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CJEU decision on the compatibility of French tax integration scheme with EU freedom of establishment

Freedom of establishment – Group taxation (French 'intégration fiscale') – Dividend taxation – 5 percent add-back

On May 11, 2023, the Court of Justice of the European Union (CJEU or the Court) gave its decision in joined cases C-407/22 and C-408/22. The cases concern the compatibility of the French tax integration scheme with the EU freedom of establishment.

The Court held that the French rules that allowed a French parent company a full exemption with respect to dividends received from domestic or foreign subsidiaries under a group taxation regime (tax-integrated groups), but effectively taxed (up to) 5 percent of dividends received from shareholdings in EU subsidiaries for non-integrated groups, are in breach of the freedom of establishment.

Background

Under French tax law applicable until 2016, parent companies were allowed to deduct from their net profits the net revenues from holdings that were eligible for the tax regime for parent companies, with the exception of a fixed proportion of 5 percent of costs and expenses. A French parent company that had opted for tax integration with resident companies was entitled to neutralize, for the computation of the tax group result, the add-back of the fixed proportion of costs and expenses for certain eligible dividends, provided the income was received from tax-integrated domestic subsidiaries (i.e. the main condition for joining a tax group was to be held at least 95 percent by a tax integrated parent company).

Following a referral received from the Administrative Court of Appeal of Versailles, the CJEU held on September 2, 2015, in case C-386/14 (hereinafter referred to as "the Groupe Steria" case), that EU law precludes rules governing tax integration schemes under which the neutralization described above is available for domestic dividends within the tax group, but denied for dividends received from subsidiaries located in other EU Member States, which would have been eligible to join the parent company's tax group if they had been French residents – please refer to EuroTaxFlash Issue 255. In other words, a French company that had opted for tax integration with resident companies should have been entitled to neutralize the add-back, irrespective of whether the dividends were distributed by tax integrated

subsidiaries resident in France or in another Member State, provided the later meet the conditions to be tax integrated (except the French residence).

The plaintiffs in the present joined cases were two French companies that received cross-border dividends from their EU subsidiaries and were subject to the 5 percent add-back into their profits. As opposed to the facts in the Group Steria case, where the French company had formed a tax-integrated group with its domestic subsidiaries, neither of the plaintiffs in the cases referred to the CJEU in 2022 had elected to form such a group with their subsidiaries, despite being eligible for the tax integration scheme. In both cases, the neutralization was denied on the grounds that the French parent companies had decided not to opt for the tax integration scheme.

The CJEU decision

The CJEU noted that, in light of the Group Steria ruling, dividends received by a resident parent company (from tax integrated resident and non-resident subsidiaries meeting the conditions to be eligible for tax integration, except residence) belonging to a tax-integrated group are deducted in full from its net profit and are therefore fully exempt from corporation tax in France. However, the Court acknowledged that, under domestic law, a parent company that is not part of a tax-integrated group and that receives dividends from a subsidiary established in another Member State (satisfying the conditions to join a tax group except the French residence) was excluded from the benefit of the neutralisation mechanism of the tax integration regime. This treatment was liable to make it less attractive for that parent company to exercise its freedom of establishment (Article 49 of the Treaty on the Functioning of the EU – TFEU), which is a restriction on that freedom and precluded by EU law.

The Court further considered, but rejected, the French government's plea that parent companies that opted for the tax integration scheme were not in an objectively comparable situation to taxpayers that did not opt for tax integration. In this respect, the Court noted that, under French tax rules, a resident parent company did not have the possibility of opting for the tax integration scheme with its subsidiaries located in other Member States, unless it formed a tax-integrated group with at least one of the eligible resident companies. Therefore, it could not be concluded that the situations were not comparable solely on the ground that the taxpayers did not elect to form tax-integrated groups. The Court also recalled its settled case-law under which, with respect to neutralizing the add-back for dividends received, the situation of companies in a tax-integrated group was comparable to that of companies that were not part of a tax-integrated group. This was due to the fact that in each case, the parent company bore the costs and expenses related to its shareholding in the subsidiary, and the profits made by the subsidiary and from which the dividends distributed were derived could be, in principle, subject to economic double taxation or to a series of charges to tax.

Based on the above, and noting that no further justifications based on an overriding reason in the public interest were brought by the referring court or the French Government, the CJEU held that the disputed legislation, which allows a resident parent company that has opted for tax integration with resident companies, to neutralize the tax on dividends received from subsidiaries located in other Member States, but does not extend the same benefits to an eligible resident parent company that has decided not to opt for such tax integration, is contrary to EU law.

ETC Comment

The French tax integration scheme was amended since the facts of the present case so that, under rules currently in force, an add-back amounting to 1 percent of dividends distributed between companies that are part of a tax-integrated group is allowed (instead of 5 percent for non-integrated groups). The reduced 1 percent rate also applies in respect of EU subsidiaries that would have been eligible to benefit from tax-integration had they been tax resident in France. However, the reduced rate is not applicable in cases where the French parent company did not opt for tax-integration despite that it would be eligible to do so. Therefore, the current ruling might create refund opportunities for taxpayers that elected not to form a tax-integrated group (subject to statute of limitations rules).

On a related note, on April 14, 2022, the Administrative Court of Appeal of Versailles denied the application of the Steria jurisprudence in two cases dealing with dividends received from third countries (see 19VE03912 and 19VE03926).

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

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