

The European Court of Justice and corporation tax: the Luxembourg Breviary

Jacques Malherbe*

October 2019

TABLE OF CONTENTS: 1. Introduction — 2. Treatment of profits — 3. Transfer pricing — 4. Treatment of losses — 5. Interest deduction — 6. Withholding taxes at source — 7. Transfer of registered office and contribution of assets — 8. Abuse of right — 9. Conclusion: the Luxembourg Breviary

1. Introduction

The decisions of the Court of Justice of Luxembourg have repeatedly influenced Belgian tax law and require the corporate tax practitioner to acquire the “European reflex” alongside national reflexes. Examples are the carry-over of permanently taxed income in loss-making companies (Cobelfret), the prohibition of the allocation of Belgian losses to the income of foreign establishments exempted by treaty (Amid), the limitation of withholding tax on dividends paid to Luxembourg companies (Tate & Lyle).

The same applies in all Member States. The case law that will be reviewed makes it possible to establish the principles to be followed and to find new arguments in new situations.

While it was not until 1986 that the Court of Justice of the European Union, then the Court of Justice of the European Communities, ruled for the first time on direct taxes, the multiplication of its decisions since then, both under the Treaty and under directives adapted since 1990 in the same field, has given rise to a rich intra-European glossary. Thus, through the disputes submitted to the Court, a number of principles appear which form a European case law. The Court applies the general principle of non-discrimination, interpreted in the light of the freedoms of establishment, the provision of services and the movement of capital. More rarely, it is called upon to clarify the meaning of the directives. Corporate income tax is remodelled according to the preliminary questions referred by the courts or infringement proceedings brought by the Commission.¹ It is

* Université de Louvain la Neuve (Belgium); ✉ Jacques.Malherbe@simontbraun.eu

1. Cfr. D. Gutmann, *Droit fiscal des affaires*, 8th ed., 2017–2018, LGDJ, 2017, p. 71; A. Maitrot de la Motte, *Droit fiscal de l'Union européenne*, 2nd ed., Bruxelles, Bruylant, 2016, p. 131; B.J.M. Terra and P.J. Wattel, *European Tax Law*, 6th ed., Alphen aan den Rijn, Wolters Kluwer Law & Business, 2012, p. 37; S. van Thiel, *EU Case Law on Income Tax*, Part I, Amsterdam, IBFD, 2001, p. 36; Ph. Marchessou and B. Trescher, *Droit fiscal international et européen*, Bruxelles, Bruylant, 2018, p. 249; V.E. Englmaier, in M. Lang, P. Pistone, J. Schuch, C. Staringer, ed., *Introduction to European Tax Law: Direct Taxation*, 3rd ed., Vienna, Linde Verlag, 2013, p. 44; Oellerich in Schaumburg, *Englisch, Europäisches Steuerrecht*, Cologne, Otto Schmidt, 2015, p. 95; R. Bufan, M. Buliga, J. Malherbe, N. Svidchi, *Tratat de drept fiscal*, vol. 2, *Drept fiscal al Uniunii Europene*, R. Bufan and J. Malherbe, coord., Bucharest, Ed. Hamangiu, 2016, p. 312. On the obligation to refer a question for a preliminary ruling where the provision of the law of the Union in question has not been interpreted in a way that leaves no room for doubt, C-416/17, *European Commission v. French Republic* (France, 2018). On the impossibility of entrusting arbitrators with the settlement of a dispute that may concern European law, since arbitrators cannot refer questions to the Court of Justice for a preliminary ruling, see C-284/16 *Achmea* (Slovakia

a principle that, if Member States have retained their tax sovereignty, they must exercise it in accordance with Union law.

2. Treatment of profits

2.1. In the host State

Freedom of establishment requires that States do not discriminate between companies from other Member States and national companies or restrict the exercise of this freedom. This freedom is exercised through the creation of branches or subsidiaries. We will first examine the treatment of their profits.

The exercise of freedom of establishment in the host State, which will be, in terms of international tax law, the source State, implies equal treatment of establishments of companies from other Member States and national companies.

If a French company benefits from a “tax credit” enabling it to offset, when a dividend is distributed by its subsidiary, the corporation tax paid by it against the corresponding profit, the French establishment of an Italian company must be granted the same option.²

A permanent establishment may not be taxed at a higher rate than a domestic company.³ This practice was common in treaty law, to replace the withholding tax that would have been levied if the investor had created a subsidiary distributing a dividend.

Moreover, although a permanent establishment is not a resident benefiting from tax treaties, the establishment in Germany of a French company is granted the right to the conventional exemption of inter-company dividends provided for by the German-American treaty instead of the foreign tax credit to which local law limited it.⁴

A “fairness tax” applied in Belgium to the difference between the dividend distributed and the taxable profit for the year. For a permanent establishment, it taxed the proportion of the dividend corresponding to the portion of the company’s profits attributable to the permanent establishment. There would be discrimination if Belgium were to tax profits that did not fall under Belgian tax jurisdiction because they were unrelated to the permanent establishment. The case is referred to the national court to establish any difference in treatment between a permanent establishment and a subsidiary, the latter being taxable only if it itself distributes a dividend.⁵

2.2. In the State of residence

As for the State of residence of the company investing in another Member State, if it can choose to tax with a tax credit or exempt the foreign permanent establishments of its resident companies, it can only tax the undistributed income of a subsidiary established in a low-tax Member State, where applicable, on income of a certain type (passive income, income from intra-group transactions) if it demonstrates the existence of a “totally artificial arrangement.”⁶ The exercise of a genuine economic activity will prevent such transparent taxation of “controlled foreign companies” (CFC, Controlled Foreign Corporations, art. 209 B of the CGI in France) if such taxation does not apply to a domestic subsidiary.

– Germany 2018, which may have implications in terms of “tax arbitration”).

2. 270-83, *Avoir fiscal* (France, 1986).

3. C-311/97, *Royal Bank of Scotland* (Greece, 1999); *Commission v Greece*; C-253/03, *CLT-UFA* (Germany, 2006).

4. C-307/97, *Saint-Gobain* (Germany, 1999).

5. C-68/15, *X v Ministerraad* (Belgium, 2017).

6. C-196/04, *Cadbury Schweppes* (United Kingdom, 2006).

Thus, German legislation imposed stricter conditions on the exemption of inter-company dividends when they came from a foreign subsidiary than when they came from a German subsidiary. The subsidiary's result had to come in particular from an "active activity" (sic). This discrimination was found, in respect of an Australian dividend distributed on a minority shareholding, to be contrary to the freedom of movement of capital and not eligible for the standstill rule applicable to legislation, which existed in 1993, the applicable regime having been fundamentally modified. The rule could not be justified by the prevention of abuse, since it constituted a general presumption, without it being necessary for the administration to prove *in concreto* the artificiality of the construction.⁷

The Parent-Subsidiary Directive regime only applies to parent companies if their shareholding is fully owned. A usufruct is not enough.⁸

On the side of parent companies of subsidiaries in other Member States, tax credit schemes were criticised and this led to their disappearance. The former British regime opened the ban: an "advance corporation tax" (ACT) had to be paid when a dividend was distributed, guaranteeing the (partial) tax credit granted to the final shareholder, comparable to the former French "précompte." A resident shareholder company could charge it against the ACT due on its own dividends. A parent company holding 51% of its subsidiary could make a "group election" with the subsidiary under which the ACT was payable only upon distribution of the dividend by the parent. The Court held that this option should be granted to parent companies from other Member States.⁹

The tax credit, partially granted by the United Kingdom to parent companies by certain British bilateral treaties, does not constitute a right for corporate shareholders of other Member States. The prevention of double taxation is a matter for the law of the State of residence of the parent, if necessary according to the Parent-Subsidiary Directive. A foreign parent company is not in the same situation as a domestic parent company.¹⁰

The UK ACT scheme was repealed in 1999.

The foreign indirect tax credit scheme was condemned when the Court decided that it should extend, also for natural persons, to the tax paid abroad by a distributing company.¹¹

In a two-rate corporate tax system, one of which is lower for distributed profits that give rise to a tax credit reserved to domestic shareholders and the other for reserved profits, there is no discrimination in applying a tax supplement when a distribution exceeds the distributable profit, even if its distribution goes to a non-resident shareholder who is not eligible for the tax credit. The supplement is levied on earnings regardless of the shareholder's residence.¹²

The French tax consolidation system was considered discriminatory in that it did not extend to foreign subsidiaries and therefore eliminated 100% double taxation of dividends only in the case of domestic subsidiaries.¹³ The parent-subsidiary regime, which exempts the dividend by up to 95%, applied to dividends from all sources.

There is no discrimination if a country applies to parent companies, in order to avoid economic double taxation, the exemption method for domestic dividends and the method of the underlying tax credit for tax paid by the subsidiary to foreign dividends.¹⁴ However, this credit must also apply in the case of holdings of less than 10%, as the exemption method applies to it when distributing

7. C-685/16, EV (Germany, 2018).

8. C-48/17, Vergers du Vieux Tauves (Belgium, 2008).

9. C-397/98, C-410/98, Metallgesellschaft/Hoechst (2001)

10. C-374/04, Test Claimants in Class IV of the ACT Group Litigation (Royaume-Uni, 2006).

11. C-319/02, Manninen (Finland, 2004); C-292/04, Meilicke, Weyde, Stöffler (Germany, 2007).

12. C-284/06, Burda (Germany, 2008).

13. C-386/14, Groupe Steria (France, 2015).

14. C-446/04, Test Claimants in the Franked Investment Income (FII) Group Litigation (2006).

domestic dividends.¹⁵ The free movement of capital requires it.¹⁶ However, the foreign tax credit did not extend to the ACT payable on the redistribution of the dividend, which constituted a cash-flow disadvantage and therefore discrimination.

To apply the Parent-Subsidiary Directive to parent companies, Member States have the choice between the exemption method and the method of the indirect tax credit for underlying taxes paid by the subsidiary on the profit distributed. The country that has opted for the exemption cannot offset the company's losses against the incoming dividend. It thus deprives the parent company of its loss carryover and adds a condition to the directive, namely that the company receiving the dividend must be in a profitable situation.¹⁷

As regards dividends from third countries, the freedom of movement of capital requires that they should not be treated less favourably than domestic dividends.¹⁸

The interpretation of the Directive is literal and not teleological. The exemption must be understood as such. Its result cannot be compared to that of the indirect credit method: if the corporate shareholder is loss-making, it will not pay any tax against which to charge the credit and the credit, in the absence of a deferral obligation, may be lost.

Similarly, France, having opted, under the Directive, for the 95 % exemption method, cannot impose a 30 % tax on profits distributed if they contain dividends from subsidiaries which must be exempt, except for a 5 % share of costs and charges.¹⁹

3. Transfer pricing

Abnormal or gratuitous benefits granted to a foreign related company are added to the benefits of the national company, in this case the Belgian company, which grants them. The rule does not apply to benefits granted to a company located in the same country when the benefits are taken into account to determine the recipient's income. There is discrimination with regard to freedom of establishment, but this discrimination is justified by the balanced distribution of tax power and the prevention of tax evasion. However, the taxpayer must be able to prove commercial reasons for the transfer and the correction must be limited to the part of the transfer that does not correspond to arm's length prices.²⁰

The commercial reasons justifying the transfer may result solely from the shareholder position of the company granting the advantage, in this case a free guarantee. The favoured foreign subsidiary had negative equity and could not obtain credit without the guarantee of the parent company.²¹

4. Treatment of losses

4.1. Deductibility

The treatment of losses is as important as the treatment of profits. The question arises mainly in the State of residence of the company investing in another Member State.

15. C-201/05, *Test Claimants in the CFC and Dividend Group Litigation*, (2008).

16. C-436/028 and C-437/08, *Haribo* (Austria, 2011).

17. C-138/07, *Cobelfret* (Belgium, 2009); C-43/07 and C-499/07 *KBC Bank NV and Beleggen Risicocapitaal Beheer NV* (Belgium, 2009).

18. C-43/07 and C-499/07, *KBC Bank and Beleggen Risicocapitaal Beheer NV*.

19. Directive, art. 4.1; C-365/16, *AFEP and others* (France, 2017).

20. C-311/08, *SIGI* (Belgium, 2010).

21. CV-382/16, *Hornbach-Baumarkt AG* (Germany, 2018).

European law does not oblige a Member State to allow the deduction in the country of losses of foreign permanent establishments,²² which some States allow by reinstating losses in taxable profits at the time when the establishment makes profits which, in principle, will be offset in the host country against previous losses. If it is indeed a restriction on the freedom of establishment, it is justified by the conventional symmetry between the exemption of the foreign establishment's profits and the non-deductibility of its losses.

If a State chooses the second system (deduction and reinstatement), it has the right to tax even in the absence of a deduction in the host State, on the basis of the coherence of its tax system.²³

Similarly, losses could be reinstated in the event of a sale of the foreign operation, since the operation disappears and will no longer make profits that would allow the reinstatement of its future profits.²⁴

However, the Court saw discrimination in a rule forming part of a system of taxation of foreign establishments with a tax credit and therefore of deductibility of losses: the State of residence cannot reinstate losses on the liquidation of establishments because it would not do so in the event of transformation into a subsidiary of a national establishment.²⁵

The deduction of the loss incurred at a foreign location must be allowed if it is a terminal and permanent loss.²⁶

Danish law allows the deduction of losses incurred in a foreign permanent establishment, but on condition that these losses cannot be offset against the profits of the parent company. In the case under review, a Danish company had two Swedish subsidiaries, both of which had permanent establishments in Denmark. One of the Swedish companies transferred its permanent establishment to the other. In Denmark, the transaction was taxable, in particular on the goodwill generated. However, due to the amortisation of goodwill, the remaining establishment in Denmark was in a loss situation. The transaction was not taxable in Sweden and therefore goodwill amortisation could not be taken into account. The Court held that Danish legislation, although the situation of a Danish establishment and that of a foreign establishment were not comparable, constituted an obstacle to freedom of establishment on the basis of the *Bevola* judgment cited above. It would be justified only in so far as it would prevent a double deduction of losses, which the national court must verify.²⁷

4.2. Consolidation

What is the treatment of losses of foreign subsidiaries when a consolidation, tax “integration” system or a “group relief” system is used to transfer losses within a group? Generally, these systems only apply to national group member companies.

It cannot be denied to the groups head company on the grounds that the majority of its subsidiaries are not national. Subsidiaries of other Member States are comparable to national subsidiaries.²⁸

Losses of foreign subsidiaries should not be allowed for domestic consolidation.²⁹ This exclusion is justified in the context of consolidation — in this case the Dutch “tax unit” — by the balanced distribution of tax power between States. The exception ceases to apply, according to the Court's

22. C-414/06, *Lidl Belgium* (Germany-Luxembourg, 2008).

23. C-157/07, *Krankenheim Ruhesitz* (Germany, 2008).

24. C-388/14, *Timac Agro Deutschland* (Germany, 2015).

25. C-48/13, *Nordea Bank Danmark* (Denmark, 2014).

26. C-650/16, *A/S Bevola* (Denmark, 2018). Comp. Marks & Spencer, *infra* note 30.

27. C-28/17, *NN A/S* (Denmark, 2018)

28. C-264/96, *ICI* (United Kingdom, 1998).

29. C-337/08, *X Holding* (Netherlands, 2010).

controversial opinion, if the losses are “final” and can no longer be deducted in the host country, because of the liquidation of the subsidiary.³⁰ However, it may be required that this compensation takes place at the end of the subsidiary’s accounting year.³¹

A parent company cannot be denied the right to deduct interest on a loan taken out to finance the acquisition of a foreign company if, if the subsidiary was domestic, the parent could consolidate its results and those of the subsidiary, thereby obtaining the interest deduction.³²

We will remember the Bosal decision.³³ Article 4(3) of the Parent-Subsidiary Directive makes it possible to exclude from the deductible expenses of a parent company those relating to a holding whose income benefits from the Directive. Dutch law made use of this possibility, but except for the non-deductibility of costs that contributed to the creation of a taxable basis in the Netherlands, either because the subsidiary company was Dutch or because the foreign subsidiary company had a permanent establishment taxable in the Netherlands.

The Court acknowledged that the Dutch scheme was, strictly speaking, in conformity with Article 4(3) of the Directive and therefore compatible with it, but that the exclusion of costs relating to Community foreign shareholdings constituted a breach of Article 49 TFEU on freedom of establishment. It had a negative impact on the parent company’s decision to set up a subsidiary company in another EU country. It was also contrary to the aim of the Directive, namely the elimination of tax obstacles to relations between parents and subsidiaries of different Member States.

A consolidation regime cannot be ruled out on the grounds that the national subsidiaries are held by a subholding company located in another Member State.³⁴

As these are not subsidiaries but permanent establishments, the loss transfer regime cannot be refused to permanent establishments of companies of other Member States if it is granted to establishments of national companies.³⁵

A system of tax-free transfer of assets between group companies should apply to cross-border situations. Similarly, the transfer of losses against a contribution to be paid by the transferee company to the transferor company must also apply if the transferor company is not a national but is a subsidiary resident in another Member State³⁶ making a transfer to its loss-making Swedish parent company.

On the other hand, the contribution made by a national subsidiary company to a parent company of another Member State must not be deductible as it would be in domestic relations: this would make it possible to choose the country in which the income of the national subsidiary would be taxed and would be contrary to a system distributing the right to tax.³⁷

The interest deduction of a loan taken out by a Dutch company to finance a contribution to an Italian company was refused under the tax unit regime. The Court found that the refusal to deduct was not an element of the tax unit scheme but a general anti-abuse measure which, in the present case, could not be accepted since the deduction would have been allowed if the Italian subsidiary had been Dutch and had formed a tax unit with the Dutch lending company.³⁸

30. C-446/03, Marks & Spencer I (United Kingdom, 2005).

31. C-172/13, Marks & Spencer II (United Kingdom, 2015).

32. C.-398/16, X BV and C-399/16 X NV (Netherlands, 2018).

33. C-168/01, Bosal (Netherlands, 2003).

34. C-418/07, Papillon (France, 2008); C-80/12, Felixstowe, Dock and Railway Ltd (United Kingdom, Consortium, 2014); C-39/13, SCA Group Holding BV (Netherlands, 2014).

35. C-18/11, Philips Electronics UK (United Kingdom, 2012).

36. C-200/98, X AB and Y AB (Sweden, 1999).

37. C-231/05, Oy AA (Finland, 2007).

38. C-398/16, X B.V. (Netherlands, 2018), case attached to C-399/16.

In another case, joined with the previous one, a Dutch company had suffered an exchange loss as a result of a reorganisation affecting a British subsidiary. The deduction was refused on the grounds that both capital losses and capital gains on investments are not taken into account in determining a company's taxable income. The company argued that such a loss would have been taken into account within a tax unit. The argument was wrong. A State should not take into account negative results if positive results are not taxed.³⁹

4.3. Capital losses on shareholdings

Equal treatment must be ensured as regards the deductibility of value reductions (provisions for impairment of securities) or capital losses on shares of subsidiaries. The deduction of a provision for depreciation on the shares of subsidiaries may not be refused on the ground that the subsidiary is located in another Member State if it is granted in the case of domestic subsidiaries.⁴⁰ The refusal would also be contrary to the free movement of capital.⁴¹

If capital gains on shares are exempt, there is no obligation to allow the deduction of write-downs or capital losses, even if they are the result of an exchange loss.⁴² On the other hand, the exchange loss resulting from the closure of a foreign permanent establishment must be deductible in the State of the head office.⁴³

5. Interest deduction

Discriminatory rules cannot apply to the deduction of interest paid to affiliated companies, depending on whether they are domestic or foreign. Thus, on the subsidiary's side, the deduction of interest on debt exceeding x times equity cannot be denied only to loans from non-resident companies to resident companies.⁴⁴ However, the rule may be applied to a foreign company in the case of a purely artificial agreement.⁴⁵

The prohibition of discrimination does not extend to lenders from third countries, as it is part of the freedom of establishment, not of the freedom of capital movement: the restriction on the latter is an inevitable consequence of the restriction on the freedom of establishment.⁴⁶

On the parent company's side, a State is not obliged to exempt interest whose deductibility is denied abroad under a stricter undercapitalization rule than its own, but must grant the exemption up to the coefficient resulting from its own undercapitalization rule.⁴⁷

39. C-399/16, X N.V. (Netherlands, 2018), aff. attached to the previous one.

40. C-347/04, Rewe Zentralfinanz (Germany, 2007).

41. C-377/07, Steko (Germany, 2009).

42. C-686/13, X AB (Denmark, 2015).

43. C-293/06, Deutsche Shell (Germany, 2008).

44. C-324/00, Lankhorst Hohorst (Germany, 2002).

45. C-524/04, Test Claimants in the Thin Cap Group Litigation (United Kingdom, 2007).

46. C-492/04, Lasertec (Germany, 2007).

47. C-593/14, Masco Denmark, Damika (Denmark, 2016).

6. Withholding taxes at source

The prohibition of discrimination has reached withholding taxes on dividends and interest,⁴⁸ even outside the framework of the Parent-Subsidiary⁴⁹ and Interest-Royalties Directives. In accordance with the Parent-Subsidiary Directive, the Court applies the qualification of withholding tax to various taxes imposed on the distributing company and having the same result.⁵⁰

Withholding tax may not be levied on dividends paid to a parent company of another Member State or to a foreign company holding a participation, whether controlled or not, if⁵¹ a national parent or participant company enjoys a (quasi) exemption of the inter-company dividend and is not subject to withholding tax.

Even if a treaty provides a tax credit for this withholding tax, it is unnecessary in the event of a dividend exemption. If the tax credit, in the absence of a tax on which to deduct it, is granted unilaterally, a State cannot rely on a foreign provision for non-compliance with Union law.⁵²

Equality must be achieved between foreign and domestic parent companies. Thus, the exemption from withholding tax in France will apply to a holding of 5%, the threshold of the parent-subsidiary regime in domestic law, below the 10% threshold prescribed by the Parent-Subsidiary Directive. The comparison must be made on the basis of national law, even if it is a situation to which the exemption from withholding tax provided for by the Parent-Subsidiary Directive would not be applicable. The Court applies the Treaty, not the Directive.

The exemption of dividends, both from corporation tax and withholding tax, is granted to Spanish companies as soon as they hold 5% of the shares of their subsidiaries, but to foreign companies only if their percentage of ownership is 15%. There is a restriction on the free movement of capital. The Court reiterates three principles:

- As soon as a State taxes dividends paid to a non-resident company, the latter is in the same situation as a resident company;
- A convention does not necessarily remedy discrimination: the other State's domestic law should subject the dividend to a tax sufficient to absorb the withholding tax;
- A State may not rely on an advantage granted unilaterally by another State as a justification for non-compliance with the obligations imposed by the Treaty.⁵³

The withholding tax must be abolished if it gives right to a tax credit or refund in the State of residence of the subsidiary for national parent companies but not for shareholder companies of

48. Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable to parent companies and subsidiaries of different Member States

49. Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

50. C-378/99, *Epson* (Portugal, 2000) for a 5% withholding tax on dividends paid to foreign companies as a flat-rate tax on inheritances and donations; C-294/99, *Athinaiki Zythopoiia* (Greece, 2001) for a Greek tax on distributed income.

51. C-170/05, *Denkavit Internationaal* (France, 2006) for a case prior to the Parent-Subsidiary Directive; C-379/05, *Amurta* (Netherlands, 2007); C-10/14, C-14/14, C-17/14, *Miljoen, X and Société Générale* (Netherlands, 2015); C-303/07, *Aberdeen* (Finland, 2009) and C-338/11 to C-347/11, *Santander* (France, 2012) for a dividend paid to a foreign SICAV, a corporate form not covered by the Parent-Subsidiary Directive; C-521/07, *Commission v Netherlands* (2009) for dividends paid to companies in the European Economic Area; C-540/07, *Commission v Italy* (2009, unless the Convention concluded with the EEA country does not contain an information exchange clause); C-493/09, *Commission v Portugal*, for dividends paid to a foreign pension fund (2011); C-190/12, *Emerging Markets* (Poland, 2014) for dividends paid to a US UCITS, on the basis of freedom of capital movement applicable to third States.

52. C-379/05, *Amurta* (Netherlands, 2007); C-10/14, C-14/14, C-17/14, *Miljoen X and Société Générale* (Netherlands, 2015).

53. C-487/09, *Commission v. Spain* (2010).

other Member States.⁵⁴ The same applies if a tax credit is granted in the event of a redistribution of dividends from domestic subsidiaries but not dividends from foreign subsidiaries.⁵⁵

This was the charge against the compensatory tax (“withholding tax”) due in the event of a redistribution by a French company of dividends from subsidiaries. This tax offset the tax credit (“tax credit”) granted to shareholders and equal to the corporate income tax on the untaxed profit redistributed to them as a dividend. French law allowed tax credits relating to dividends received by a parent company from French subsidiaries but not from foreign subsidiaries to be deducted from this withholding tax. This situation was considered discriminatory.

The Court considered it a failure of a Member State not to refer for a preliminary ruling in this case concerning the taking into account of tax. A refund of compensatory tax due on the redistribution of dividends from subsidiaries where the court of last resort concerned departed from the solution previously reached by the Court.⁵⁶

The credit must also take into account the tax paid by a granddaughter company, as long as economic double taxation is neutralised in a national context.⁵⁷

A withholding tax cannot be levied on Danish dividends paid only to foreign collective investment undertakings, whereas Danish UCITs are exempt from it if they redistribute dividends to their shareholders: the tax is transferred from the fund to the shareholders. It is therefore logical to extend the exemption to foreign funds that satisfy the same redistribution condition.⁵⁸

On the other hand, the freedom of movement of capital does not oblige a Member State to grant a tax credit to compensate for the foreign withholding tax.⁵⁹ The applicable bilateral convention may establish an allocation of the right of sharing taxation between two States.

Two decisions seem to be exceptions, based on a reasoning that considers both withholding tax and foreign corporation tax.

Pension funds are taxed in Sweden at 15% on theoretical interest, being that of State bonds, applied to net assets at the beginning of the year; a 30% withholding tax, reduced to 15% by treaty, is applied to dividends paid to foreign pension funds. The Court found that the situations were not comparable, as Sweden did not tax the assets of foreign funds. However, it had to allow the deduction from the withholding tax base of professional expenses related to dividends.⁶⁰

The application of higher withholding tax rates to interest paid to creditors in other Member States was considered contrary to the freedom to provide services.⁶¹ Nevertheless, a withholding tax on interest applicable to foreign companies creditors of a Belgian company, whereas such a tax does not apply to national creditor companies, has been accepted as corresponding to a conventional division of the tax power between Belgium and Luxembourg.⁶² The Belgian creditor company is subject to Belgian corporate income tax and the foreign creditor company to a withholding tax. The comparison seems flawed since the foreign company is also subject to foreign corporation tax.

The exemption from withholding tax imposed by the Parent-Subsidiary Directive is probably excluded in the event of abuse. However, a Member State may not introduce a general presumption

54. C-284/09, *Commission v. Germany* (2011); C-384/11, *Tate & Lyle*, (Belgium, 2012).

55. C-310/09, *Accor* (France, 2011).

56. C-416/17, *European Commission v. French Republic* (France, 2018) cited in note 1.

57. C-416/17, *Commission v. France* (France, 2018).

58. C-480/16, *Fidelity Fund* (Denmark, 2018).

59. C-436/028 and C-437/08, *Haribo* (Austria, 2011); C-194/06, *Orange Smallcap Fund* (Netherlands, 2008).

60. C-252/14, *Pensioenfonds Metaal en Techniek* (Sweden, 2016).

61. C-18/15, *Brisal-Auto Estradas do Litoral*, *KBC Finance Ireland* (Portugal, 2016).

62. C-282/07, *Truck Center* (Belgium, 2008).

of abuse, according to which the interposition of an intra-European company benefiting from the Directive between the distributing company and a foreign parent company not benefiting from the Directive would *per se* constitute the justification for an exception to the exemption.⁶³

Finally, a withholding tax cannot be definitively imposed when the non-resident beneficiary company is in a loss situation. A national company would not pay tax on the dividend in this case and would benefit from a tax deferral until a profitable financial year. In the event of cessation of activity, the tax would never be levied. Tax deferral can be arranged for non-resident companies without jeopardizing tax collection.⁶⁴

7. Transfer of registered office and contribution of assets

The transfer of the registered office from one Member State to another is regulated only in respect of European companies and European cooperative societies.⁶⁵

However, the Court's doctrine implies that the exit tax does not apply to assets remaining attached to a permanent establishment in the country of departure, which retains its right to tax future capital gains on these assets.⁶⁶ The exit tax may apply to unrealised capital gains on other assets, but the proportionality rule requires that this taxation may be spread over time, so as not to constitute an obstacle to the freedom of establishment.⁶⁷ This rule was applied to a trust whose trustees had changed their country of residence, although a trust does not have legal personality. The trust gives rise to a separate patrimony which is indivisibly linked to the activity of the trustees.⁶⁸

The same reasoning is applied to the contribution to a non-resident company of a permanent establishment situated in a Member State other than the State of residence of the company's registered office.

In this case, the Merger Directive allows the State of residence of the transferring company which makes a contribution of assets relating to that establishment, resulting in the loss of the right of the State of residence to tax the capital gain realised, provided that the tax that could have been levied in the State of the establishment is deducted from the tax due.⁶⁹

However, if the capital gain realised on a transfer of internal assets can be tax-deferred until the assets are sold, immediate taxation in the case of a transfer of external assets constitutes an infringement of the freedom of establishment, even if the Merger Directive is observed.

8. Abuse of rights

The prohibition of abuse of rights is a general principle of Community law. It must be applied in the implementation of European directives.

In four joint cases,⁷⁰ companies established in islands constituting tax havens by investors whose countries of residence did not have a treaty with these islands had, for the holding of the bonds

63. C-6/16, *Egiom and Enka* (France, 2017); C-504/16, C-613/16, *Deister Holding and Juhler Holding* (Germany, 2017).

64. C-575/17, *Sofina and others* (France, 2018).

65. Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States

66. C-38/10, *Commission v. Portugal* (2012).

67. C-371/10, *National Grid Indus* (Netherlands, 2011).

68. C-646/15, *Trustee of the P. Panayi Accumulation & Maintenance Settlements* (United Kingdom, 2017).

69. C-292/16, *A Oy* (Finland, 2017).

70. C-115/16, C-118/16, C-119/16, C-299/16, *N Luxembourg 1, X Denmark ApS, C Danmark I, Z Denmark ApS* (Denmark, 2019).

issued by a Danish industrial company, substituted Luxembourg companies for Danish companies. Indeed, the Danish withholding tax exemption on interest on loans was no longer applicable to the former group structure. The group was therefore seeking the benefit of the exemption provided for in the Interest/Royalties Directive.

The Court of Justice considers that, although the OECD Model Treaty and its commentary are not sources of law, the drafting of the Directive was based on them. It is therefore legitimate to interpret the notion of beneficial owner of the perceived interest by also drawing inspiration from it.

It is not necessary, in order to apply the restriction that the exemption from withholding tax is reserved for the beneficial owner of the interest established in a Member State of the Union, that the source State has transposed the Directive into its national law or that that State has introduced into its national law a general provision likely to prevent abuse of rights. The State is entitled to apply the general principle of European law according to which this law cannot be applied to an abusive practice.

The use of a company from a Member State as a “conduit” used only to transfer interests of the main debtor company to companies from third countries constitutes an abuse of rights. The source State is not obliged to establish the identity of the ultimate beneficial owner, which could make the exemption applicable, if it were a company resident in a Member State or in a State that has concluded a treaty with the source State providing for exemption from withholding tax.

It is true that directives that have not been transposed can only be applied between States and not to individual subjects. This does not prevent the refusal to apply it in the event of abuse of law.

It was thus held that, even if the search for a favourable tax regime is not in itself an abuse of law, the application of an advantage provided for by European law may be refused in the case of wholly artificial arrangements. It should be noted with the Advocate General that intermediary companies had offices and staff and significant costs, covered by a difference between credit and debit interest rates.

The existence of abuse can be inferred from evidence, including the fact that the intermediary entity has no other function than to transfer the interest to the beneficial owner who could not enjoy the benefits of the Directive and the intermediary makes an insignificant profit. Even in the absence of a formal contract, the role of “conduit” can be established by the fact that the interposed entity is not entitled to enjoy the interest and the simultaneity of the arrangement with a change in legislation in the source country.

Regardless of the existence of a double taxation treaty between the country of source (Denmark) and the country of residence of the intermediary entity (Luxembourg), such a treaty does not establish the reality of beneficial ownership.

The source country cannot apply withholding tax default interest to a company while a domestic creditor company is not, as the withholding tax does not apply to it, required to pay withholding tax for two years, nor to apply a higher rate of interest to the withholding tax due than that which would apply to a delay in payment of corporate tax.

The source country will also have to take into consideration the deduction of interest due by the creditor company in its capacity as debtor, as it would for a national company, pursuant to Article 63 TFEU applying to third countries.

The Court handed down a similar judgment on the same date⁷¹ concerning the distribution of dividends and the application of the Parent-Subsidiary Directive in a case where a United States parent company, in order to prohibit the possibility of repatriating the profits of a Bermuda subsidiary to the United States, had transferred the participation in a Danish company from a Bermuda subsidiary to a Cypriot subsidiary.

The judgment also concerns the relations in terms of the distribution of dividends from one of the groups referred to in the judgment cited above concerning transfers of interest.

9. Conclusion: the Luxembourg Breviary

The principles resulting from the Court's case-law are summarised below in the form of a "Luxembourg Breviary."

1. If a non-resident taxpayer is in the same situation as a resident taxpayer, he or she must be treated in the same way as a resident taxpayer, including with respect to the benefit of tax treaties.
2. A restriction on the use of treaty freedoms may be eliminated by the application of an international convention which eliminates the effects of differential treatment but not by an advantage granted unilaterally by another State.
3. The freedom of establishment applies and not the freedom of movement of capital if the legislation in question concerns holdings which enable the subsidiary company to be influenced. The freedom of capital movement applies if the legislation in question does not take into account the importance of the participation held.
4. If the purpose of the legislation does not permit the determination of the applicable freedom, the Court shall take into account the facts in determining the applicable freedom.
5. A restriction on the freedoms of the Treaty may be justified by overriding reasons of general interest, such as the effectiveness of tax collection, the effectiveness of tax controls: the coherence of a tax system or the distribution of taxing power between States, particularly the symmetry between the taxation of profits and the deduction of losses, but not by the loss of tax revenue, the compensation of an obstacle by a benefit or the mere risk of tax evasion and particularly not by a general presumption of tax evasion.
6. The principle of proportionality requires that legislation does not go beyond what is necessary to achieve its objective.
7. The prevention of abuse of rights is a general principle of Community law.

71. C-116/16 and C-117/16, Grand Chamber, T Denmark and Y Denmark ApS (Denmark, 2019).

8. The possibility of administrative assistance under the Directives precludes obstacles allegedly justified by the difficulty of collecting information.
9. Member States have no obligation under European law to eliminate international double taxation.
10. There is no most-favoured-nation rule requiring a Member State to extend the benefit of a tax treaty to all residents of other Member States.

Jacques Malherbe: Université de Louvain la Neuve (Belgium)
✉ Jacques.Malherbe@simontbraun.eu
Professor Emeritus.