CJEU decision on the Parent-Subsidiary Directive exemption in the context of a merger

Belgium – Parent-Subsidiary Directive – Carrying over of dividend received deduction (DRD) – Transfer of DRD to the absorbing company

On October 20, 2022, the Court of Justice of the European Union (CJEU or the Court) gave its decision in the case C-295/21 concerning the compatibility of the Belgian partial exemption regime (dividends received deduction) with Article 4(1) of the Parent-Subsidiary Directive (PSD).

The Court held that EU law does not preclude domestic legislation that limits the amount of dividends received deduction (DRD) surpluses that can be carried over to the acquiring company in the context of a merger by absorption.

Background

The plaintiff was a Belgian insurance company that absorbed several other Belgian insurance companies that had a surplus DRD carried forward from previous tax years. The Belgian DRD regime provided – at that time – that the distributed benefits covered by the PSD are included in the basis of assessment of the company receiving the dividends, followed by a deduction of 95 percent of the total amount (100 percent for dividends received since 2018). Moreover, DRDs could be carried forward to subsequent tax years, subject to anti-tax abuse provisions in place in case of a change in control of the company entitled to DRDs.

Following the domestic merger mentioned above, the acquiring company decided to carry forward to subsequent tax years the full amount of excess DRDs transferred from the acquired company. The Belgian tax authorities rejected this approach and argued that the amount of DRDs to be transferred and subsequently utilized should be computed on a pro-rata basis, corresponding to the net tax assets of the absorbed company in the total of the net tax assets of the absorbing company and the absorbed company. This approach was adopted by analogy to the rules applicable for the transfer of deductible losses incurred by the acquired company before the merger. Following an appeal brought by the taxpayer, the Brussels Court of Appeal decided to refer to the CJEU the question of whether the disputed measure is contrary to EU law. On April 28, 2022, Advocate General (AG) Athanasios Rantos of the CJEU recommended that the Court finds that the measure under dispute was not precluded by the PSD - see E-News Issue 154.

The CJEU decision

The Court noted that, Member States that choose to eliminate double taxation under the PSD by exempting profits received by a parent company from a qualifying subsidiary, are free to determine the detailed arrangements for ensuring that the exemption is attained. Furthermore, the Court observed that EU law does not provide for the right to carry forward surpluses unconditionally in the context of mergers.

The Court went on to examine whether the disputed system leads to direct or indirect taxation of dividends received, which is incompatible with the PSD. First, as regards the possible direct taxation of dividends, the Court concluded that – by including the dividends in the tax base and allowing for a subsequent deduction of 95 percent of that amount – the system does not entail direct taxation of the dividends at the level of the recipient. As a result, the related dividend income is not taxable at the level of the absorbing company either.

As regards the possible indirect taxation of dividends, the Court noted that it should be analyzed whether the situation in the main proceedings, whereby the same limitation on a pro rata basis was applied to the carry-forward of both the losses and the DRD surpluses of the absorbed company, results in a heavier tax burden as compared to the case where dividends would have been directly treated as non-taxable income in the hands of the recipient.

The Court concluded that tax neutrality in both situations appears to be respected. Moreover, the Court agreed with the argument brough forward by the European Commission, that if the DRD surpluses were transferred in full to the absorbing company, whereas the transfer of losses is subject to a pro rata a limitation, the company would be in a more favorable situation than if Belgium had provided for a simple exemption.

Based on the reasoning above, the Court ruled that Article 4(1) of the PSD does not preclude the measure under dispute.

EU Tax Centre comment

The case follows previous decisions of the CJEU about the DRD regime, and it clarifies that the PSD does not deal with the possibility to transfer excess DRDs in the context of a merger by absorption.

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

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