ECJ to Review Belgian Dividend Treatment

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The European Court of Justice has published the reference for the case referred by the European Commission against Belgium (Commission v. Belgium, Case C-307/08) for its discriminatory taxation of dividends received by Belgian private investors from foreign companies. (For the EC ruling request, see Doc 2008-21838 or 2008 WTD 200-15.)

Inbound dividends are effectively taxed twice: in the country of origin, and in Belgium. The commission believes Belgium should take measures to eliminate that double taxation. In fact, the commission is asking the ECJ to reverse its decision in Kerckhaert-Morres, in which it decided that Belgium was not obliged to give a credit for the foreign tax. (For prior coverage, see Tax Notes Int’l, Sept. 15, 2008, p. 931, Doc 2008-18367, or 2008 WTD 181-8.)

Belgian Tax Rules

Belgium taxes dividends separately from the other elements of income a resident taxpayer receives. Dividends are subject to (Belgian) withholding tax at the rate of 25 percent. This withholding tax is the final tax for the taxpayer, which means that a Belgian taxpayer does not even have an obligation to declare the dividend in its tax return.1

The same tax regime applies to foreign-source dividends. Unless the 25 percent Belgian tax has been withheld at source,2 the taxpayer must report these dividends in its tax return. The income tax is levied at a rate of 25 percent of the net dividend received, that is, after deduction of foreign withholding tax. That is the only relief for foreign withholding tax.

In Kerckhaert-Morres,3 the ECJ had decided on the situation of a Belgian resident couple that had received dividends from a French company. The couple received payment of an imputation credit (the old French avoir fiscal, equal to 50 percent of the dividends paid as compensation for the French corporate income tax) from the French tax authorities. Under the Belgium-France income tax treaty, this imputation credit was treated as dividend income and the French company withheld 15 percent tax at source.

The Court found that, contrary to other cases,4 the Belgian tax legislation does not make any distinction between domestic and inbound dividends: Both are taxed at the identical income tax rate of 25 percent. That a Belgian taxpayer ends up paying more tax on foreign dividends is the consequence of the French, not the Belgian, income tax system. It results from two member states exercising their fiscal sovereignty in parallel.

The Court acknowledged that this may have negative effects on the functioning of the internal market, but that those effects need to be resolved by double taxation agreements, which is a matter for the member states. Moreover, since the referring court had limited its question to the Belgian income tax law, and had not included the double tax convention between Belgium and France in its preliminary reference at hand, the Court believed it could not look into that. The Court could, therefore, only conclude that Belgium does not have an obligation to offer its residents a tax credit to set off the French withholding tax.

A New Attempt?

The decision in Kerckhaert-Morres came a couple months after the European Commission had sent Belgium a reasoned opinion under article 226 of the EC

2This can occur if the bank through which the dividends are paid withholds the tax.

Treaty for failure to fulfill a treaty obligation. When it announced that it had started procedures on the basis of article 226, the commission mentioned the Kerckhaert-Morres case, stating that the subject matter was comparable but that there was a difference between the procedures, in that Mr. and Mrs. Kerckhaert-Morres had received from France an avoir fiscal, a credit for French corporation tax, "ultimately making it more attractive for Belgian investors to invest in France than in Belgium."5

That is correct, as the following example will show. The avoir fiscal is a tax credit paid by France for French corporation tax, and taxpayers were entitled to claim repayment of the French avoir fiscal. For French taxpayers, the avoir fiscal was set off against their progressive income tax rates. Under the Belgium-France treaty, the avoir fiscal was treated as dividend income: The French company withheld 15 percent tax at source, and the taxpayer paid 25 percent withholding tax.

In Kerckhaert-Morres, Belgium gave the following example:

<table>
<thead>
<tr>
<th></th>
<th>French-Source Dividend</th>
<th>Belgian-Source Dividend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend</td>
<td>1,000.00</td>
<td>1,000.00</td>
</tr>
<tr>
<td>15% French withholding tax</td>
<td>-150.00</td>
<td>850.00</td>
</tr>
<tr>
<td>50% avoir fiscal</td>
<td>500.00</td>
<td>500.00</td>
</tr>
<tr>
<td>15% French withholding tax</td>
<td>-75.00</td>
<td>425.00</td>
</tr>
<tr>
<td>Total amount subject to 25% Belgian dividend tax</td>
<td>1,275.00</td>
<td>1,000.00</td>
</tr>
<tr>
<td>25% Belgian dividend tax</td>
<td>-318.75</td>
<td>-250.00</td>
</tr>
<tr>
<td>Net dividend after tax</td>
<td>956.25</td>
<td>750.00</td>
</tr>
</tbody>
</table>

This shows that a Belgian taxpayer only paid 4.375 percent tax on French dividends versus 25 percent on Belgian dividends.

However, one must evaluate comparable situations. The avoir fiscal is a tax credit paid by France to the shareholder to set off the double tax effect of the French corporation tax. The actual dividend paid to the shareholder is not €1,000, but €1,500. And on €1,500 paid out by a Belgian company, the Belgian taxpayer would retain a net dividend of €1,125, which is more than the €956.25 he receives net from French-source dividends.

The French avoir fiscal was abolished in 2004, which makes the comparison easier and the double taxation all the more obvious. In fact, it became so obvious that when the French Suez group decided to buy out the Belgian utilities company Electrabel, Belgian Finance Minister Didier Reynders asked his French counterpart to revise the income tax treaty to neutralize the effect of the double taxation. Indeed, the Electrabel shareholders discovered that when they exchanged their shares for Suez shares, their net return would be reduced by half. Both private investors and municipalities holding shares in Electrabel would undergo double taxation.6 Jacques Dansauteux v. Belgium (C-128/08) concerns dividends paid by the French company Total.

Catch-22

Notwithstanding this setback in Kerckhaert-Morres, the commission announced that it would refer Belgium to the ECJ over its discriminatory taxation of dividends paid by foreign companies to Belgian private investors (inbound dividends).7 It is difficult to imagine how the commission will persuade the Court to change its unambiguous position that Belgian tax law does not require Belgium to distinguish between domestic and inbound dividends, particularly when the commission itself had previously indicated in its dividend communication8 that it did not see any discrimination.

When a country like Belgium9 does not allow a credit for the foreign withholding tax but only a deduction, it creates the problem of double taxation. The question is how the problem can be solved. The commission had examined that situation in its dividend communication, and it conceded that in such a situation, the member state does not have a discriminatory domestic tax system10: It subjects domestic and inbound dividends to the same tax regime. If there is a

6See Doc 2005-18754 or 2005 WTD 177-8.
9That is, a country that subjects a company’s profit to corporation tax at the company level and that taxes the distributed profit (the dividend) at the level of the shareholder without a credit for the tax levied at the company level.
10In Dividend Communication, nr. 3.2.4., p. 17, the commission distinguishes what it calls “classical systems,” where the
(Footnote continued on next page.)
restriction of the free movement of capital, it is caused by the withholding tax levied by the other member state, the member state of source. This is exactly the position taken by the Court in  *Kerckhaert-Morres*.\(^{11}\)

However, in its dividend communication, the commission did find one situation in which the culprit for the higher tax is not the member state of source: when it has signed a double tax treaty with another member state, in which it receives the right to levy withholding tax (under article 10 of the OECD model), and the other state has undertaken to give a credit for this foreign withholding tax (under article 23 of the model). In such circumstances the restriction of the free movement of capital would be caused by the Member State itself, and not by the source State, as the OECD Model and the applicable tax treaties require that the State of residence must provide the relief.\(^{12}\)

In other words, under that double condition, it is indeed Belgium that causes the restriction of the free movement of capital and not France, because the tax treaty requires Belgium to give a tax credit, which it has failed to do since the repeal of the foreign tax credit in 1988. However, this hypothesis will prove to be purely hypothetical and a Catch-22 situation for individual taxpayers: Either the member state of residence undertakes to provide relief (article 23) so that the taxpayer does not pay more tax on inbound dividends than on domestic dividends, and then there is no restriction of the free movement of capital; or the member state of residence does not undertake to give a tax credit\(^{13}\) (or undertakes to give a limited tax credit), and then the taxpayer does not fall within the one (limited) situation that the commission has defined as a restriction of the free movement of capital.

### The Wrong Battle?

The ECJ case law concerning dividend taxation, especially following  *Kerckhaert-Morres*, leaves little scope to oblige the member state of residence to grant a tax credit for the tax withheld at source in the member state of source. By deciding to refer Belgium to the ECJ over its discriminatory taxation of inbound dividends, the commission may well have chosen the wrong battle.

The outlines of the Court’s case law on taxation of cross-border payments of dividends within the European Union are becoming clearer, and it is unlikely that a member state of residence will be obliged to give a tax credit for the corporate income tax or the withholding tax levied in the member state of source, unless, of course, it grants a tax credit for the domestic corporate income tax.\(^{14}\)

Belgium subjects domestic and inbound dividends to the same level of taxation. If French-source dividends are subject to a higher level of taxation, it’s because tax has been withheld at source in France. The question is then whether the member state of source must provide relief for double taxation.

### The Alternative Route: *Denkavit* and *Amurta*

It does indeed appear the ECJ is stating that double taxation must be eliminated in the member state of source, and that could be on two levels: the company level, or the shareholder level.

The first is a no-go. In its decision in *Test Claimants in Class IV of the ACT Group*, the Court had indicated that it could not require the member state of source to provide relief for double taxation either by granting an exemption of corporate income tax or by granting the shareholder a tax advantage equal to the corporate income tax. That would amount to obliging that state to abandon its right to tax a profit generated through an economic activity undertaken on its territory.\(^{15}\)

However, a mere two days later in *Denkavit International BV*, the Court was asked to examine the taxation in the member state of source on the next level that is, at the time of the distribution of dividends to the shareholder. The case concerned tax withheld at source on intercompany dividends paid before 1992, when the parent-subsidiary directive came into force. The Court decided that, even though the case predated the directive, France’s refusal to extend to nonresident parent companies the exemption of withholding tax

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\(^{14}\)That was the case in  *Manninen*. Finland allowed individual shareholders to impute a tax credit equal to 29/71 of the dividend received to compensate for the 29 percent corporate income tax paid by Finnish companies, but it refused this tax credit for the corporate income tax paid by Swedish companies. This case law was confirmed in  *Meilicke* (C-292/04, Dec 2006-21007, 2006 WTD 197-9).

granted to resident parent companies was a discriminatory measure incompatible with article 43 of the EC Treaty, the freedom to provide services.16

The ECJ’s decision in Amurta concerned a situation in which the Portuguese parent company held a 14 percent shareholding of a Dutch company and was therefore denied the exemption of withholding tax. Fourteen percent was well below the threshold of the parent-subsidiary directive.17 The Court decided that the Dutch legislation was contrary to the free movement of capital when it denied the exemption to foreign (EU) companies while it granted that exemption to domestic companies and domestic branches of foreign companies.

It appears that the ECJ is in its own way harmonizing the tax rules regarding the double taxation of cross-border dividends. It is systematically breaking open the parent-subsidiary directive to apply to situations for which it was not initially intended. Companies that hold participations in companies they control can invoke EC Treaty article 43; the criterion that the Court uses is whether the shareholding gives its holder definite influence over the company’s decisions and allows the shareholder to determine its activities. Other shareholders that are excluded from the parent-subsidiary directive can claim the exemption of withholding tax on the basis of the violation of the free movement of capital.

In Denkavit Internationaal BV, the Court granted the exemption to parent companies for dividends they had received even before the directive came into force. In Amurta, it did so for shareholders with small participation.

The next decision will probably come in the procedures initiated by the European Commission against Belgium, Italy, the Netherlands, Spain, and Portugal because they infringe the EC Treaty and the European Economic Area Agreement18 by charging a higher withholding tax on dividends paid to nonresident (EU) countries than on dividends paid to domestic companies.19 Luxembourg and the Netherlands have adapted their rules. The Dutch government has already done away with part of the discrimination except for dividends paid to shareholders in EEA countries that do not exchange information. Procedures have also been initiated against Austria and Germany.20

For parent companies that do not have the correct legal form under the parent-subsidiary directive, the ECJ may offer a solution in Aberdeen Property Fininvest Alpha Oy.21 The case concerns the withholding tax that a Finnish company must retain on dividends paid to a Luxembourg SICAV. Since the SICAV is not liable to Luxembourg corporate income tax, this decision may also offer a solution for parent companies that are fiscally transparent and/or are not liable to corporate income tax.

Meanwhile, the Czech Republic, Denmark, Estonia, Finland, Germany, Italy, Latvia, the Netherlands, Poland, Portugal, Slovenia, Spain, and Sweden have been targeted by the commission because they tax dividends paid to EU pension funds more than domestic pension funds.22

So far, it appears no cases have been submitted to the ECJ about dividends paid to public bodies, financial institutions, or insurance companies, or by private investors who contest the withholding tax in the member state of source. But logically that is only a matter of time.

Conclusion

The ECJ is making it difficult for a member state of source to levy withholding tax on outgoing dividends paid to nonresident shareholders, while resident shareholders enjoy that exemption.

That does not mean that the ECJ is tolling the bell for the withholding tax on dividends and the economic double taxation of dividends. Following the Denkavit Internationaal BV decision, France adapted its legislation by exempting all dividends from withholding tax. The situation in the Netherlands is a bit more complex. Nonresident parent companies owning more than 15 percent enjoy the exemption under the parent-subsidiary directive, and nonresident shareholders owning between 5 percent and 15 percent can invoke the ECJ decision in Amurta. However, nonresident parent companies owning 5 percent or less will continue to pay the withholding tax because Dutch parents owning 5 percent or less also pay the withholding tax.

COUNTRY DIGEST

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17The threshold was then 25 percent. Currently, it is 15 percent; it will drop to 10 percent in 2009.
21See Aberdeen Property Fininvest Alpha Oy (Case C-303/07, O.J. C 211, Sept. 8, 2007, p. 21).