction company. Whatever argument might be advanced in respect of a company that carried on business purely intended to be embraced by the export sales relief provisions, such to do not exist in the instant case."*

What are we to understand from that statement? Are we to understand that a construction company is in some sense debarred from passing on to its shareholders the benefit of export sales relief obtained itself from dividends from manufacturing companies? Given that many, and possibly even the majority, of manufacturing companies in Ireland were subsidiaries of other companies which did not carry on manufacturing, the conclusion that a company did not itself manufacture and export was outside the ambit of export sales relief, or at least was abusing its purposes, if it sought to avail of it, is a startling matter to discover some fifty years after relief was introduced.

There have been construction companies that had manufacturing subsidiaries, and obtained dividends from them, and whose shareholders ultimately claimed export sales relief. Are we to assume that because a construction company passed on export sales relieved dividends, there has been an abuse of the legislation? It is difficult to understand much else from the quotation given above. It is so obviously wrong, that one is driven back to the conclusion that the quotation given simply throws no light whatsoever on the subject matter of the O'Flynn case.

Many of Ireland's quoted plcs have export sales relief reserves (or had), derived from dividends from the manufacturing subsidiaries. The shareholders in such plcs may from time to time have included other corporates who could be shareholders for a short, or for a long, period to a greater or lesser extent. If a dividend were paid to such corporate shareholders out of export sales relief reserves of the Plc, are we to take it that there was abuse? I doubt it. The real problem is, of course, that this Judgement simply does not explain in any sensible fashion the conclusion arrived at, that s811 was correctly applied.

At the outset I pointed to the critical importance of the definition of "the transaction", since everything else in s811 flows from that transaction as defined, i.e. from the steps included in it, and also from the steps excluded from it. At the time of writing, I do not have access to the case stated, which was supposed to be attached to the Judgement. It may be that it would throw some light on the steps that were included in the defined transaction, and might enable readers to form some view of wherein abuse was detected. However, it is surely not satisfactory that one can read the High Court Judgement from beginning to end without having the faintest clue as to where abuse was found, or why or how, and that one is left to go seek the Appeal Commissioner's Judgement, or the case stated in an effort to find the answer to this.

It is pointless to go on to discuss this judgement any further. It sheds no light whatsoever on s811 and is useless as a guide to the interpretation of the legislation.

Controlled Foreign Companies

I will comment only briefly on the Advocate General's opinion on the Cadbury/Schweppes case. That opinion, while formally stating that CFC legislation is not incompatible with EU treaties, in reality has the effect of rendering most CFC legislation in the community illegal. The contrast between what was formally stated, and in reality achieved, is remarkable. Readers might reasonably detect reluctance and distaste on the part of the Advocate General in arriving at the conclusions that he was obliged to arrive at.

The outcome of the case was open and shut, and therefore there is no need to hold you in suspense before telling you that controlled foreign company legislation, when applied to a group resident in one Member State, which establishes a trading subsidiary in another State, is in almost every circumstance illegal. The circumstances in which it remains legal are sufficiently unusual and unremarkable not to be worth thinking about.

One of the most interesting aspects of the Advocate General's opinion arises in paragraph 31 of that opinion where he states, "*I am of the opinion, like several of the interveners, that it is in the light of freedom of establishment that the compatibility of the legislation in question should be examined*". In saying this, the Advocate General rejected the proposition that he should consider whether or not freedom of movement of capital had also been contravened. Freedom of establishment is a freedom that applies only insofar as a person resident in one Member State seeks to carry on business in another Member State. In contrast, freedom of movement of capital includes the right of persons to move capital out of the community into States outside of the community. It follows therefore from paragraph 31 of the opinion that whatever will be decided would effect only the establishment of subsidiaries within the community, but not the freedom to establish subsidiaries outside of the community.

This approach was justified as follows:

> *"According to case law, the nationals of a Member State have a holding in the capital of a company established in another Member State giving them definite influence over that company's decisions in allowing them to determine its activities, it is the provisions of the treaty of freedom of establishment which apply and not those relating to the freedom of movement of capital."*

It therefore remains for another day for the legality of CFC legislation insofar as it impacts an investment outside the EU, to be challenged. It would be quite illogical if the freedom of movement of capital were infringed where "transfer of assets abroad" type legislation is applied to an individual requiring a unit in a foreign collective investment undertaking, but is not infringed if CFC legislation is applied to a quoted company setting up wholly-owned treasury management subsidiary in Guernsey.

The Advocate General also declined to examine the matter in terms of whether or not CFC legislation conflicted with the freedom to provide services. He justified his refusal on a number of grounds, including that any interference with the provision of services was inherent in interference with the freedom of establishment, and secondly, that in any event it would not change the outcome of his analysis.

In this, I think that the Advocate General was wrong. UK CFC legislation makes specific reference to transactions between the foreign subsidiary and UK companies, insofar as those transactions produce a reduction in UK taxation, i.e. a reduction compared to the tax which would have been due in the UK if those transactions had not been carried out. Where that latter condition exists, to avoid CFC legislation, the UK company must show that the reduction in UK tax was not the main purpose, or one of the main purposes, of the transaction. That particular legacy of CFC legislation is quite distinct from the freedom of establishment issue. Even if CFC legislation did not interfere with the setting up of a foreign subsidiary, which it does, it would, on that footing have interfered with its freedom to provide services to its UK associate companies.

The Advocate General went on to make an important statement:

> *"I do not believe that the fact that a parent company establishes a subsidiary in another Member State for the avowed purpose of enjoying the more favourable tax regime in that State constitutes in itself, an abuse of freedom of establishment, which would thereby deprive that company of the opportunity of relying on the rights conferred by Articles 43 and 48."*

He then went on to examine prior case law on freedom of establishment, illustrating how it led to that conclusion. That case law illustrated that,

> *"Establishment means "integration into a national economy". It is therefore the exercise of an economic activity in the host Member State which is the raison d'être of freedom of establishment – – it can be inferred from that case law that as long as there is genuine and actual pursuit of an activity by the controlled subsidiary in the Member State in which it was established, the reasons for which the parent company decided to establish the subsidiary in that host country cannot call into question the rights which that company derives from the treaty. Cadburys right to rely on the protection conferred by articles 43 and 48 therefore depends, in this case, on whether (its subsidiaries) are in fact conducting genuine and actual business in Ireland. It is for the National*

> *Court to decide that question, which is keenly disputed between the applicants and the United Kingdom."*

The Advocate General went on to say in paragraph 54:

> *"The level of taxation is a factor which a company may legitimately take into account in choosing the host Stateint which it intends to establish its subsidiary – – a Member State cannot hinder the exercise of the rights of freedom of movement in another Member State by using the pretext of a low level of taxation in that State."*

The Advocate General went on to note that all interference with freedom of establishment is not outlawed by the EU treaties. Some interference can be justified and the counteracting of tax avoidance is one possible justification for interference. That was confirmed as recently as the Marks & Spencer ECJ judgement. But, the interference must be proportionate. Furthermore, "tax avoidance" cannot be used as a cover from protectionism. Blanket measures catching the innocent and the guilty are not permissible and legislation must be sufficiently specific as to enable the Courts, on a case by case basis to determine that there has been tax avoidance of an abusive nature, and to ensure that the legislation is applied to that alone.

He went on to say:

> *"We have seen that 'establishment', within the meaning of Article 43 et seq., involves the actual pursuit of an economic activity in the host State. If the subsidiary is actually carrying on such an activity in that State, and in that connection, it provides genuine and actual services to the parent company, I do not think that the situation may 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 in the State of origin. – – as long the subsidiary carries on a genuine economic activity in the host State, there is no difference between the provision of services to third parties and the provision of those services to companies belonging to the same group as the subsidiary."*

These quotations from the Advocate General have two direct implications. Firstly, CFC legislation can be applied where a foreign subsidiary is set up so that it diverts income from the parent company, without carrying out any genuine economic activities to earn that income; and that transfer pricing legislation which applies open market value to all transactions within a foreign subsidiary and its resident parent company, are justifiable, and that indeed the proper limits to CFC legislation lie in (1) the application of transfer pricing to economic transactions between the foreign subsidiary and the parent and (2) the countering of the diversion of income without a corresponding diversion of economic activity. That is not what he said, but I think I've said it much better than he did.

What the Advocate General said was,

> *"The assessment of whether there is a wholly artificial arrangement intended to circumvent national tax legislation in a parent company's relationship with a CFC must entail a case-by-case examination of whether the subsidiary is genuinely established in the host State and carries on its activities in that State with regard to the services provided to the parent company, the payment for which has resulted in a reduction in the tax due by that company in the State of origin. – – it means examining whether the subsidiary has the premises, staff and equipment necessary to carry out the services provided to the parent company – – it is a question of looking at the competence of the subsidiary staff in relation to the services provided and the level of decision-making in carrying out those services – – it (is) possible to take account of an objective situation which the services provided by the subsidiary are of no economic substance in the light of the parent company's activity."*

I wouldn't really dispute much of what the Advocate General said above but for one major ambiguity inherent in it. What about outsourcing? A company may be established in Ireland, with a board of directors that meets here and have neither premises, nor employees, nor equipment and yet may very adequately carry out real economic activities in Ireland, and genuinely earn profits from those activities. It can do that entirely by employing agents to conduct its affairs, rather than employees. The conduct of business through agents is commonly known as 'outsourcing'. Now, if a company resident in the UK (e.g. a subsidiary of the same parent to whom CFC legislation is applied in the case of an Irish subsidiary) outsources all of its activities in the UK, there are no adverse UK economic consequences (outside possibly of the area of VAT in the case of companies carrying on exempt activities). Why therefore should there be any inhibition placed on a subsidiary resident in Ireland in fully outsourcing its business? This is the major flaw in the Advocate General's opinion. It may be a politically satisfactory opinion, reconciling the demands of the high tax economies for CFC-type protection, with the requirements of the Treaty that freedom of establishment be permitted. However, it is based on a superficial understanding of the manner in which companies may conduct their business and is flawed for that reason. It does no more than put off the day when another case will have to be taken to the ECJ (assuming the ECJ confirmed its opinion) on which the issue of the application of CFC legislation to a foreign subsidiary which engages in outsourcing, is raised.

It seems to me that the basic principle stated by the Advocate General – the freedom of establishment does require that the person claiming it should establish abroad and carry on business abroad – is correct. Where he has gone is being dogmatic in the criteria by which one may determine whether or not a company is established abroad, and does carry on business abroad. Employees, premises, etc are mere points of evidence as to whether one is established abroad. They are not central to the principle that the Advocate General was stating, and I think it will ultimately be clarified that outsourcing may not be interfered with by CFC legislation, anymore than may establishment using employees be interfered with by it.

Having carried out a reasonable analysis, and arrived at fairly reasonable conclusions (as the reservations have noted), the Advocate General then went on to make the startling statement that UK CFC legislation was compatible with the EU treaties – provided it actually meant no more than what he had set out, i.e. that it countered, on a case-by-case basis, only totally artificial arrangements involving no real establishment abroad, and no real provision of services abroad for a commercial price. Now, everybody on earth knows that that is not what CFC legislation means, nor is what it achieves. One can only surmise why the Advocate General could not bring himself to state what was plain from his analysis, i.e. that UK CFC legislation was dead, and had at all times been illegal since the UK signed up to the Treaty of Rome.

The last thought. This case was brought by a UK company. It was brought over 30 years after Ireland joined the EU. For 30 years, our attempts to attract inward investment have been severely hampered by CFC legislation in other Member States of the EU. We have known all along that such legislation was illegal. Was our timidity in failing to challenge illegal actions on the part of our fellow members wise? Was it statesmen-like, or just sheer funk? This case could have been brought 30 years ago. In my view, nothing is gained by tolerating illegal action on the part of one's partners. Ultimately, they will not be grateful to you for it, and the first time you tread on their interests, you will hear all about it. Nobody will look after our interests if we don't do it ourselves – thankfully, our interests and those of Cadbury/Schweppes happen to coincide on this occasion, or nothing else would have happened as regards CFC legislation. Those who should have brought this action on behalf of the Irish State have some explaining to do, and I don't think that they would have any very convincing explanations to come up with.