



FEE Position Paper

Pending ECJ case N. V. Cobelfret, C-138/07

Objectives and content

The case deals with the treatment of dividends that a parent company resident in one Member State receives from a subsidiary resident in another Member State. The Advocate General opined that the Member State of the parent company must either refrain from taxing the dividend or authorise the parent company to deduct from the amount of tax payable thereon tax paid by the subsidiary on the profits thereby distributed.

FEE supports this opinion and hopes the Court will deliver a judgment in the same direction.

About FEE

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Short description of the case

- (1) The case deals with the way Belgium implemented Article 4(1) of Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (in its original version; hereafter: “the Directive”). Article 4 provides that, where a parent company resident in one Member State receives a dividend from a subsidiary resident in another Member State, the Member State of the parent company shall, except when the latter is liquidated, either refrain from taxing the dividend, or tax such profits while authorizing the parent company to deduct from the amount of tax due that fraction of the corporation tax paid by the subsidiary which relates to those profits.



- (2) According to Belgian legislation, dividends received from subsidiaries within the meaning of the Directive are, in a first step, included in the basis of assessment of the parent company. In a second step, 95% of the amount of such dividends is deducted from the parent company's taxable profits, provided several conditions are met. That deduction is known as the "deduction of definitively taxed income" (DDTI). In a third step, the DDTI is limited to the amount of profits to be assessed for the taxable period concerned. The DDTI cannot therefore be used in a year where there is no taxable profit; moreover, where the DDTI exceeds the taxable profit before the deduction in discussion, the unused portion of the DDTI cannot be carried forward.

Example:

- (3) A Belgian company receives a dividend of 100. The result of all its other operations gives a loss of 50. The basis of assessment before DDTI is therefore 50 (= 100 - 50). In theory, a DDTI of 95 is granted to that company. Under the present legislation, the deduction is limited to 50 (= the taxable profit). The unused portion of DDTI (= 45) cannot be carried forward, and cannot benefit the company.
- (4) Such situation was experienced in each year from 1992 to 1998 by N. V. Cobelfret (Cobelfret), a Belgian company, which received dividends from its holdings in companies in both Belgium and the United Kingdom.
- (5) In 1994, 1995 and 1997, Cobelfret suffered losses and was hence unable to use the DDTI for those years. In 1996, the DDTI to which Cobelfret was entitled exceeded its taxable profits by EUR 277 432. It was unable to carry forward that unused portion to the following year, when it made a loss. Cobelfret takes the view that Belgium therefore does not genuinely exempt dividends, since tax losses which can be carried forward are reduced in such a way that, in the following year, the taxable profit is artificially increased by the amount of dividends which should have been exempted.
- (6) On 8 May 2008, Advocate General Sharpston delivered her opinion to the Court. In her view, "Article 4 of Council Directive 90/435/EEC precludes national legislation under which dividends received by a parent company in one Member State from a subsidiary in another Member State are, first, added to the taxable basis of the parent company and, subsequently, deducted from that taxable basis (in the amount of 95%) only in so far as the parent company has taxable profits."

FEE position

- (7) FEE supports this opinion, and hopes the Court will deliver a judgement in the same direction.
- (8) The Advocate General's opinion explains why Article 4 (1) of the Directive has direct effect, and gives the reasons why the Belgian rules do not properly implement that article.
- (9) The effect of those rules is that dividends received from a subsidiary are always included in the parent company's basis of assessment but not always deducted from it, since
 - o no deduction is operated where the parent does not declare a taxable profit for the same period;
 - o an insufficient deduction is granted where the parent declares for the same period a taxable profit smaller than the whole amount of the dividend.
- (10) The Belgian system accordingly provides for the exemption of dividends solely where the other elements influencing the basis of assessment do not reduce the latter to a smaller amount than the dividend. Belgium thus subjects the exemption of dividends from tax to a condition not envisaged by the Directive. It is therefore not a true exemption system.
- (11) The European Commission submitted also that the Belgian rules are contrary to the Directive.
- (12) The Belgian Government argued that limiting the DDTI would lead to a result at least as favourable as the imputation method. If the imputation method satisfies Article 4(1), the limited DDTI must also do so, since there is no reason why 'refrain[ing] from taxing' distributed profits must lead to a more generous result than the imputation method.

Example:

- (13) Let us assume an imputation system would be in force in Belgium, according to which the foreign corporate tax of 30 % on a gross foreign dividend of 150 would be credited against the Belgian corporate tax levied on the gross foreign dividend of a Belgian company (assumption of an "ordinary tax credit", by which in order to avoid subsidizing of higher State of source tax, State of residence limits the imputation of the foreign taxes to the amount of its tax relating to the foreign income).
- (14) The result of all the other operations of the Belgian company gives a loss of 50. The basis of assessment before tax credit is therefore 100 (= 150 - 50). If the Belgian corporate tax rate is (also) 30%, the imputation of tax credit would be limited to 30, so that a waste of (45 - 30=) 15 would be suffered.

- (15) But the Advocate General observed that the Belgian system is not an imputation system, which would provide that tax paid by the subsidiary is deducted from the tax payable by the parent company.
- (16) That Belgium presently does not use an imputation system may easily be acknowledged by every one. Up to the tax year 1992, a tax credit existed for the dividends of Belgian origin. A law of 1991 abolished the tax credit from the tax year 1992 onwards, so that the second alternative offered by article 4 (1) of the Directive was not taken by the Belgian legislation.
- (17) Moreover, a Member State may not rely on how it might have implemented a directive, had it chosen to do so in a particular way. Belgium did not purport to have opted to implement Article 4(1) of the Directive by the imputation method. It is therefore to the Advocate general's mind irrelevant whether and to what extent the exemption method which it has chosen operates no less favourably than the imputation method would have operated.
- (18) The Belgian Government further argued that it would not follow from the wording of Article 4(1) of the Directive, which requires Member States to 'refrain from taxing' dividends, that Member States were required to grant an 'exemption' and that such an 'exemption' would require that dividends received should have no effect on the amount of losses to be carried forward.
- (19) But, as Cobelfret pointed out with good reason, the preamble to Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC, in effect describes Article 4(1) as requiring that 'double taxation should be eliminated either by exemption or tax credit'. The Court had, moreover, used in previous judgements the concept of 'exempting' interchangeably with that of 'refrain[ing] from taxing' within the meaning of Article 4(1).
- (20) The Belgian Government reasoned that the Belgian legislation would be in accordance with the objective of Article 4(1), in particular the elimination of the disadvantage in cross-border parent/subsidiary relations in comparison with such relations in a domestic context. Limiting the DDTI would not disadvantage the creation of parent/subsidiary relations, in particular cross-border relations, as illustrated by the fact that application of the limited DDTI treats equally domestic and cross-border parent/subsidiary relations.
- (21) But, according to the Advocate General's conclusions, even if Belgium's assertions were correct, the fact that a Member State's incorrect transposition of a provision of a directive does not conflict with the objectives of that directive cannot in itself render that transposition correct.

- (22) It must be observed that already when the original Directive entered into force in 1992, and further to the abolition of tax credit for dividends of Belgian origin as from that year, there was no discrimination in the main stream taxation (in opposition to the withholding taxes) of flows of dividends from a subsidiary abroad, in comparison with a flow of domestic dividends. However, this situation did not preclude Belgium from the obligation to implement Article 4(1) of the Directive. This implementation was intended to apply worldwide, concerning the flows of dividends between parent companies and their subsidiaries, whatever would be the location where the latter are established. The official reason why the implementation of the Directive was not restricted to the subsidiaries established in other Member States was to prevent a risk of relocation.
- (23) The Belgian Government further argued that the Council Directive 90/434/EEC on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, simply requires with regard to losses arising from cross-border reconstructions, that Member States treat such losses in the same way as losses arising from reconstructions within a single Member State. By analogy, Article 4(1) of the Parent/Subsidiary Directive likewise would permit a Member State to apply a system such as the DDTI rules to dividends received by a parent company from a subsidiary in another Member State provided that it applies the same system to dividends received from a domestic subsidiary.
- (24) The Advocate General stated that this was not, however, what Article 4(1) says, and did not see how a provision of an entirely separate instrument would be relevant.
- (25) Belgium referred to the Model Convention with respect to taxes on income and on capital, published by the Organisation for Economic Cooperation and Development (OECD). But the submitted argument was not relevant to the case, where what is at issue is the interpretation of a harmonising Community measure.
- (26) Noteworthy is also that the Belgian Government did not use anymore the argument it put forward in 1991, according to which, if companies were authorized to accumulate DDTI to carry forward, each estimate of the yield of the corporation tax would be made more difficult.
- (27) FEE is of the opinion that that last argument would have been of no avail, given the direct effect of the Directive.
- (28) In the Advocate General's view, it would not be appropriate for the Court, if it rules that Article 4(1) of the Directive precludes national legislation such as the DDTI system, to limit the effects of that ruling in time.

Conclusion

- (29) FEE believes that a decision of the Court in line with the opinion of the Advocate General would promote the necessity for Member States to implement correctly the Directives they agreed upon, bearing in mind that in the particular case a correct implementation would generally favour the need to prevent economic double taxation.
- (30) It has been noted in the Study requested by the European Parliament's Committee on Economic and Monetary Affairs "The Impact of the Rulings of the ECJ in the Area of Direct Taxation, 2008, nr. 175", that "when a Member State abolishes its tax credit system both for domestic and cross-border dividends, it complies with the requirement of non-discrimination provided by the Treaty. However, this reinstatement of economic double taxation is detrimental to the good functioning of the Single Market". In the particular case of Belgium, the intention of the abolition of tax credit for domestic dividends was not to reinstate economic double taxation. It appears that such economic double taxation is nevertheless indirectly suffered in a case such as the one experienced by Cobelfret, the company requesting a preliminary ruling.
- (31) The Court has already ruled that, since the purpose of the Directive is to facilitate the tax arrangements governing cross-border cooperation, Member States cannot unilaterally introduce restrictive measures such as a requirement that a minimum holding period must already have been completed when the profits in respect of which the tax advantage is sought are distributed (Joined Cases C-283/94, Denkavit, C-291/94, VITIC, and C-292/94, Voormeer, mentioned in the Advocate General's opinion).
- (32) The limitation of DDTI in a case such as Cobelfret could also be seen as a further kind of "unilaterally introduce(d) restrictive measures".

FEE would be pleased to discuss any of the points above in further details. To this end, or for further information, please contact Petra Weymüller (email: petra.weymuller@fee.be) from the FEE Secretariat.

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