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SURVEY ON THE ALLOCATION OF EXPENSES RELATED TO CROSS-BORDER DIVIDEND INCOME COVERED BY THE PARENT SUBSIDIARY DIRECTIVE

Part I: *Summary Conclusions*

Part II: *Answers by Country*

PART I

SUMMARY CONCLUSIONS

I. INTRODUCTION

FEE has recently completed a survey on the allocation of expenses related to cross-border dividend income covered by the Parent Subsidiary Directive. Under the Parent Subsidiary Directive dividends distributed from subsidiary to parent within the EU are tax exempt (or entitled to credit for tax already paid). However, as the deductibility of expenses related to tax exempt income can be questioned, the Directive allows Member States the option of providing that any charges relating to the holding of the subsidiary may not be deducted from the taxable profits of the parent company.

The study investigates the restrictions to the deductibility of such charges, also with the purpose to assess the implementation in each Member State of the Parent Subsidiary Directive (Directive 90/435/ EEC of 23 July 1990).

The Parent Subsidiary Directive (Directive 90/435/ EEC of 23 July 1990)

The Parent Subsidiary Directive (Directive 90/435/ EEC of 23 July 1990) intends to harmonise the tax treatment of dividends distributed from subsidiary to parent within the EU, by:

- the prohibition to impose withholding taxes on such dividends,
- the requirement to exempt the dividends from tax (or to give credit for tax already paid).

To be considered "parent company", a company must hold directly 25% of the capital (or the voting rights) of the subsidiary. This is only a minimum requirement, as Member States can adopt lower thresholds. Indeed Member States are free not to adapt domestic provisions to the Directive if those provisions are "designed to eliminate or lessen economic double taxation".

According to Article 4, paragraph 2, of the Directive, each Member State has the option of providing that any charges relating to the holding and any losses resulting from the distribution of the profits of the subsidiary may not be deducted from the taxable profits of the parent company. Management costs relating to the holding can be fixed as a flat rate, which may not exceed 5 % of the profits distributed by the subsidiary.

II. MAIN OUTCOMES OF THE SURVEY

Legal Framework

In implementing the parent subsidiary Directive, Member States could opt for:
exempting from tax the dividends received by the parent company, or
giving credit for tax already paid.

Every EU Country except for the UK and Ireland opted for the exemption system for dividends qualifying under the parent subsidiary Directive. The UK and Ireland operate a foreign tax credit system, with no disallowance of expenses.

In some EU countries there are legal provisions (and/or rules issued by the tax authorities) regulating the allocation of business expenses to cross-border dividend income, namely in:

Austria;
Belgium;
Denmark;
Germany;
Luxembourg;
The Netherlands.

In Denmark- irrespective of whether the dividend-income is tax-exempt under a double taxation treaty and /or under the EC parent subsidiary Directive.

In all other countries surveyed there are neither specific provisions nor tax authorities' rules regarding business expenses related to dividend income. Deduction of the business expenses is regulated in the general provisions.

Definition of parent/subsidiary for the purpose of dividend-income

In seven Member States, the minimum participation quota required - for benefiting both of the exemption (or tax credit) on dividends received by the parent company and of the exemption of withholding tax on dividends paid by the subsidiary - is the 25% set by the Directive as the minimum requirement, and namely in:

Austria;

Denmark;

Finland (25% of the distributing company's capital or 10% of its voting rights);

Ireland (for underlying foreign tax credit relief);

Italy;

Portugal;

Sweden (with respect to dividends received: 25 % of capital or of voting rights).

A minimum participation quota of 10% is required in:

Germany;

Luxembourg;

UK (for underlying foreign tax credit relief).

In Spain and the Netherlands a minimum participation quota of 5% is required.

In Sweden, dividend income on shares in domestic companies is exempt if the shares are held for business purposes. Where the holding is at least 25% of voting rights of the value by the end of the financial year, the shares are generally deemed to be held for business purposes. Under Swedish domestic rules dividend income on shares in foreign companies is exempt under the same conditions as dividend income on shares in Swedish companies, provided that the foreign dividend income is distributed by a company that has been subject to tax that is "comparable" to Swedish tax. In the case of dividends exempt under the Directive the minimum holding is 25% of the share capital with the same proviso as regards the "comparability".

In two Member States diverging participation quota apply:

- for the exemption on dividends received by the parent company:

Belgium => a minimum participation quota of 5% or a cost of participation of 50 MBEF is required.

France => a minimum participation quota of 10% or a cost of participation of 150 MF is required.

- for the exemption of withholding tax on dividends paid by the subsidiary:

Belgium => a minimum participation quota of 25% is required.

France => a minimum participation quota of 25% is required.

Allocation of expenses to tax-exempt dividend income under a double taxation treaty (and/ or under the EC parent subsidiary Directive)

The deduction of the full amount of business expenses related to tax-exempt dividend income (under a double taxation treaty and/ or under the EC parent subsidiary Directive) is permitted in:

Portugal;
Spain;
Sweden.

The UK and Ireland, which operates under the tax credit system, also allows the full deduction of business expenses related to dividend income.

Limitations to the deduction of business expenses related to tax-exempt dividend income (under a double taxation treaty and/ or under the EC parent subsidiary Directive) apply in:

- Austria: financing costs incurred in connection with the acquisition of shares in a foreign subsidiary qualifying for benefits under the Parent Subsidiary Directive are generally not deductible. According to recent case law financing cost could become partly deductible if there is also a taxable capital gain from the sale of the shares and part of the financing cost is allocated to the capital gain. Under certain conditions dividends received from a subsidiary qualifying for Parent-Subsidiary Directive would not be exempt but taxable in Austria with a credit allowed against Austrian tax for foreign income tax and withholding tax paid by the subsidiary; in this case the financing expense incurred in relation to the acquisition of the subsidiary would be tax deductible. The deduction of costs incurred by the parent company in respect to the co-ordination and management of its subsidiaries by the parent company's personnel ("stewardship expenses") is allowed.

- Belgium: dividends received by the parent company can benefit of 95% exemption. The 5 % taxable portion represents, as a flat rate, deemed expenses related to the holding.

- Denmark: business expenses incurred in respect of shareholdings are not deductible, unless the taxpayers are trading in shares, e.g. bank (and this irrespective of whether the dividend-income is tax-exempt under a double taxation treaty). Non-deductible expenses may be added to the purchase price of the shares in the computation of capital gain/losses. Interest expenses and losses on debt are normally always deductible. However, interest and losses on capital loans are not deductible, if they relate to the financing of shares in finance companies located in tax heavens. When calculating foreign tax credit according to Danish domestic rules or a tax treaty, costs, which are related to foreign income, must be deducted in the foreign income.

- Finland: expenses related to the acquiring or maintaining of tax exempt income are not deductible. However, in cases where the expenses related to tax exempt income exceed the amount of income, the excess is deductible.

- France: dividends received by the parent company can benefit of 95% exemption. The 5% portion represents, as a flat rate, deemed expenses related to the holding. The 5% taxable portion for deemed expenses qualifies for the *avoir fiscal* (tax credit according to the imputation system) – equal to 50% of the taxable dividend – and in this respect it has to be grossed up. Therefore, an amount equal to 7,5% - 5% of the dividend plus 50% credit - is added back to the taxable income.

- Germany: in general, expenses directly related to tax-exempt dividend income are not deductible. They are only deductible in cases where the expenses related to tax exempt income exceed the amount of income, and only limited to the part in excess. Expenses not directly related to tax exempt income are deductible as well. However, according to a new tax bill, 5 % of the tax exempt income are considered as directly related and therefore not deductible.

- Italy: dividends received by the parent company can benefit of 95% exemption. The 5% taxable portion represents, as a flat rate, deemed expenses related to the holding.

- Luxembourg: expenses (and losses) related to tax-exempt dividend income are never deductible.

- The Netherlands: costs that are related to a subsidiary are not deductible, unless these costs (indirectly) result in profits that can be taxed in the Netherlands.

In the UK dividends are never tax exempt (because the UK operates a credit system) and business expenses are always fully deductible. Expenses of management of investments are tax deductible in the normal way and losses can be surrendered to other UK group companies. No specific rules exist and, in particular, expenses do not first have to be set against foreign dividends, thus restricting foreign tax credits.

In all the countries surveyed - with the exception of Austria - the rule relating to the deduction of expenses is not dependent on whether dividends are received. Of course when non-deductible (deemed) expenses are represented, as a flat rate, by a non-exempt proportion of the dividends received, the non-deductibility of such expenses arises only as a consequence of the receipt of the dividends.

In Ireland a credit system is operated so that dividends are never tax exempt. Business expenses incurred by the Irish parent company are fully deductible, subject to the normal rules applying for deduction of any business expenses. There are specific rules set out under which expenses relating to foreign dividend income are allocated to the specific dividend so as to calculate the effective foreign tax rate and so determine the maximum rate of credit available in Ireland in respect of the foreign dividend.

Cases where dividend distribution is waived and at the same time a loan is granted to the national parent company are considered as an abuse of the legal limitations in:

Belgium;
Germany;
Luxembourg (loans can be re-qualified as constructive dividends if it appears that the loan is not going to be reimbursed).

In all the other countries surveyed a loan to the parent company is not considered as an abuse of legal limitations (in Austria, Finland and the UK this is subject to the assumption that the loan is genuine and arm's length).

When the business expenses exceed the dividend income, the excess is fully deductible in all the countries surveyed with the exception of Italy and Spain. In Austria the issue is controversial, but recent case law show that the deduction is admitted if there is also a taxable capital gain from the sale of the respective shares. In Denmark whether the business expenses are deductible or not is not connected to the fact that they exceed the income.

In the case of several participations, it is necessary to proceed with an allocation on a pro rata basis in:

Austria;
Belgium;
Denmark;
Finland;
Germany;
Ireland.

This is not necessary in:

France;
Italy;
Luxembourg (the expenses will have to be allocated to each participation);
The Netherlands;
Portugal;
Spain;
UK.

III TABLE SUMMARISING THE RESTRICTIONS ON THE DEDUCTION OF EXPENSES RELATED TO CROSS-BORDER DIVIDEND INCOME COVERED BY THE PARENT SUBSIDIARY DIRECTIVE.

Austria	Financing costs incurred in connection with the acquisition of shares in a foreign subsidiary qualifying for benefits under the Parent Subsidiary Directive are generally not deductible.
Belgium	Dividends received by the parent company can benefit of 95% exemption. The 5 % taxable portion represents, as a flat rate, deemed expenses related to the holding.
Denmark	Business expenses incurred in respect of shareholdings are not deductible - irrespective of whether the dividend-income is tax-exempt under a double taxation treaty and /or under the EC parent subsidiary Directive - unless the taxpayers are trading in shares, e.g. bank..
Finland	Expenses related to the acquiring or maintaining of tax exempt income are not deductible.
France	Dividends received by the parent company can benefit of 95% exemption. The 5% taxable portion represents, as a flat rate, deemed expenses related to the holding.
Germany	In general, expenses directly related to tax-exempt dividend income are not deductible. 5 % of the tax exempt income are considered as directly related.
Ireland	No restrictions.
Italy	Foreign dividends received by the parent company can benefit of 95% exemption. The 5% taxable portion represents, as a flat rate, deemed expenses related to the holding.
Luxembourg	Expenses related to tax-exempt dividend income are never deductible.
The Netherlands	Costs that are related to a subsidiary are not deductible, unless these costs (indirectly) result in profits that can be taxed in the Netherlands.
Portugal	No restrictions.
Spain	No restrictions.
Sweden	No restrictions.
The UK	No restrictions.

IV. CONCLUSION

In most EU countries there are restrictions to the deductibility of expenses related to cross-border dividend income covered by the Parent Subsidiary Directive.

In Finland, Germany, in Italy and the Netherlands: the same restrictions do not apply in connection with dividend income received from domestic subsidiaries.

Such discrimination leads to an unequal treatment of non-domestic companies and hampers the proper functioning of the Single Market, creating distortions of competition. Therefore it should be abolished.

Even though Article 4 allows Member States the option of prohibiting the parent company to deduct from the taxable profits charges relating to the holding of the subsidiary, FEE holds the view that those restrictions are in contrast with the rationale of the Directive, as stated in the first and third *consideranda*, where it says: "… the grouping together of companies of different Member States may be necessary in order to create within the Community conditions analogous to those of an internal market … such operations ought not to be hampered by restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States; … whereas cooperation between companies of different Member States is thereby disadvantaged in comparison with cooperation between companies of the same Member State; … it is necessary to eliminate this disadvantage by the introduction of a common system in order to facilitate the grouping together of companies".

Indeed, the main aim of the Directive appears to be that a parent company from one Member State do not suffer any taxation on the income received by its subsidiary from a second EU Member State that a parent company established in that second Member State would not have suffered. This is clearly not reflected in the present situation.

In addition, we think that prohibiting the deduction of expenses related to cross-border dividend income covered by the Parent Subsidiary Directive on the grounds that they are related to tax exempt income is fundamentally wrong because actually such income is not tax exempt. Dividend income is normally taxed at subsidiary level, and indeed the main reason why it is exempt at parent company level is to avoid double taxation.

Action required

As the main conclusion FEE would recommend that:

- any restrictions on the deductibility of the expenses related to cross-border dividend income covered by the Parent Subsidiary Directive be abolished, allowing full exemption of dividend income received from EU subsidiaries.
- the Parent Subsidiary Directive be modified, eliminating paragraph 2 of Article 4.

Date of reference and coverage

The survey has been carried out taking into account the legal situation in the respective Member States (except Greece) as at 30 November 1999 (Germany: 1 January 2000).

PART II

ANSWERS BY COUNTRY

1 Legal Framework

1.1 Are there legal provisions regulating the allocation of business expenses to tax-exempt dividend income under a double taxation treaty and /or under the EC parent subsidiary Directive?

	Yes	No
Austria	X	
Belgium	X	
Denmark	N/A Business expenses incurred in respect of shareholdings are not deductible - irrespective of whether the dividend-income is tax-exempt under a double taxation treaty and /or under the EC parent subsidiary Directive - unless the taxpayers are trading in shares, e.g. bank. Non-deductible expenses may be added to the purchase price of the shares in the computation of capital gain/losses. Interest expenses and losses on debt are normally always deductible. However, interest and losses on capital loans are not deductible, if they relate to the financing of shares in finance companies located in tax heavens, cf. The Danish Tax Assessment Act Section 5 E.	
Finland		X There are no specific domestic regulations or provisions regarding business expenses related to the tax exempt foreign dividend income. Deduction of the business expenses is regulated in the general provisions described below. We are not aware of any ordinances issued by the tax authorities either.
France		X
Germany	X	
Ireland	Dividend income is not tax exempt.	
Italy		X

Luxembourg	X	
The Netherlands	Costs that are related to a subsidiary are not deductible, unless these costs (indirectly) result in profits that can be taxed in the Netherlands	
Portugal		X There are no specific provisions regarding business expenses related to dividend income.
Spain		X
Sweden		X There are no specific provisions regulating the deductibility of business expenses in relation to dividend income. This means that all expenses are deductible.
UK	N/A. The UK operates a foreign tax credit system, with no disallowance of expenses.	

1.2 Have the tax authorities issued rules providing for allocation of business expenses to tax-exempt dividend income under a double taxation treaty and /or under the EC parent subsidiary Directive?

	Yes	No
Austria	X	
Belgium	X	
Denmark	N/A The tax authorities have issued ordinances providing for the practical application of The Danish Tax Assessment Act Section 5 E, described under question 1.1	
Finland		Same as 1.1
France		X

Germany	X	
Ireland	Same as 1.1	
Italy		X
Luxembourg	X	
The Netherlands		X
Portugal		Same as 1.1
Spain		X
Sweden		X
UK	Same as 1.1	

2 Definition of Dividend-Income qualifying under the Parent Subsidiary Directive

2.1 What minimum participation quota is required in your country for the purpose of dividend-income qualifying under the parent subsidiary Directive?

	minimum participation quota of 10%	minimum participation quota of 25%
Austria		X
Belgium		
Denmark		X
Finland	See below 2.2	
France	N/A	
Germany	X	
Ireland		X (for underlying tax credit relief)
Italy		A minimum participation quota of 25 % for the purpose of the domestic legislation implementing the EC parent subsidiary Directive
Luxembourg	X	
The Netherlands	N/A	
Portugal		X 25% participation required for: - benefiting of the 95% exemption on dividends received; the exemption of withholding tax on dividends paid.
Sweden		X
UK	X (for underlying foreign tax credit relief)	

2.2 To the extent that diverging participation quota apply, please specify.

Belgium	5% participation or 50.000.000 BEF required for benefiting of the 95% exemption dividends received. 25% participation required for the exemption of withholding tax on dividends paid.
Finland	According to the Taxation of Business Income Act 6.2 §, dividend income received from the foreign corporate body by a domestic corporate body, is tax exempt in case when there is a double taxation agreement between Finland and the home country of the distributing company and the agreement has been effective in January 1st 1995 and where 1. the shares or stocks owned by the receiving company constitute at least 10% participation of the voting power in the distributing company or 2. the receiving company owns at least 25% of the distributing company's capital.
France Ireland	A minimum participation quota of 10% or a cost of participation of 150 MF is required for benefiting dividends received exemption. A minimum participation quota of 25% is required for the exemption of withholding tax on dividends paid. 25% for underlying foreign tax credit.
Italy	In case the EC parent subsidiary Directive does not apply, a 20 % minimum participation quota is required for benefiting from a 60 % exemption on dividends received from a foreign company. No participation exemption rules exist as regards the domestic dividend income.
The Netherlands Portugal	In general the minimum participation is 5%. If the foreign subsidiary is not carrying on a business, the participation exemption is only applicable in case the participation is 25% or more.
Spain	5% minimum participation and one year holding period.
Sweden	Dividend income on shares in Swedish companies is exempt if the shares are held for business purposes. Where the holding is at least 25% of voting rights of the value by the end of the financial year, the shares are generally deemed to be held for business purposes. Under domestic rules dividend income on shares in foreign companies is exempt under the same conditions as dividend income on shares in Swedish companies, provided that the foreign dividend income is distributed by a company that has been subject to tax that is “comparable” to Swedish tax. In the case of dividends exempt under the Directive the minimum holding is 25% of the share capital with the same proviso as regards the “comparability”.
UK	10% for underlying foreign tax credit.

3 Detailed Provisions concerning Tax-Exempt Dividend Income under a Double Taxation Treaty

3.1 Is it permitted to deduct the full amount of business expenses related to tax-exempt dividend income under a double taxation treaty and/ or under the EC parent subsidiary Directive?

	Yes	No
Austria		X
Belgium		X
Denmark	If the business expenses are deductible, the full amount may be deducted irrespective of whether the dividend-income is tax-exempt under a double taxation treaty. The rules regulating whether business expenses are deductible or not are described under question 1.1	
Finland		According to the Taxation of Business Income Act 16§2, expenses related to the acquiring or maintaining of tax exempt income are not deductible. However, in cases where the expenses related to tax exempt income exceed the amount of income, the excess is deductible.
France		Not applicable, dividends never exempted.
Germany		X
Ireland	Not applicable: credit rather then exemption method is used.	

Italy	Dividends received by parent company can benefit of 95% exemption. In general, business expenses are always fully deductible. Under the EC parent subsidiary Directive, the exemption of the 95 % of the dividend instead of the 100 % realises itself the non-deductibility of the management costs of the participation on a 5 % flat basis. Therefore, business expenses allocated in the income statement are always fully deductible. Capital losses strictly related to tax-exempt dividend income are not fully deductible even under domestic rules implementing the EC Directive. Further limitations are provided for should the dividend income be received from a tax haven resident distributing company or, under the EC Directive rules, should the owner of the Italian receiving company be non-EU resident.	
Luxembourg		X
The Netherlands		X
Portugal	X	
Spain	X	
Sweden	Business expenses related to tax exempt dividend income are fully deductible under domestic rules, irrespective of whether exemption applies under domestic law, a double taxation treaty or the Directive.	
UK	Not applicable: Dividends never exempted	

3.2 If the answer to question 3.1. is "no", under what conditions is full ~~or partial~~ deduction of business expenses permitted?

Austria	According to a recent decision by the Austrian Constitutional Court (VfGH v. 25.6.1998, B125/97) interest expense incurred in connection with the financing of a participation has to allocated pro-rata to (tax exempt) dividend income and a capital gain realised on the sale of the participation. If the capital gain is taxable the respective portion of the financing costs becomes tax deductible. If the subsidiary has not paid any dividends since it was acquired the financing cost becomes fully deductible. It is not yet clear how this case law will be implemented.
Belgium Finland	Dividends received and which can benefit of the 95% exemption, will however not be deductible from certain specified disallowed expenses which are to be included in the company's taxable basis. This concerns basically following disallowed expenses: - 25% of the car expenses, - 50% of entertainment expenses, - disallowed interests, - disallowed part of group insurance premiums. The disallowed interests can result either from excessive interest rates or from a requalification in dividends. The disallowed part of group insurance premiums may result from restrictions in the amounts of premiums paid to the group insurance (in relation to the salary earned). In cases where the expenses related to tax exempt income exceed the amount of income, the excess is deductible.
France	When dividends received exemption is applicable, an amount equal to 5% of the net dividend plus credit is added back to the taxable income.
Germany	In cases where the expenses related to tax exempt income exceed the amount of income, the excess is deductible. Expenses not directly related to tax exempt income are deductible as well. 5% of the tax exempt income are considered as directly related and therefore not deductible.
Ireland	See 3.1
Italy	In general, ~~capital losses~~ strictly related to the dividends received are not deductible up to the amount of the tax-exempt dividend income.
Luxembourg	

The Netherlands	If the foreign subsidiary creates profits that are taxable in the Netherlands, the costs of the parent are deductible in as far these can (indirectly) be connected to the Dutch profits of the foreign subsidiary.
UK	Dividends are never tax exempt - business expenses are not restricted and therefore fully deductible.

3.3 Is the full amount of business expenses tax deductible if no dividends were received during the business year?

	Yes	No
Austria		X
Belgium	X	
Denmark	There is no connection between the deduction and distribution of dividend.	
Finland	The nature of the expenses is decisive, not the moment when the income is received.	
France	X	
Germany	X	
Ireland	X	
Italy	The deduction is not related to the distribution.	
Luxembourg	X	
The Netherlands	There is no connection between the deduction and distribution of dividend.	
Portugal	X	
Spain	X	
Sweden	X	
UK	X	

3.4 Are situations where dividend distribution is waived and at the same time a loan is granted to the national parent company considered as an abuse of the legal limitations?

	Yes	No
Austria		No, assuming that the loa n is genuine and arm's length
Belgium	X	
Denmark		X
Finland		No, assuming that the loan is genuine and arm's length.
France		X
Germany	X	
Ireland		X
Italy		X
Luxembourg	X Loans can be requalified as constructive dividends if it appears that the loan is not going to be reimbursed.	
The Netherlands		No, assuming that the loan is genuine and arm's length
Portugal		X
Spain		X
Sweden		X
UK		As for Finland

3.5 If the business expenses exceed the dividend income, is the excess fully deductible?

	Yes	No
Austria	Probably yes (recent case law VfGH v. 25.6.1998, B 125/97) if there is also a taxable capital gain from the sale of the respective shares	
Belgium	X	
Denmark	Whether the business expenses are deductible or not is determined by the rules described under question 1.1.1. If the business expenses are deductible, the excess will be fully deductible as well.	
Finland		Same as 3.1.
France	X	
Germany	X	
Ireland	X	
Italy		X
Luxembourg	X	
The Netherlands	This criterion is not valid in the Netherlands. In general costs that are related to a subsidiary are not deductible	
Portugal	X	
Spain		X
Sweden	X	
UK	X	

3.6 In the case of several participations, is it necessary to proceed with an allocation on a pro rata basis?

	Yes	No
Austria	X	
Belgium	X	
Denmark	X	
Finland	Yes. Assuming that the question deals with the situation where the taxpayer owns participation in different companies and some of the dividends are taxable income and some tax exempt.	
France		X
Germany	X	
Ireland	Yes. In relation to determining the effective rate of foreign tax on the dividend.	
Italy		X
Luxembourg		X The expenses will have to be allocated to each participation.
The Netherlands		X The expenses will have to be allocated to each participation.
Portugal		X
Spain		X
Sweden	Not applicable	
UK		X

Notes to part 3

Finland: In Finland all taxable business income (including dividends from the subsidiaries) is taxed in one source of (business) income and all business expenses are deducted from that income in the same source of income. Therefore it is rather difficult to allocate which expenses are related to tax exempt income. However, if there are expenses which can be linked to the tax-exempt income, they may be for example administrative or other business expenses. However, financing expenses such as interests or exchange losses are usually considered deductible even if they are connected to the tax-exempt income.

UK: In the UK no restriction on relief for expenses arise with respect to dividend income.

NOTES BY COUNTRY

Austria

Allows the deduction of costs incurred by the parent company in respect to the co-ordination and management of its subsidiaries by the parent company's personnel ("stewardship expenses"). Financing costs incurred in connection with the acquisition of shares in a foreign subsidiary qualifying for benefits under the Parent Subsidiary Directive are generally not deductible. According to recent case law financing cost could become partly deductible if there is also a taxable capital gain from the sale of the shares and part of the financing cost is allocated to the capital gain. Under certain conditions dividends received from a subsidiary qualifying for Parent-Subsidiary Directive would not be exempt but taxable in Austria with a credit allowed against Austrian tax for foreign income tax and withholding tax paid by the subsidiary; in this case the financing expense incurred in relation to the acquisition of the subsidiary would be tax deductible.

Belgium

1.*Dividends received by a Belgian company*:

will be tax exempt for the beneficiary up to 95 % provided:

Beneficiary company has a participation of at least 5 % or BEF 50.000.000.

Paying company is subject to "normal" corporate tax (excludes i.e. tax exempted holding companies, tax heaven companies, etc).

Technically, the deduction applies against the taxable basis formed by operating profit, distributed dividend, disallowed expenses and after splitting up the taxable basis between:

- "Belgian" income taxable at normal rate
- "Foreign source" income taxable at reduced rate
- "Foreign source" income exempt by Treaty.

2. *Dividends paid by a Belgian company*

The parent subsidiary regulation (exemption of withholding tax at source) will apply provided the Belgian or foreign EU beneficiary company was held or undertakes to hold without interruption at least 25 % participation during a 12-month period.

3 *Thin capitalisation rule*

In some cases, interest paid on loans received may be requalified as dividends.
C.C.: loans granted by a company located in a tax heaven country or not subject to normal income tax as far as the loan exceeds 7 times the equity of the Belgian beneficiary company.

Sweden

Our response does not take shares held as inventory into consideration.

UK

Expenses of management of investments are tax deductible in the normal way and losses can be surrendered to other UK group companies. No specific rules exist and, in particular, expenses do not first have to be set against foreign dividends, thus restricting foreign tax credits.

ADDITIONAL QUESTIONS

1. Are there any differences in your country between the tax treatment of crossborder dividend income covered by the Parent Subsidiary Directive in comparison with the tax treatment of domestic dividend income?

AUSTRIA

Foreign dividends are tax exempt at the recipient only if the following conditions are met:

- the participation in the foreign subsidiary represents at least 25% of share capital and;

- the participation is being held for at least 2 years (in line with the "Denkavit"-judgment of the ECJ the 2 year holding period can be completed also after the receipt of the dividends). Capital gains on the sale of foreign participations are also exempt if the above conditions are met.

Domestic dividend income is tax exempt if the shareholder is himself subject to corporation tax. For domestic dividends there is no minimum percentage of the participation nor a minimum holding period requirement. Capital gains on the sale of domestic share are always fully taxable.

BELGIUM

There is no difference of treatment for foreign (EU) or domestic dividends. The article relating to foreign dividend income refers to the Council regulations (90/435/CEE).

DENMARK

Basically, dividend distributed between domestic companies and cross-border dividend covered by the Parent Subsidiary Directive is treated in the same way for tax purposes. In both cases, such dividend will not be subject to tax. Dividend received from a finance company subject to low taxation is taxable income unless certain requirements are complied with.

FINLAND

Crossborder dividend income covered by the Parent Subsidiary Directive and internal legislation is tax exempt. Dividend income from domestic companies is, however, normal taxable income to the receiver.

FRANCE

No.

GERMANY

Yes, there are differences.

Crossborder dividend income covered by the Parents Subsidiary Directive, when distributed, is not subject to a distribution burden. No tax credit is granted.

Domestic dividend income, when distributed, is charged at a rate of 30 per cent (distribution burden). Tax credit is granted to domestic shareholders.

IRELAND

Yes. The dividends from Irish subsidiaries are exempt. Dividends from EU subsidiaries are taxable and foreign tax credit is allowed for the foreign tax suffered provided there is at least a 25% ownership. In both cases, the dividend income is regarded as investment income in the hands of the parent company, and may, in circumstances where the company is closely controlled and where the investment income is not paid out by way of dividend, lead to a further tax charge to the parent company.

ITALY

Yes.

LUXEMBOURG

No.

NETHERLANDS

No.

PORTUGAL

There is no difference of treatment.

SPAIN

No.

SWEDEN

Yes. In the case of purely domestic dividends exemption applies where the holding amounts to at least 25 % of the voting rights or, where the holding is less, the shares are held for business purposes. Exemption under the parent subsidiary directive applies if the holding amounts to at least 25% of the share capital, provided the distributing company is subjected to an income tax which is "comparable" to the one levied under Swedish tax law, had the income been received by a Swedish enterprise.

UK

Yes. Dividends from UK subsidiaries are exempt, dividend from EU subsidiaries are taxed and foreign tax credit is allowed for all foreign taxes suffered provided at least 10% ownership.

2. In case in your country there are restrictions to the deductibility of expenses related to crossborder dividend income covered by the Parent Subsidiary Directive, do the same restrictions apply in connection with dividend income received from domestic subsidiaries?

[For example, a case of discriminatory tax treatment of expenses related to crossborder dividend income covered by the Parent Subsidiary Directive could be when:

- *crossborder dividend income covered by the Parent Subsidiary Directive is exempted,*
- *domestic dividend income is treated according to the imputation system (i.e. a tax credit is allowed to avoid double taxation), and*
- *there are restrictions to the deductibility of expenses related to tax exempt income.]*

AUSTRIA

In general the same restrictions regarding deductibility of expenses apply for participations in case the dividends out of a participation would be exempt. Therefore, for foreign participations below 25% (or if the participation is sold before the 2 year holding period is completed) there are no restrictions (e.g. interest incurred to finance the acquisition is fully deductible with regard to foreign participations).

BELGIUM

The restrictions are the same:

- minimum participation of 25% for the preceding 12 months,
- or for a total period of 12 months as from the acquisition date,
- the paying company must be subject to a "normal" corporate tax regime.

DENMARK

The restrictions to the deductibility of business expenses in respect of shareholdings, as mentioned under item 1.1., applies in general equally to dividend income covered by the Parent Subsidiary Directive and dividend income received from domestic subsidiaries. However, it is not possible to deduct interest expenses and losses on debt related to acquisition of shares in finance companies subject to low taxation.

FINLAND

All costs related to domestic dividend income are tax deductible as the income is taxable income. The costs related to tax exempt crossborder dividend income is generally not deductible because of the general regulation in our business income tax act.

FRANCE

Not applicable.

GERMANY

There is a general rule in Germany income tax law that expenses directly related to tax exempt income are not deductible. However, since domestic income is not exempted from tax (see question 1), in practice, the rule does not apply to domestic dividends.

IRELAND

Not applicable.

ITALY

Domestic dividend income is taxed and a full tax credit is allowed to avoid double taxation. EU dividend income covered by the Parent Subsidiary Directive is 95% exempted (with a 5% flat rate not exempted for expenses income)

LUXEMBOURG

The same restrictions apply. As a general restriction expenses are deductible insofar as the amount exceeds dividend income. Expenses deducted in the past may be subject to income tax if a capital gain is realised when selling the participation, but only up to the capital gain realised.

NETHERLANDS

Yes, deduction is not allowed for dividend income which has not been taxed in the Netherlands.

PORTUGAL

Not applicable. See answer 3.1.

SPAIN

There are no restrictions to the deductibility of expenses related to dividends, both those paid by domestic companies and those paid by foreign ones.

SWEDEN

Not applicable.

UK

Not applicable.

Overview of Findings from the Survey

Firstly, it was found that the parent subsidiary directive has been successfully and virtually fully implemented by all Member States. In the area of deductions for expenses relating to interest income, a number of countries, particularly Belgium, France and, under current proposals, Germany, have taken advantage of the rules of the directive to disallow 5% of otherwise exempt dividend receipts and effectively subject this to tax as a means of recapturing expenses which it is deemed have been incurred in relation to the ownership and management of the shares from which the dividends flow.

Only four countries – Portugal, Spain, Sweden and the United Kingdom – allow, without restriction, the full amount of business expense relating to tax exempt dividend income as a deduction. Nine countries do not always allow full deduction of business expenses relating to tax exempt dividend income. A further two countries – Italy and Spain – do not allow a full deduction for business expenses relating to the participation that exceed the dividend income. Although many of the disallowances arise from domestic law and have no direct relationship with the terms of the directive, they do, in effect, lead to a degree of unjust treatment of European taxpayers. The expenses incurred by the parent company's management should be deductible in the view of FEE either in the country of residence of the parent company or by means of an allocation charge to the country where the taxable profits underlying the dividend are earned. Other than in the case of France, and then only in very restricted circumstances, no country has a worldwide tax consolidation system and yet, looking at European wide activities, there is no reason why genuine business expense should be disallowed in one country as relating to dividend income when looking at worldwide or European wide operations in total such expenses should fall to be deducted against taxable income in some location. This is an area we believe should be studied further with a view to trying to redress the issues identified.