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CJEU decision in the *Argenta Spaarbank* case on the application of the EU Parent Subsidiary Directive (C-39/16)

EU Parent Subsidiary Directive – Exemption of dividends – Costs relating to the shareholding – Tax evasion or avoidance

On October 26, 2017, the Court of Justice of the European Union (CJEU) rendered its decision in the Argenta Spaarbank NV v Belgische Staat case (C-39/16). The case concerns the compatibility with the EU Parent-Subsidiary-Directive (90/435/EEC) of Belgian rules under which the deduction of interest payments was disallowed to the extent that in the same tax year the taxpayer had received exempt dividends from shares held for less than one year, irrespective of whether the interest payments were relating to the holding.

Background

According to the domestic legislation implementing the Parent-Subsidiary Directive ('Directive") applicable in the years at issue, dividends received by a Belgian company from a foreign subsidiary were up to 95% exempt, provided that at the time of distribution the parent held at least 5% of the capital of the distributing company or the participation held reached a certain value. However, under a different article of the Belgian Income Tax Code applicable in the years at issue, if a company received dividends from shares that, at the time of distribution, were held for less than a year, the interest claimed by the company in the same tax year could not be deducted to the same extent. There was no requirement that the interest paid had to be connected to the holdings from which the exempt dividends were derived. As a consequence, the dividend exemption was in effect cancelled out if a company declared a higher interest expense, even where there was no casual connection between the two.

Based on these provisions, the Belgian tax authority disallowed the deduction of interest paid by the Belgian-based credit institution Argenta Spaarbank in 1999 and 2000 (= 2000 and 2001 tax years), on the ground that in the same tax years it had also received dividends from holdings which it had not held for a full year at the time of distribution. Argenta Spaarbank disputed the tax assessment arguing that the rules should only apply in cases where there is a causal relationship between the interest and the partially exempt dividends.

The question referred to the CJEU was whether the disputed Belgian rules are compatible with, on the one hand, Article 4(2) of the Directive, which allows the Member State of the parent company to refuse the deductions of costs relating to holdings in a subsidiary established in another Member State, and, on the other hand, Article 1(2), under which Member States may refuse to grant the benefits of the Directive for reason of preventing tax evasion and abuse.

The CJEU's Decision

The Court first examined the applicability of the Directive to the present case and concluded that the disputed Belgian rule did fall within the scope of the Directive, contrary to the opinion of the Advocate General Kokott (see ETF 321). In this respect, the Court underlined that in the context of a request for a preliminary ruling, it falls outside its remit to decide on the interpretation of national provisions and to assess whether the interpretation given by the national court of those provisions is correct. As a consequence, the Court simply referred to the comments provided by the referring court and ruled that the Directive is applicable.

In a second step, the Court addressed the compatibility of the Belgian provisions with Articles 4(2) and 1(2) of the Directive. The Court held that Article 4(2) represents an exception to the general rule contained in Article 4(1) of the Directive, according to which Member States should provide either an exemption on dividend income from qualifying subsidiaries or a credit for the underlying tax suffered by the subsidiary, and should therefore be interpreted narrowly. Relying on the objectives and wording of Article 4(2), the Court further considered that a deduction can only be refused where costs incurred are causally connected to a holding, in particular, interest paid in relation to capital borrowed to finance the purchase of the holding in question. The disputed Belgian rules did not take into account whether the interest cost was connected to the holdings for which an exemption was granted. Article 4(2) of the Directive empowers the Member States only to provide that the costs relating to the holding in the subsidiary are not deductible. Therefore, the Court decided that the Belgian rules in question are precluded by Article 4(2) of the Directive.

The Court also held that the aim of the measures set out in Article 4(2) is indeed the prevention of tax evasion and abuse, such as obtaining tax deductions for loans obtained to finance the purchase of holdings benefiting from a participation exemption regime. In the Court's view it is therefore not necessary to rely on the more general anti-abuse rule which is incorporated in Article 1(2) of the Directive.

EU Tax Centre comment

Even if the disputed Belgian rules are not in force anymore, the CJEU provided further clarity on how much discretion Member States have in exercising the options available under the EU Parent Subsidiary Directive and in particular on the nature of costs that may be treated as non-deductible. As regards the applicability of the EU Parent-Subsidiary-Directive, it is worth noting that the CJEU did not follow the AG opinion and relied exclusively on the interpretation provided by the referring court.

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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