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## Freedom of capital transfers

The Council of State transmits to the CJEU the next preliminary questions ("questions préjudicielles"):

- Should articles 56 and 58 of the Treaty establishing the European Community (TEC) - now articles 63 and 65 of the Treaty on the Functioning of the European Union (TFEU) - be interpreted as a cash-flow disadvantage ("désavantage de trésorerie") resulting from the application of the withholding tax ("retenue à la source") on the distribution of dividends ("distribution de dividendes") to non-resident loss-making companies, whereas resident loss-making companies are not imposed on the dividend amount that they perceive only throughout the tax period in which they become profitable again?

Would this not constitute in itself a difference of treatment characterizing a restriction to the freedom of capital transfers?

- Should the potential restriction of freedom of capital transfers in the aforementioned questions be, in view of the requirements resulting from the articles 56 and 58 of the TFEU, regarded as justified by the necessity of guaranteeing the effectiveness of tax collection ("recouvrement de l'impôt"), as non-resident companies are not subject to French tax authorities' control or by the necessity of preserving the distribution of the power to tax between Member-States?

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- In the hypothesis where the application of withholding tax is contested may nonetheless be admitted in theory in view of the freedom of capital transfers:
  - Do these provisions oppose to the collection of withholding tax on the dividends paid by a resident company to a non-resident unprofitable company in another Member-State when the latter stops its activity without becoming again profitable, while a resident company placed in the same situation is not effectively taxed on the amount of such dividends?
  - Should these provisions be interpreted in that way when taxation rules treat dividends differently whether they are paid to resident or non-resident companies, it is relevant to compare the effective tax burden borne by all of them for these dividends, so that a restriction brought to the freedom of circulation for capitals resulting from the fact these rules exclude for the sole non-residents, the deduction of fees directly related to the collecting, in itself, dividends, could be seen as justified by imposing rates, which are different for ordinary taxation borne by residents for a future tax period and the withholding tax withdrawn on the dividends paid to non-resident company when this difference compensates, regarding tax paid, the difference of tax base?

CE, under-sect. 9 and 10, 20 September 2017, n°398662 and 398663, Sté Sofina, n° 398666 and 398672, Sté Rebleco, n°398674 and n° 398675, Sté Sidro.

## Note

1 - The commented decision records an evolution in the position of the Council of State in the long litigation that opposes tax authority to several European companies that have paid withholding tax on the dividends that they perceived from French sources while they were fiscally in loss-making situations.

Indeed, in spite of the repeated requests from taxpayers, the Highest Court (la “Haute Juridiction”) has always refused to rely on the European judge in order to determine whether the article 119 bis of General Tax Code (GTC) (“Code Général des Impôts”) is or not compatible with the European principles of non-discrimination.

Today it has been accomplished.

The object of this comment is not to examine the questions sent by the Council of State to the European Court of Justice (ECJ) (“Court de Justice de l’Union Européenne”) as such but to examine the reasons why it is legitimate to think that the current rulings of the Council of State cannot remain as they are.

Without coming back in detail to the origins of these litigations, it should be reminded that the claiming companies have requested from the Administration the reimbursement of the withholding tax that they had to pay on the dividends that they perceived from French sources.

These requests are based on the difference of treatment that currently exists between the companies which are profitable of these distributions of dividends depending on whether they are residents in France or non-residents.

Resident companies are taxed in France on corporate tax dividends (“impôt sur les sociétés”) while the non-resident companies are subject to a withholding tax provided by the article 119 bis of GTC.

Non-resident companies argued that this difference of treatment is discriminatory in nature which is prohibited by the principles of the European Union Law.

The discrimination invoked by the claimants presents a double aspect.

On the one hand, the current device creates discrimination about the base retained for the taxation of dividends to the extent that only the resident companies are taxed on the net amount of dividends **(1)**.

On the other hand, in the situation where the companies have a deficit tax result, the current system creates an advantage in favor of French companies **(2)**.

Lastly, in the hypothesis – highly desirable in our opinion – where the CJEU would decide to render a decision which would confirm the non-compliant nature of the French positive law (“droit positif”), it is relevant to wonder about the practical aftermaths that such a decision would have and especially about the terms under which the companies having paid withholding tax could be get their reimbursement **(3)**.

**1. The withholding tax as a temporary term of taxation, not as a definitive term of taxation.**

**2** - First, it is relevant to examine the difference of treatment which exists between the resident companies and the non-resident companies about the tax base of dividends that they perceive from a French source.

Today, it is established that the application of a withholding tax mechanism only to non-resident does not constitute, in itself discrimination in the sense of the European law.

Indeed, if there is effectively a difference of treatment, the latter is in this case justified by a legitimate goal, namely: facilitating and guaranteeing the tax collection by the source State.

So, the legitimacy of the withholding tax mechanism provided by the article 119 bis of the GTC is not challenged in its principle.

However, as for any difference of treatment instituted by a Member-State, the source State has an obligation to ascertain that the device it implements itself is limited to what is necessary and proportioned to reach the goal pursued.

Yet, in its current state, the article 119 bis of GTC provides that non-resident companies are subject to a withholding tax withdrawn on the gross amount of dividends without giving them the possibility to deduct the expenses incurred by these profits contrary to resident companies subject to corporate tax which benefit from the principle of deduction of expenses provided by the article 39 of the GTC and which are therefore taxable on a net income basis.

This difference of treatment may be understood when it concerns a taxation on dividend flow.

Due to the immediate nature of the taxation, it is logical that the withholding tax base corresponds, first, to the gross paid dividend amount.

Indeed, it is not possible to deduct the expenses that haven't necessarily been determined when the withholding tax is withdrawn.

However, this situation may only be temporary.

With time, that is to say when the amount of expenses is known, French administration has to grant non-resident taxpayers the right to deduct them from the dividends and then to reimburse the overpaid taxes.

Finally, if the taxation mechanism of withholding tax is, in its principle, in compliance with European Law, it is only in so far and on the condition that its application remains proportionate to the goal pursued.

First, this balance requirement allows to perceive a tax amount based on a gross base but only if secondly the taxpayer is allowed to be taxed solely on the net base.

The reasoning, yet simple enough in its principle, had, up until now, always been rejected without hesitation by the Council of State which considered that the base difference, systematically unfavorable to non-resident was compensated by a withholding tax base lower than a corporate tax

base (*CE, 10e et 9e under sect., 4 June 2012, n°330075, Sté Aggreko France – CE, 10e et 9e under sect., 4 June 2012, n° 330088, Sté Aqualon France BV*).

As well as the comments by the public rapporteur about the commented decision, this vision is not compliant with the CJEU rulings which refused to admit expressly that a difference of treatment imposed by a Member-State to the detriment of a resident from another Member-State could have been compensated by another difference of treatment that would this time be favorable to the non-resident (*CJEU 1<sup>st</sup> Chamber, 4 June 2016, aff. C- 252/14, Pensioenfond Metaal en Technick – CJEU, 5<sup>th</sup> Chamber, 5 July 2016, aff. C-18/15, Brisal – Auto Estradas do Litoral SA and KBC Finance Ireland v/ Fazenda Publica*).

Therefore, as one of basis of its “Sté GBL” decision (*CE, plen., 9 May 2012, n° 342221 et 342222, Sté GBL Energy*) is thus questioned according to the conclusions of the public rapporteur on the commented decision, the Council of State could no longer refrain from asking a preliminary question about the base rulings applicable to the withholding tax provided by the aforesaid article 119 bis (one of the rare articles of GTC continuing to treat in the same way non-residents, without taking into account the rights derive from European Union principles).

## **2. The particularly situation of non-resident companies in loss-making situations**

**3 -** When a French company in a fiscal loss-making situation receives dividends from a French source, it can allocate its “stock” of losses carry-forward (“déficits reportables”) to its taxable profit generated by the tax collection, in full or in part.

If we admit the company has a sufficient loss carry-forward to compensate the taxable profit generated, so the company will escape taxation throughout the collection of dividends; generally it will be considered as a company having paid tax throughout future fiscal period in which it will become profitable again (as result of correlative reduction of its “stock” of the losses carry-forward).

In contrast, a non-resident company in a fiscal deficit situation remains subject to withholding tax (except in the very marginal situation provided for in article 119 quinquies of GTC): so, it will perceive a net dividend amount of the withholding tax mechanism referred to article 119 bis of GTC in its current draft creates a second difference of treatment arising especially in presence of fiscal loss-making company.

This difference of treatment corresponds to a cash-flow disadvantage (even a definitive disadvantage when, for instance, the deficit is structural) for the non-resident companies, to the extent that these companies immediately paid the owed tax in respect of tax collection, while resident companies are considered as having paid tax, by construction, only when they become

profitable again: the occurrence of this event being accelerated by the reduction of the losses carry-forward amount.

Nowadays, it is established that a cash-flow disadvantage may be constitutive of a difference of treatment (CJEU, 29 November 2011, *aff. C-371/10, National Grid Indus*).

Thus, the CJEU has been able to withhold in the decision 17 September 2015 (CJEU, Chamber 5th, 17 September 2015, *aff. C-589/13 Familienprivatstiftung Eisenstadt*) on the private foundations of Austrian law, submitted to a temporary tax on the donation that they do, that a difference of treatment on the temporary imposition calculation can bring a cash-flow disadvantage for the private resident foundation wishing to grant a donation to the beneficiaries residing in another Member-State and thus, can constitute a restriction of fundamental freedoms if the situation concerned doesn't undergo some disadvantage in a totally national situation.

In the past, the Council of State had rejected this argument by refusing to admit the existence of a difference of treatment by considering the tax was effectively paid by resident companies and by non-resident companies alike, regardless of whether for the first this payment intervenes subsequently to the dividends collection.

The Council of State had chosen to adopt a multi-exercises approach in order to determine the existence of a difference of treatment.

One of inherent weaknesses of this reasoning had been quickly identified: indeed, what do we do when faced to companies which never become profitable again and therefore close down?

In such a situation, only foreign companies would have effectively paid tax.

The legislator tried to remedy this first difficulty by adding to the article 119 quinquies of GTC a safeguard clause ("clause de sauvegarde"), whose narrowness and inappropriateness have been criticized and visibly did not convince the European Commission ("Commission Européenne"), which sent a reasoned opinion to France on May the 17<sup>th</sup> 2017 to contest the unfair treatment inflicted to other Member-State resident companies.

Indeed, this safeguard clause concerns the sole case where a foreign company, in a loss-making situation, would be covered by the foreign equivalent of a bankruptcy procedure ("procédure de liquidation judiciaire") or would be in such a situation that a similar procedure could be executed.

Obviously, this approach confuses the fiscal situation of a company and its accounting situation; well, if both can be related, they are rarely the same.

The other intrinsic weakness of the Council of State argument results from this multi-exercise approach that can, in some circumstances, extend for very long periods: notably when the companies are structurally unprofitable.

Well, it's increasingly difficult to sustain that non-resident companies are not treated differently from resident companies when there is an accumulation of loss-making fiscal periods for one and the other, by having only a vague perspective, that one day, the French company will become profitable again and will then pay its taxable dividends due.

The recent CJEU decision confirms that a multi-exercises approach could not validly be used to determine the existence of a difference of treatment.

Thus, in the *Miljoen* 17 September 2015 decision, the CJEU held that *"as far as the duration of the reference period in order to compare definitive fiscal expenses of resident taxpayers and non-resident taxpayers is concerned (...) it is relevant to take note that about the first the period considered is the calendar year. Henceforth, we have to compare this period"*.

Likewise, in its aforesaid decision 2 June 2016 *Pensioenfond Metaal en Techniek*, the CJEU held *"the appreciation of the existence of a potential unfavorable treatment of dividends paid to non-resident pension funds must be done for each individual fiscal period"*.

These decisions allow to establish to determine whether a difference of treatment exists, it is necessary to consider the respective situation of residents and non-residents on the duration of one fiscal period.

To resolve this difference of treatment, French Law could in the future take into account the fiscal situation of non-resident companies and, for instance, allow a deferral taxation ("report d'imposition") at least until the fiscal period in which this company succeeds to get the allocation, in its resident State, of a "full tax credit" ("crédit d'impôt intégral") in the sense of the CJEU (*CJEC, Chamber 1<sup>st</sup>, on November 8<sup>th</sup> 2007, aff. C-379/05 Amurta*).

Faced to this common-sense solution, some have been able to plead the administrative charge that could be borne by non-resident companies: indeed, it would be necessary for companies to demonstrate, at the closure of each fiscal period that they are still unprofitable to be able to continue to benefit from deferral taxation.

Such a criticism would not be admitted for two reasons: on the one hand, it's easy to establish a mechanism of optional deferral taxation, and on the other hand, it doesn't belong to a Member-

State to determine what may or may not be in the best interest of a company and to use this interest to divest them of rights derived from European Union principles.

Lastly, we observed that the multi-exercises approach used by the Council of State in its recent decision limits itself to acknowledging the existence of this “simple cash-flow disadvantage”.

Actually, however this simple “cash-flow disadvantage” corresponds to an immediate and definitive tax levy in the form of a withholding tax at the expense of the only non-resident companies.

Indeed, whether resident or not, the loss-making company perceiving dividends, if it is subsequently profitable, will be subject to corporate tax in its resident State.

Yet, where the French resident company will not be bearing any fiscal charge on the dividends year perception, the non-resident company will be bearing a definitive withholding tax and won't be able to impute any tax credit corresponding to this withholding tax on corporate tax that it will bear in the subsequent beneficiary fiscal period.

Under these circumstances, was the withholding tax not effectively paid?

Should it still be called a “simple cash-flow disadvantage”?

### **3. Redressing discrimination created between resident and non-resident companies**

**4** - In the hypothesis where, as we believe, the CJEU conclude that the withholding tax provided for in the article 119 bis of GTC mechanism has a discriminatory nature, it's relevant to think about the conditions in which the discrimination should be repaired.

Several years ago, we had already expressed the wish that the reparation of the discriminations contrary to European Union Law be made primarily by law.

Indeed, first, it belongs to the French legislator, pursuant to the obligation of cooperation imposed on him by the European Union law to modify the dispositions of his national law in order to make it compatible with the European Union Law.

In our opinion, this requirement results directly from the European Union principles of primacy and effectiveness: so, it would be appropriate that the legislator make necessary modifications in the GTC in order to exclude any future discrimination.

In this context, the question is to know in which conditions a non-resident loss-making company will be able to benefit from deferral taxation mechanism which would be implemented.

The conclusions deposited by fiscal administration in several cases make us think that, in the future, the legislator could foresee that non-resident companies which will be asking for a tax deferral must prove that it would also have been too in a loss-making situation if it had determined its tax result in compliance with French Law, which would imply in practice that the company reprocess (“procéder à un retraitement”) its result.

However, this solution does not correspond to the solution held by the legislator in the article 119 quinquies of the GTC which states “*according to rulings of the State or territory where there is its center of effective management (“siège de direction effective”) or permanent establishment (“établissement stable”)*”.

Henceforth, it would be logical that the legislator did not require such a reprocessing and recognized the result determined by the company based on national rulings.

Moreover, such a requirement which would potentially aim at previous fiscal periods (compared to the date in which the CJEU and the Council of State would be asked to give a ruling) would be disproportionate in view of administrative charges that it would impose on claimants and would bring the taxpayer to bear the burden of the aftermaths of the discriminatory nature of French Legislation.

Indeed, in this situation, the fault is the responsibility of the Legislator for creating and enabling to continue a discriminatory dividends taxation system and the responsibility of Administrative Court having permitted to maintain such a system because of their decisions.

Not taking into account these elements would amount to allowing French authorities – which would have perceived withholding taxes prohibited by the European Union Law for several years - to benefit from their own turpitude.

Furthermore, taxation of non-resident companies has to be based on a net tax base, that will imply to define imputable fees or charges on the gross amount of dividends received.

On this point we have to note that the CJEU rulings already provide some clues.

Indeed, the CJEU has already had to examine this question in its decision *Miljoen and Société Générale v/ Pays-Bas* 17 September 2005 (CJEU, Chamber 3rd, 17 September 2015, aff. C-10/14, JBG T Miljoen, C-14/14, X and C-17/14, Société Générale SA).

In this decision, CJEU specified that it was imperative to establish a direct link between collecting dividends and the fees where the taxation is required.

Thus, the CJEU noted that *“particularly for incomes received in the form of dividends, such a link, only exists if these fees can, if appropriate, be directly linked to an amount paid during a securities transactions operation (“opération de transaction de titres”), are directly related to this incomes collection”*.

In our opinion, the existence of such a direct link should not be appreciated restrictively; on the one hand because of the obligation of reparation which is the responsibility of France and on the other hand as a result of international fiscal law principles and especially of tax treaties (“conventions fiscales internationales”) on the inclusion of charges economically related to the exercise of an activity (notably when this activity is carried out thanks to a permanent establishment).

There remains the case of companies having exhausted their contentious appeal (“recours contentieux”) before the CJEU ruling its decision.

These companies seem to be able to require from Administration a systematic rebate (“dégrèvement”) relevant to unfairly paid withholding tax.

The administration is obliged to grant their requirement to satisfy obligations of correction and reparation imposed by European Union Law to Member-State having introduced discriminatory mechanisms.

However, that does not prevent the Council of State from judging in a decision on June 19<sup>th</sup> 2017 (CE, 9 and 10 under sect., n°403096, Sté GBL Energy) that the administration rejection to grant a systematic rebate was not open to appeal to the extent that the decision by the administration has a purely ex-gratia nature.

There is in this instance a lack of consistency in the Council of State rulings.

Indeed, if the Highest Court accepted to return preliminary questions to the CJEU in the commented decision, it is probably that it does not exclude to proceed with over rulings (“revirement de jurisprudence”), henceforth is it truly appropriate to prevent non-resident companies having failed from getting the reimbursement of taxes paid and that will come in the future, to ask for systematic tax rebate from the Administration?

What is more, such a solution would be opposite to the effectiveness principle of European Union Law, as above-recalled, that imposes to Member-States to use all existing means in their respective national laws to ensure the respect of the European Union Law, obligation which has been expressly asserted by the CJEC in her decision on January 13<sup>th</sup> 2004 (CJEC, January 13, 2004, aff. C 453/00 Kühne et Heitz NV).

The net result of his decision is that pursuant to cooperation principle that results from the article 10 of TEC, an administrative authority grasped of such a request, must “examine again a definitive administrative decision in order to take into account the interpretation of the relevant disposition by the Court when : it disposes, according to national law, of the possibility to come back on this decision, the decision in question becomes definitive subsequently to a national Court ruling in last resort; this decision is, in view of subsequent Court ruling, based on a wrongful interpretation of European Law (...)”.

A Council of State decision on the rejection of prior claim deposited by a taxpayer gives him the right to depose a systematic rebate claim.

Originally, the mechanism of systematic rebate is a mechanism which has an exclusive ex-gratia nature (hence the comprehensible reluctance of administrative judges) generally the decision founded on non-legal reasons (the personal situation of the taxpayer for instance).

This consideration is not important in regards to European Union Law, as it does not emphasizes the fact that taxpayers have been deprived of a right and requires the correction the correction of this factual situation and that by the all means made available to taxpayers in national law.

The decision of June 19, 2017 results in discharging the Administration of its obligation to redress a situation and consequently challenges the effectiveness of European Union Law and does so at the specific moment when this process allows to redress a situation where the taxpayer in question's only fault was to be right too early.

Translated by Emilie Luzi from the French article written by Allard de Waal

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