

The case was referred to the European Court of Justice in proceedings between Cadbury Schweppes plc ("CS") and Cadbury Schweppes Overseas Ltd ("CSO") on the one hand and the Commissioners of Inland Revenue on the other hand, concerning the taxation of CSO in respect of the profits made in 1996 by Cadbury Schweppes Treasury International ("CSTI"), a subsidiary of the Cadbury Schweppes group established in the International Financial Services Center in Dublin (Ireland) ("the IFSC").

CS, a resident company, is the parent company of the Cadbury Schweppes group which consists of companies established in the United Kingdom, in other Member States and in third States. That group includes, *inter alia*, two subsidiaries in Ireland, Cadbury Schweppes Treasury Services ("CSTS") and CSTI, which CS owns indirectly through a chain of subsidiaries at the head of which is CSO.

CSTS and CSTI, which are established in the IFSC, were subject to a tax rate of 10%. The business of CSTS and CSTI was to raise finance and to provide that finance to subsidiaries in the Cadbury Schweppes group. CSTS and CSTI were established in Dublin solely in order that the profits related to the internal financing activities of the Cadbury Schweppes group could benefit from the tax regime of the IFSC. Given the rate of tax applicable to companies established in the IFSC, the profits of CSTS and CSTI were subject to 'a lower level of taxation' within the meaning of the legislation on CFCs. The United Kingdom tax authorities took the view that, for the 1996 financial year, none of the conditions for exemption from taxation provided for by that legislation applied to those subsidiaries.

Although direct taxation falls within their competence, Member States must none the less exercise that competence consistently with Community law. Freedom of establishment entails the right to exercise their activity in the Member State concerned through a subsidiary, a branch or an agency. Even though the provisions of the Treaty concerning freedom of establishment are directed to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation.

The separate tax treatment under the legislation on CFCs constitutes a restriction on freedom of establishment within the meaning of Articles 43 EC and 48 EC. Such a restriction is permissible only if it is justified by overriding reasons of public interest. The need to prevent the reduction of tax revenue is not one of the grounds listed in Article 46(1) EC or a matter of overriding general interest which would justify a restriction on a freedom introduced by the Treaty. On the other hand, a national measure restricting freedom of establishment may be justified where it specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned.

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

