Euro Tax Flash from KPMG's EU Tax Centre

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CJEU rules that former French "précompte" system of dividends taxation is contrary to EU law

CJEU – France – Parent Subsidiary Directive – Avoidance of economic double taxation of dividends

On May 12, 2022, the Court of Justice of the European Union ('CJEU' or 'Court') rendered its decision in case C-556/20. The case concerns the compatibility with the Parent Subsidiary directive ('PSD') of a system of dividend taxation that France operated until 2004. In contrast to the opinion of the Advocate General ('AG'), the Court concluded that the French legislation under dispute is contrary to the PSD.

Background

Until 2004, France operated a special system of dividend taxation that applied on distributions along a chain of companies. According to the system, a French parent entity receiving dividends from a resident subsidiary benefited from a tax credit equal to 50 percent of the distributed dividend. When distributed profits were derived from amounts which had not been subject to corporate income tax at the normal rate, an advance payment of tax (the amount of which was equal to the abovementioned tax credit) was payable by the distributing company. For dividends received by a parent entity from a domestic subsidiary, the tax credit attached to the distribution was therefore offset against the advance tax payment due on the redistribution of such dividends, meaning that the amount of dividends available for redistribution was not impacted. However, as the tax credit was not available in cross-border scenarios, a French parent company receiving dividends from subsidiaries established in another EU Member State, would be liable to pay an advance payment upon redistribution without having received a corresponding tax credit. Applying an advance tax obligation therefore reduced the amount of dividends available for distribution.

In a previous CJEU decision on the disputed regime (C-310/09), the Court held that EU law precludes the regime, which essentially gives entitlement to an offsetting tax credit when dividends originate from companies established in France, but those originating from companies established in another Member State are not given the same tax treatment. The current case, however, deals with the issue of whether the imposition of the advance payment is contrary to the PSD.

On October 14, 2021, AG Kokott of the CJEU concluded that the provision under dispute is compliant with the PSD (please refer to our E-news 141). In short, in the AG's view, the disputed advance payment was paid by the distributing company – and not by the shareholders, and therefore does not represent a withholding tax precluded by the PSD. Furthermore, from a substantive perspective, to the extent that the advance payment was eventually offset by a tax credit received by the recipient of the distribution, no additional taxation occurred. In this respect, the AG reiterated settled case-law based on which granting a French company a tax credit for advance tax payments due on French-sourced dividends redistributed to its shareholders, while no equivalent tax credit was available in respect of dividends received from subsidiaries located in other Member States, was contrary to the freedom of establishment and the free movement of capital. The AG therefore concluded that the PSD does not preclude a levy such as the advance payment on redistributions, as long as a corresponding tax credit which neutralizes the levy is equally granted in both domestic and cross-border scenarios.

The CJEU decision

In its opening remarks, the CJEU noted that France opted for exemption as the method of elimination of economic double taxation on dividends, in accordance with Article 4(1) of the PSD. The disputed advance payment should therefore be assessed in light of this method. Article 4(1) establishes a prohibition of taxing dividends received by a qualifying shareholder. Member States have the option to disallow the deductibility of charges relating to the holding and any losses resulting from the distribution of the profits of the subsidiary. Where the management costs relating to the holding in such a case are fixed as a flat rate, the fixed amount may not exceed 5 percent of the profits distributed by the subsidiary. France exercised this option, and therefore 95 percent of qualifying dividends distributed by French companies are exempt.

The Court noted that the imposition of any levy that has the effect of subjecting the income – in the hands of the parent company (with the conditions of the PSD being met) – to a tax that exceeds the 5 percent ceiling, thereby giving rise to double taxation at the level of that company, is prohibited by the PSD.

The CJEU clarified that the prohibition under Article 4 of the PSD also covers a national measure that, although does not tax dividends received by the parent company as such, is liable to have the same effect. The Court concluded that the way the advance payment was imposed on the applicant companies had the effect of subjecting such dividends, upon their redistribution, to tax. This taxation was found contrary to the prohibition of the PSD as set out in Article 4(1).

In particular, the Court observed that, when dividends were received from subsidiaries resident in member states other than France (in which cases a tax credit was not granted by the disputed system), the application of the advance payment had the effect of reducing the mass of distributable dividends and that the recipient company was led either to distribute the dividends reduced by the amount of the advance payment or recover by its own reserves the amount necessary to reach the same amount for distribution. By contrast, the mass of the dividends available for distribution were not affected in re-distributions of dividends received from subsidiaries resident in France.

The CJEU highlighted that this conclusion is not impacted by the fact that the applicant companies could, eventually, claim a tax credit based on settled EU case law. The Court's reasoning was based on three grounds. First, that obtaining the tax credit, that would eliminate the economic double taxation, requires taxpayers to carry out administrative and judicial procedures and that taxpayers may be subject to additional requests for evidence that the conditions for receiving the tax credit have been fulfilled. According to the Court, Member States may not impose conditions for obtaining the benefits of the PSD, other than those laid down in that Directive. Secondly, the Court stated that, by accepting that the tax credit could be relied upon to eliminate economic double taxation, in substance, France applied the imputation method (instead of exemption) as means of elimination of economic double taxation. The Court clarified that when a Member State opts for one of the two methods provided under the PSD, which have different features and results, it cannot rely on the other system. Lastly, the Court noted that the tax credit could not fully offset the advance payments in certain cross-border scenarios (when the tax rate in the other Member State was lower than the one of France).

The Court then went on to assess the French government's argument that the system of taxation in question might fall within the scope of Article 7(2) of the PSD. Under Article 7(2), the application of domestic provisions designed to eliminate or lessen economic double taxation of dividends, in particular provisions relating to the payment of tax credits to the recipients of dividends, shall not be affected by the prohibitions of the PSD.

In this respect, the Court noted that the scope of Article 7(2) should be interpreted strictly and, most importantly, by taking into account the objectives of the PSD. The Court clarified that Article 7(2) allows the application of specific national measures designed to eliminate economic taxation only if these are consistent with the objective of the Directive. Since in its previous analysis, the Court established that the advance payment had the effect of creating double economic taxation that was contrary to the PSD, the disputed measure could not be considered consistent with the purpose of the Directive. Firstly, the measure in question was found by the Court to be liable to give rise to double taxation, as set out above. Secondly, because the economic double taxation was a result of the disputed system's effect of differentiating between cross-border and domestic distributions, whereas the objective of the PSD is to eliminate such discrepancies. Lastly, because the Court established, based on its previous analysis, that the national legislation in question cannot be regarded as compatible with the objective of the PSD even where the effects of that double taxation may be mitigated by a subsequent claim for repayment of the amounts unduly paid.

Based on the above, the Court concluded that Article 7(2) is not applicable in the case at hand.

EU Tax Centre comment

It is interesting to note that the CJEU's decision deviates fully from the AG's conclusion. In this respect, the Court also addressed a request by some applicants for the reopening of the oral phase of the proceedings. The request was based on the view that the conclusion of the AG's Opinion was, amongst others, based on an incorrect understanding of the disputed system. The Court noted that, when issuing its decisions, it is not bound by the conclusions of the AG . Furthermore, parties to a case before the Court do not have the option of submitting observations on the opinion of the AG.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, your local KPMG tax advisor or KPMG Avocats in France (Marie-Pierre Hôo).

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