EU Direct Tax Newsalert

CJEU rules the ordinary tax credit method provided for by DTTs compatible with the free movement of capital

On 24 April 2019, the French Supreme Administrative Court asked for a preliminary ruling on the *Société Générale* case (C-403/19) to the Court of Justice of the European Union (CJEU). The CJEU delivered its Judgment on 25 February 2021 without any Advocate General's opinion.

Background

A French company belonging to a tax group headed by Société Générale received dividends from Italy, the United Kingdom and the Netherlands. An amount equal to those dividends was then paid to third parties pursuant to two different financial contracts. As they had been subject to withholding tax in the source country on the gross amount, the French company deducted from the corporate income tax which it was liable for in France, the tax credits provided for by the Double Tax Treaties (DTTs) concluded by France with these countries. The deduction amounted to the withholding taxes.

However, the tax authorities reassessed the French company on the ground that the amount paid in accordance with the terms of the contracts entered into by the bank, was an expense connected to the dividends which should then be deducted from the theoretical tax base determining the maximum deduction as provided for by the three tax treaties. Such computation method (the so-called ordinary one by the OECD) reduced to almost nil the amount of the tax credits.

Before the French Supreme Administrative Court, Société Générale argued that this limitation contravened the free movement of capital enshrined in Article 63 of the TFEU (former Article 56 of the TEC).

The CJEU's judgement

The CJEU recalled firstly that the disadvantages which may arise from the parallel exercise of powers of taxation by different Member States, in so far as such an exercise is not discriminatory, do not constitute restrictions prohibited by the Treaty. Therefore, the Member State of residence is not obliged under EU law to prevent the disadvantages which could arise from the exercise of competence attributed by the two Member States.

Notwithstanding this, the CJEU reminded that even if the Member States are free to determine in the framework of DTTs the connecting factors for the purpose of allocating powers of taxation, the Member States must comply with EU rules and, more particularly, observe the principle of equal treatment where they exercise their power of taxation so allocated.

In the case at hand, the CJEU noted that the dividends received from Italy, the United Kingdom and the Netherlands were not subject to a heavier taxation compared to French-source dividends (same tax base and rate). In particular, the expenses "specifically" related to the foreign-source dividends which are deducted for the computation of tax credit are also deducted from the global tax result of the company receiving French-source dividends. In other words, there is no difference of treatment.

For the CJEU, the disadvantage suffered by the company stems from the difference of tax base used in the source State for the computation of the withholding tax and the State of residence for the computation of the corporate income tax. As each Member State is free to define, in accordance with EU law, the basis of assessment for tax purposes which applies to the shareholder in receipt of the dividends distributed, there is no restriction to the free movement of capital. Moreover, the CJEU recalled that the purpose of DTTs is not to ensure that the taxation to which the taxpayer is subject in one Member State is not higher than that to which it would be subject in the other.

Takeaway

This new ruling from the CJEU is a reminder of the great freedom EU Member States have in defining the allocation of their respective powers of taxation by means of DTTs. In particular, the Member State of residence is not forced to match the tax base of the tax credit it granted on the one used by the source State for the computation of the withholding tax in order to fully eliminate the double taxation of the income.

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