

# Direct Tax Cases and *Halifax*

## A help or a hindrance?

**A**s an advocate I subscribe to the view that anything that hinders my opponent must help my client and *vice versa*. Classifying propositions of law as a help or a hindrance is therefore typically my first port of call. What then of the current vogue for relying upon propositions of law to be derived from ECJ judgments in direct tax cases and applying them to VAT disputes concerning *Halifax*?

Paragraphs 74 and 75 of the ECJ's judgment in *Halifax* were cited in its judgment in *Case C-196/04 Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue*. The context was a discussion about wholly artificial arrangements in the field of direct tax. It was in paragraphs 74 and 75 of *Halifax* that the Court of Justice laid down the two conditions for the application of the principle of prohibiting abusive practices in the field of VAT:

- firstly, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, the transactions under consideration result in the accrual of a tax advantage, the grant of which would be contrary to the purpose of those provisions; and
- secondly, that the essential aim of the transactions is to obtain a tax advantage.

Although the guidance given by the ECJ in *Halifax* was broken down into two parts, the principle of abusive practices is based upon one unitary concept whose origins lie in the general principle of Community law that any legal order which aspires to achieve a minimum level of completion must contain self-protection measures. Those measures ensure that the rights conferred by the legal order are not exercised in a manner which is abusive, excessive or distorted. I call this the safety-valve principle. The need for self-protection is inherent in the

*Melanie Hall QC of Monckton Chambers explores the extent to which it is helpful to read across principles to be derived from ECJ case law in direct cases to VAT cases concerning abusive practices*

legal order itself, which is why ultimately the principle of abusive practices is simply a principle of interpretation – the most effective safety valve of all.

It is because the principle of abusive practices is a principle of interpretation that very little of any real value can be derived from the ECJ case law on direct tax. Since the legal orders under consideration in direct tax cases have different objectives from the legal orders comprising the VAT system, the opportunities for a read-across are very limited indeed and in some instances to do so would be positively dangerous.

The point can be illustrated by reference to the *Cadbury Schweppes* case, although other cases such as *Case C-446/03 Marks & Spencer plc v Halsey* and *Case C-524/04 Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue* could equally well illustrate the point.

As a brief reminder, *Cadbury Schweppes* concerned the taxation of profits made by a Cadbury Schweppes subsidiary established in Ireland. The dispute arose out of the UK legislation on controlled foreign companies (CFCs), which provided for an exception to the general rule that a resident company is not taxed on the profits of a subsidiary as they arise. The effect of the legislation was that profits of a foreign company in which a resident company owned a holding of more than 50% were to be attributed to the resident company and taxed in its hands. The legislation was designed to apply when the CFC was subject to taxation in the State in which it was established which was lower than

that to which it would be subject if it were in the UK. The effect of the legislation was to take away the tax benefits of establishing and capitalising companies in another Member State where that had taken place solely to take advantage of a more favourable tax regime than that applicable in the UK. The legislation provided for an exclusion where two cumulative conditions were satisfied: first, that the reduction in UK tax was not the main purpose of the transactions giving rise to the profits of the CFC; second, that the reduction in UK tax was not the main or one of the main reasons for the particular structure under consideration. That Cadbury Schweppes had been motivated by tax considerations was not in issue. The ECJ was asked to consider whether Articles 43, 49 and 56 of the Treaty concerning freedom of establishment precluded the legislation.

The Court concluded that the legislation could not be applied where it is proven, on the basis of objective factors ascertainable by third parties, that despite the existence of tax motives, the CFC was actually established in the host Member State and carried out genuine economic activities there. The converse of that proposition was that a restriction on freedom of establishment could be justified if the restriction was designed to prevent wholly artificial arrangements.

### The potential for a read-across

On the face of it there appears to be some scope for a read-across from *Cadbury Schweppes* into VAT cases concerning abuse.

