



# Euro Tax Flash from KPMG's EU Tax Centre



[Background](#)

[The CJEU decision](#)

[EU Tax Centre comment](#)

## **CJEU decision in the Sofina case (C-575/17)**

[France – Free Movement of Capital – Freedom of Establishment – Withholding Tax on Dividends – Net Taxation – Comparability – Loss-making shareholder](#)

On November 22, 2018, the Court of Justice of the European Union (CJEU) rendered its decision in the Sofina and Others case (C-575/17). The case concerned the compatibility with EU law of the French withholding tax levied on dividends paid by French companies to non-resident loss-making companies. The Court concluded that the French legislation is contrary to the free movement of capital.

### **Background**

Sofina SA, Rebelco SA, and Sidro SA are three Belgian companies that received French-sourced dividends, which were subject to a 15% withholding tax (WHT) in accordance with the applicable double tax treaty between France and Belgium. The three Belgian companies being loss-making, the WHT resulted in a non-recoverable expense. By contrast, loss-making French companies are only taxed on the amount of the dividends they receive once they become profitable again. The Belgian companies considered that this less favorable tax treatment infringes EU law and requested a refund of the tax levied.

On September 20, 2017, the French Supreme Tax Court requested a preliminary ruling from the CJEU to clarify whether the French dividend taxation regime constitutes a restriction on the free movement of capital, and if so, whether such a restriction is justified. The French Court questioned, in particular, whether the resulting cash flow disadvantage for non-resident loss-making companies is compatible with EU law. The referral also mentions cases where a non-resident loss-making company terminates its activity, meaning that it would never be in a profit position again. Lastly, the French Court asked whether the fact that non-residents cannot deduct expenses directly linked to the collection of dividends (the “net taxation” argument)

could be justified by the difference in tax rates between income tax paid by residents and the WHT paid by non-residents, although the actual tax burden is not higher for the latter.

### **The CJEU decision**

The Court first noted that the French legislation results in the less favorable tax treatment of dividends paid to a non-resident loss-making company, since dividends paid to a French shareholder in a similar situation would either never be effectively taxed or would be taxed at a later stage, thus creating a cash flow disadvantage. Referring to its previous case law, the Court concluded that such a difference in treatment constitutes a restriction on the free movement of capital. The fact that French legislation places non-resident loss-making companies at a disadvantage cannot be compensated for by the fact that the same legislation would not discriminate between non-resident and resident profitable companies.

The Court then addressed whether such a restriction is justified and first observed that resident and non-resident companies are in a comparable situation, since France taxes the dividend income received by both resident and non-resident shareholders. The Court also rejected the need to ensure a balanced allocation of taxing rights between Member States as a possible justification. In particular, the Court underlined that the loss of tax revenue resulting from the non-imposition of WHT on dividends distributed to non-resident loss-making companies ceasing their activities, cannot be regarded as an appropriate justification, insofar as such lost revenue is accepted by France in a similar domestic situation. As regards the need to ensure the effective collection of tax, the Court underlined that the existing mutual assistance mechanisms at the EU level are sufficient to enable France to recover a tax debt in Belgium, if a tax deferral had been granted to Belgian shareholders. As a consequence, French rules on the taxation of dividends received by non-resident loss-making companies constitute an unjustified breach of EU law.

In light of these conclusions, the Court did not consider it necessary to address the French Supreme Tax Court's question on the net taxation argument.

### **EU Tax Centre comment**

The CJEU decision is broadly in line with its previous case law on the taxation of outbound dividends. Although the decision is favorable to EU-resident shareholders that do not benefit from the participation exemption regime, it would have been particularly interesting to follow the Court's argumentation on the net taxation issue, which was not addressed in this decision.

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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