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Euro Tax Flash from KPMG's EU Tax Centre

CJEU decisions on the Parent-Subsidiary Directive

X v Ministerraad case (C-68/15) on the Belgian 'fairness tax'

and

Association française des entreprises privées (AFEP) and Others v Ministre des finances et des comptes publics case (C-365/16) on the French additional contribution

Freedom of establishment – EU Parent-Subsidiary Directive — Fairness tax — French additional contribution – Withholding tax — Distribution of profits by parent companies

On May 17, 2017, the Court of Justice of the European Union ('CJEU', or 'Court') rendered its decisions in two cases concerning the compatibility with EU law of two types of Member State levies in connection with the distribution of profits.

The *X v Ministerraad* case (C-68/15) concerns the compatibility of the Belgian 'fairness tax' with the freedom of establishment as provided for under the Treaty on the Functioning of the European Union (TFEU) and with the EU Parent-Subsidiary Directive ("Directive"). The 'fairness tax' is an additional tax imposed in respect of certain corporate profit distributions. The CJEU ruled that it is for the referring court to ascertain whether the method of determining the taxable amount of 'fairness tax' puts a non-resident company in a less advantageous position than a resident company, thereby violating the freedom of establishment. The CJEU further noted that the disputed tax does not qualify as a withholding tax within the meaning of the Directive but nevertheless found that, to the extent that the parent company redistributes dividends received from non-resident subsidiaries, it is precluded by Article 4 of that Directive.

The *Association française des entreprises privées (AFEP) and Others v Ministre des finances et des comptes publics* case (C-365/16) concerns the compatibility with the Directive of Article 235 ter ZCA of the French General Tax Code, which provides for an additional contribution to corporate income tax (‘ additional contribution’) imposed in respect of profits distributed by a resident company. As in the *X* case, AFEP and Others argued that the contribution infringed Article 4 of the Directive and, in the alternative, that it should be regarded as a withholding tax within the meaning of the Directive and therefore precluded by its provisions. The CJEU found that the contribution did infringe Article 4 where the parent company redistributes dividends received from non-resident subsidiaries. The Court noted that there is no need to rule on whether the contribution has the characteristics of a withholding tax within the meaning of the Directive.

The *X v Ministerraad* case

Background

According to Belgian domestic legislation, the ‘fairness tax’ applies as a separate assessment from corporate income tax, where the distributing company’s profits are wholly or partially reduced owing to the use of certain tax deductions provided for by the national tax system. The tax rate is 5.15 percent and the taxable amount is the positive difference between the gross dividends distributed and the distributing company’s final taxable profits in the same taxable period, subject to certain adjustments.

The ‘fairness tax’ also applies to non-resident companies that operate in Belgium through a permanent establishment (PE), in which case the taxable base is the portion of dividends distributed by the non-resident company that corresponds to the Belgian PE’s share in the company’s total profits. The tax applies irrespective of whether profits have been transferred from the Belgian PE to the company established in another Member State.

The Belgian Constitutional Court asked the CJEU for a preliminary ruling on (i) whether the application of the ‘fairness tax’ to non-resident companies with Belgium branches violates the freedom of establishment, (ii) whether the ‘fairness tax’ is a prohibited withholding tax within the meaning of Article 5 of the Directive, and, (iii) whether Article 4 of the Directive precludes the application of the ‘fairness tax’ on dividends that a Belgian company has received from a subsidiary and that it subsequently redistributes to its own parent.

The CJEU decision

The CJEU first addressed the question of compatibility of the ‘fairness tax’ with the freedom of establishment and noted that companies established within the EU have the freedom to choose the legal form (e.g. a subsidiary or a branch) in which to operate their activities in another Member State, without hindrances by discriminatory tax provisions. In determining whether a non-resident company with a Belgian branch is treated in a manner that is discriminatory, its situation must be compared to that of a resident company, including a Belgian subsidiary of a non-resident company. The CJEU concluded that it is for the referring court to determine whether the method of establishing the taxable amount for the purposes of the 'fairness tax' results, in all situations, in the non-resident company not being treated in a less advantageous manner than a resident company. In this respect, the Court noted that, given the aim of the tax, there would be less advantageous treatment if the tax was levied in respect of profits that were outside the Belgian tax jurisdiction. The Court rejected the justifications brought forward by the Belgian Government – the balanced allocation of taxing rights and combating abuse – as, on the one hand, the disputed legislation is aimed at taxing profits derived in Belgium and therefore does not seek to allocate taxing rights and, on the other hand, it is not intended to prevent abusive practices.

The Court then went on to assess whether the 'fairness tax' qualifies as a withholding tax within the meaning of Article 5 of the Directive, and is therefore precluded by the provisions of that article and did so by reference to the three conditions established in its previous decision in the *Burda* case (C-284/06), i.e. whether (i) the chargeable event is the distribution of dividends, (ii) the tax base is the amount of dividends distributed, and (iii) the taxable person is the holder of the shares. The Court noted, in agreement with the parties to the case, that the 'fairness tax' satisfies the first two conditions, but concluded that the third condition is not met because the taxable person in this case is not the holder of the shares but the distributing company.

Article 4 of the Directive requires Member States either to exempt dividends received by a parent company from its EU subsidiaries or to tax them and provide a credit. There is also an option to deem up to 5 percent of the management costs relating to holdings in a subsidiary to be non-deductible. Belgium had exercised this option so that they effectively provided for a 95 percent exemption. The CJEU concluded that where the application of the 'fairness tax' has the effect of subjecting profits received by a Belgian parent company from its EU subsidiary to taxation exceeding the 5 percent ceiling, the disputed legislation is precluded by the Directive. In this respect the Court noted that profits redistributed by a parent company to its shareholders do fall within the scope of Article 4 of the Directive, which is aimed at eliminating double taxation at the level of the parent company, without drawing a distinction based on the chargeable event, i.e. the receipt of qualifying dividends or their redistribution.

The *AFEP and Others* case

Background

The additional contribution to corporate income tax is due by entities that are liable to French corporate income tax, at the rate of 3 percent on the amount of distributed profits. AFEP and Others argued that the contribution is determined based on all income distributed by a French parent company and, as in the case of the ‘fairness tax’ in the *X* case, may therefore include dividends received from subsidiaries located in another EU Member State. Like Belgium, France had exercised the option to effectively exempt only 95 percent of such dividends. AFEP and Others argued that the levy infringed both Article 4, as well as the withholding tax exemption under Article 5. As was argued in the *X* case, the French tax authorities were of the opinion that Article 4 did not apply to profits redistributed by a parent company but only when the parent receives profits distributed by its subsidiaries.

In its referral, the French Supreme Court (*Conseil d’Etat*) noted that the additional contribution had characteristics that were similar to a corporate income tax as well as a withholding tax, and therefore found it difficult to determine whether the contribution represented a tax on profits prohibited under Article 4 of the Directive.

When assessing its conformity with Article 5 of the Directive, the referring court raised a similar issue to that before the Court in the *X* case, regarding the three criteria for defining a withholding tax.

The CJEU decision

In considering the compatibility of the contribution with Article 4 of the Directive, the Court referred to its decision in the *X* case mentioned above and reiterated its conclusion that the Parent-Subsidiary Directive makes no distinction between a tax due by the parent company when it receives the distributed profits or when it subsequently redistributes those profits.

The CJEU also concluded that it is irrelevant whether the disputed tax qualifies as a corporate income tax or a withholding tax since the exemption for the parent company under the Directive is not conditional on a certain type of tax, but rather applies to all taxes levied by the Member State of residence of the parent on profits it receives from an EU subsidiary.

In the light of these considerations, and since it was common ground that the application of the additional contribution to redistributions of dividends received from EU subsidiaries meant that this effectively resulted in a less than 95 percent exemption, the Court decided that it infringed Article 4 of the Directive.

The Court noted that there was no need for an answer to the second question on whether the contribution has the characteristics of a withholding tax.

EU Tax Centre comment

Through its decisions in the two cases discussed above, the CJEU clarified that the provisions of the Parent-Subsidiary Directive apply to dividend income received by a parent company from a subsidiary located in another Member State, irrespective of the chargeable event of the taxation of the parent company, i.e. including tax charged at the moment of redistribution of that income to its shareholders.

Both cases provided the Court with the opportunity to clarify its decision in the *Athinaïki Zythopoiia* case (C-294/99), where the third condition for a tax to qualify as withholding tax within the meaning of the Directive was not met but where the Court nevertheless found in favor of the taxpayer. While the Court did not address this in the *AFEP and Others* case, it did confirm in the *X* case that all three conditions must be met in order to qualify.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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