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► **To cite this version:**

Georges Cavalier. France : Recent and Pending ECJ Cases. Recent and Pending Cases at the CJEU on Direct Taxation, Nov 2021, Vienne, Austria. hal-04607206

HAL Id: hal-04607206

<https://univ-lyon3.hal.science/hal-04607206>

Submitted on 10 Jun 2024

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1. Introduction

As in previous years, the European Court of Justice (ECJ) is dealing with quite a number of cases that relate to French direct tax law. In this contribution, we will discuss two international distribution of dividend cases and one fundamental freedom case. The first case, decided, concerns the (gross or net) tax base to limit the deductible tax credit (*règle du butoir*) provided by Double Tax Treaty (“DTT”) to avoid, as much as possible, juridical double taxation (*Société Générale* case)¹ (Section 2). The cases that are still pending deal with the advance payment of tax (*précompte mobilier*) related to the old French tax credit (*avoir fiscal*) designed to prevent economic double taxation and, with the obligation placed on tax lawyers, to report “cross-border arrangements” to tax authorities. Interestingly, both of these last two cases relate to a request for a preliminary ruling not only to interpret EU secondary acts but also to decide on their validity. There is potential incompatibility between (i) in the *Schneider Electric* case² (Section 4), the Parent-Subsidiary Directive (“PSD”) and the free movement of capital, and (ii) in the *Conseil national des barreaux* case³ (Section 5), the recently amended (1998) Directive on Administrative Cooperation (“DAC Directive”) with the rights guaranteed by both the Charter of Fundamental Rights of the European Union (“CFREU” or “Charter”) and the European Convention for the Protection of Human Rights and Fundamental Freedoms (“ECHR” or “European Convention”).

2. Société Générale SA (C-403/19)

2.1. Facts and legal background

This is the first ECJ decision following a saga of French cases on the treaty rule limiting the imputation of tax credits attached to dividends in the event of a purchase and resale of securities:⁴ a French bank Société Générale Asset Management (SGAM) Banque (“SGAM Bank”), belonging to a tax-integrated group of which *Société Générale* is the parent company, received dividends from companies resident in Italy, the United Kingdom and the Netherlands. An amount equal to those dividends was then paid to third parties pursuant to two different standard financial contracts: (i) securities lending transactions involving the remittance by

1 ECJ, 25 February 2021, C-403/19, *Société Générale SA v. Ministre de l’Action and des Comptes publics*, ECLI:EU:C:2021:136.

2 Opinion of Advocate General Kokott, 14 October 2021, C-446/20, *Schneider Electric SA, Axa SA, BNP Paribas, Engie, Orange SA, L’Air liquide, société anonyme pour l’étude et l’exploitation des procédés Georges Claude v. Premier ministre, Ministre de l’Economie, des Finances et de la Relance*, ECLI:EU:C:2021:857.

3 C-398/21, *Conseil national des barreaux, Conférences des bâtonniers, Ordre des avocats du barreau de Paris v. Premier ministre, Ministre de l’Economie, des Finances et de la Relance*, Request for a preliminary ruling from the Conseil d’Etat (France), lodged on 28 June 2021.

4 E.g. Conseil d’Etat (France), plen. session, 7 December, 2015, no 357189, *CIC Alsace-Lorraine*.

the borrower of securities intended to guarantee those lent by SGAM Bank, which thus temporarily became the owner of the remitted securities; (ii) fund structuring transactions consisting, in particular, in managing baskets of shares corresponding to management profiles set by its contracting partners, where SGAM Bank received the dividends attached to securities included in the equity baskets. These business operations are far from anecdotal since they concern many standardized financial transactions structured under the Overseas Securities Lender's Agreement (OSLA) model contract or equity swap contracts.

In accordance with the terms of these financial contracts entered into by SGAM Bank with its contracting partners, for the first above transaction, the bank was required to return to the borrower securities equivalent to those given as collateral, so that the borrower could benefit from the payment of the dividend attached to those securities and, in the absence of restitution, either pay it a sum of money or remit property to it of a value equal to the amount of those dividends. For the second above transaction, in respect of the performance sold to its contractual partners, SGAM Bank was required to repay a sum corresponding to the amount of dividends received and any increase in the value of the securities. It is important to note at this stage that these payments were, therefore, expenses related to dividends. In return, the customers paid SGAM Bank a fixed remuneration fee for managing the equity basket.

As a reminder, when a dividend is paid by the resident of a State to a non-resident person, the provisions of the domestic law of that State often require the debtor to make a withholding tax on the payment to that person. This taxation technique is justified by the difficulty of recovering amounts due from a non-resident person. However, the income will also be taxable in the State in which the person who is the beneficiary resides. As a consequence, the dividends will have borne a double taxation on the beneficiary who is the only one to bear the tax costs: the foreign withholding tax and the French tax.

To avoid this double taxation, the ECJ case law accepts both the ordinary credit or the exemption, but the situation depends on the absence or existence of a DTT.

In the absence of a DTT, when the sums are paid by a non-resident person to a French company that is the beneficiary of the income, the withholding tax shall not be eligible for a tax credit but shall be deductible from its tax result under Article 39, 1, 4 of the French General Tax Code according to which "*The net profit is established after deduction of all expenses, which include (...) in particular (...) 4 Subject to the provisions of section 153, taxes payable by the company, collected during the financial year (...)*". However, this deduction does not eliminate double taxation, as the following example shows.

If we assume that a French company is a creditor of dividends in the amount of 100 and further assume that the parent-subsidiary regime is not applicable, the

withholding tax applied is 15, and the tax result will therefore be equal to 85. The corporation tax (in principle 25 % as of 1 January 2022, but previously usually 33.1/3 %) will then be 21.25 %. In the end, the overall tax rate will be 36.25 %.

The Withholding Tax is a Deductible Expense

Dividend gross amount	100
WHT	-15
Taxable amount	85
Corporate tax (25 %)	21.25
Foreign tax paid	15 %
French tax paid	21.25 %
Overall tax paid	36.25 %

In the presence of a DTT, the right to tax dividends is allocated between the residence State (the State of the dividend beneficiary/shareholder) and the source State (the State of the distributing company). This source State applies a withholding tax at a given rate. Note that these are not primary or secondary taxation rights (or “rule versus exception” logic) as residence or source States are on an equal footing when it comes to the allocation of taxing rights by a tax treaty.⁵

For instance, Article 10 of the Franco-Italian DTT states:

1. Dividends paid by a company resident in one State to a resident of the other State shall be taxable in that other State.
2. However, such dividends may also be taxed in the State of which the company paying the dividends is a resident and according to the laws of that State.

To eliminate this juridical double taxation of dividends, France has chosen the credit method: each State retains the right to tax the dividends in accordance with the provisions of its national law under the conditions and limits laid down by the DTT, but the State of residence of the recipient company grants a tax credit generally equal to the amount of the withholding tax, deductible of the tax payable by that company. This method organizes a tax sharing without double taxation.

For instance, Article 24(1)(a) of the above DTT provides that double taxation is to be avoided in the following manner as far as France is concerned:

Profits and other positive income arising in Italy and taxable there under the provisions of this Convention shall also be taxable in France where they accrue to a person resident in France. The Italian tax is not to be deductible for calculation of the taxable income in France. However, the recipient shall be entitled to a tax credit to be set against

5 M. Lang, DBA-Interpretation durch den EuGH, SI 2017, p. 507 (513.); Kerschner, Deutsche Genuss-scheinertträge: Debut des EuGH als DBA-Schiedsrichter, *ecolex* 2017, p. 1102 (1005).

the French tax charged on the taxable amount which includes that income. This tax credit shall be equal:

- For income referred to in Articles 10, 11, 12, 16 and 17 ... to the amount of tax paid in Italy in accordance with the provisions of those articles. That tax credit shall not however exceed the amount of French tax on that income.

Resuming the previous example, although the overall tax rate is equal to the corporate tax rate, this tax is distributed between the two States: 15 % for the foreign State; 10 % for the French State.

The Withholding Tax is Eligible for a Tax Credit

Dividend Gross Amount	100
Theoretical Corporate Income Tax (25 %)	25
– Tax credit	–15
Corporate Tax	10
Foreign Withholding Tax	15 %
French Tax paid	10 %
Overall Tax paid	25 %

However, this tax credit could be limited as provided by the final provision of the Article eliminating double taxation in DTT (for instance, Article 24(1)(a) in the Franco-Italian tax treaty). This latter provision stresses that:

That tax credit shall not however exceed the amount of French tax on that income.

This is also the case, with a slightly different wording, of the Franco-British DTT (Article 24(b)(ii)) and of the Franco-Netherlands DTT (Article 24B(b)). This limitation of the tax credit echoes French domestic tax law.⁶

This rule prevents France from granting a higher tax credit and thus having to bear all or part of the foreign withholding tax.⁷

Therefore, and under this rule, the deductible tax credit is capped at the amount of “corporation tax theoretically payable” by the French company in respect of the income that has been withheld at source, less the expenses relating to that income. It is this *theoretical tax base* which determines the maximum deduction as provided for by DTT. It will be recalled, in the determination of this *theoretical tax base*, that this tax base adopted by France, and protected by the principle of tax sovereignty, consists of taking into account, in addition to the expenses directly *related* to the income received, all the expenses related to the acquisition, the retention and disposal of the product-generating asset, in accordance with Article 39(1) of the General Tax Code.

⁶ French General Tax Code, Article 220 paragraph 1.

⁷ Paragraph 22 *in fine* of the Société Générale decision.

For example, a corporation received dividends of a gross amount of 100 for which a withholding tax of 15 applied. Assuming that the parent-subsubsidiary regime is not applicable, the expenses associated with these dividends amount to 70.

Theoretical Corporate Tax

Dividends Gross Amount	100
Expenses	-70
Dividend Net Taxable Amount	30
Theoretical Corporate Tax (25 %)	7.5
Foreign Withholding Tax	15
Deductible Withholding Tax	7.5

The withholding tax will be deductible on corporation tax only up to 7.5,⁸ whereas it amounts to 15.

Having this background in mind, the main question in the *Société Générale* case was how to apply the rule for calculating the maximum deductible tax credit, given the expenses paid according to the two financial contracts and its consistency with the free movement of capital. How to treat these expenses related to the Italian, UK and Dutch dividends within the computation of the limitation of the tax credit (*règle du butoir*)? More precisely, the question was to determine if this *maximum deduction* of the tax credit was limited to the French corporate income tax corresponding to those dividends after deduction of these expenses (net amount) or before this deduction (gross amount).

In the context of the two types of financial transactions, the position of SGAM Bank was as follows: the bank received dividends paid by companies resident in Italy, the United Kingdom, and the Netherlands, less withholding tax paid on the dividends in those three countries respectively. Consequently, SGAM Bank offset – against the amount of corporate income tax due in France – the tax credits corresponding to those withholding taxes. As they had been subject to withholding tax in the source State 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 DTTs concluded by France with these countries. The deduction amounted to the withholding taxes.

However, the tax authorities reassessed the French bank on the grounds that the amount paid, in accordance with the terms of the contracts entered into by the

8 Dividend Gross Amount (100) – Expenses (70) = Dividend Net Taxable Amount (30), upon which the Theoretical Corporate Tax (at a rate of 25 %) would be 7.5.

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 *Conseil d'Etat* (France), *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). According to *Société Générale*, transactions made by companies subject to corporation tax in France involving the securities of foreign companies are at a disadvantage compared to those involving securities of French companies, because of the difference between the tax base applied by the Member State in which the dividends are paid and that of French corporation tax, which determines the maximum amount of the tax credit that can be deducted. The latter only allows for an insufficient amount of the foreign withholding taxes to be offset against the French corporation tax.

In the *Société Générale* case, the withholding tax paid in Italy, the United Kingdom, and the Netherlands has been calculated on the gross amount of those dividends without the possibility of deduction of expenses. Whereas French corporation tax is calculated on a net basis in which the French Republic allows the deduction of charges, the net income for the calculation of the tax credit is reduced by that deduction of charges.

In other words, a company established in France, placing transactions involving securities of non-resident companies has a disadvantage compared to companies placing transactions involving securities of resident companies. This results in a higher tax burden on foreign source dividends than on domestic source dividends.⁹

Assume that a bank receives, in the context of a securities lending transaction, dividends in the amount of 100 and has to return 100 % of the dividends received to its co-contracting party. This bank further receives additional income in the amount of 200. In this scenario, the French corporate income tax rate is 25 %.

If, on the one hand, the securities held temporarily are securities held in a French company, the situation will be as follows: the bank will record an income of 100 in respect of dividends received, an income of 200 in respect of other income, and an expense of 100, deducted under its contractual obligations under the securities loan. In total, it will therefore report a taxable income of 200. The corporation tax to which it is subject is 50, or an effective tax rate of 25 % (50/200).

9 Paragraph 36.

Distribution from a FRENCH subsidiary

Corporate Tax

Dividends Gross Amount	100
Other Income	200
Expenses	-100
Dividend Net Taxable Amount	<u>200</u>
Corporate Tax (25 %)	50
Effective Tax Rate	25 %

If, on the other hand, the same bank placed transactions involving securities held in a company resident in another State which, under the DTT, it entered into with France, applies a withholding tax at the rate of 15 % on dividends, the situation shall be as follows: a withholding tax of 15 will be levied in the source State; the Bank will record an income of 100 (85 net dividend + 15 DTT tax credit) plus an income of 200 on other income, and deduct an expense of 100, which will bring its taxable income to 200, as in the case of the collection of dividends from French sources.

However, the *mini-P&L account* used to calculate the *theoretical corporate tax* determining the maximum deduction of the tax credit will take into account the amount of expenses repaid of 100, or a base equal to 0 (100 – 100), implying that the entire tax credit falls into default.

The total effective tax rate is 32.5 % ((15 + 50)/200).

Distribution from a FOREIGN subsidiary

Theoretical Corporate Tax

Dividends Gross Amount	100
Other Income	200
Expenses	-100
Dividend Net Taxable Amount	200
Theoretical Corporate Tax (25 %)	50
Foreign Withholding Tax	15
Deductible Withholding Tax	
French Corporate Tax (25 %)	
Overall Effective Tax Rate ((15 + 50)/200)	32.5 %

It follows that, in the event of a distribution from a foreign source and with identical tax results, the beneficiary company bears a tax surcharge in relation to the situation where it would have received dividends from French sources.

The Conseil d'Etat (France) was well aware of the Court's case law, but was "unsure as to the margin of discretion left to Member States when adopting a mechanism for the elimination of double taxation." Therefore, it referred the question of whether the application of the above rule, limiting the credit to the amount which the first Member State would receive if those dividends alone were subject to corporate tax and thus creating a disadvantage to the detriment of transactions involving the securities of foreign companies, violated the free movement of capital under Article 63.

2.2. Judgment and comments

The Second Chamber of the ECJ delivered its decision on 25 February 2021.¹⁰ The Court first observed that dividends distributed by a company established in one Member State to a shareholder resident in another Member State are liable to be subject to juridical double taxation where the two Member States choose to exercise their fiscal competence and to subject those dividends to taxation in the hands of the shareholder.¹¹

The Court then repeated its previous case law that the disadvantages that may result from the parallel exercise of the tax powers of the various Member States do not constitute restrictions prohibited by the FEU Treaty in so far as such an exercise is not discriminatory.¹²

The Court then checked if French law was discriminatory and observed that all resident companies are subject to corporation tax on dividends received, regardless of whether such dividends are from domestic or foreign sources, and that such income is part of the total income of the company concerned, from which operating costs are deducted, without any reference to differential tax rates, and, lastly, that the same rules for allocating costs which derive from the French General Tax Code would apply to that income, regardless of its origin.¹³

Therefore, France makes no discrimination between domestic income and foreign income: the same tax base rules and rate apply in France, whatever the origin of the dividends.

In particular, the Court noted that the charges relating specifically to dividends deducted in making that calculation, in accordance with the case-law of the *Conseil d'Etat*, also appear to be deducted from the overall profits of the resident company in respect of domestic-source dividends.¹⁴

10 See supra fn no 1.

11 Paragraph 27.

12 Paragraph 28 citing *Haribo Lakritzen Hans Riegel* (2011) and *Baudinet and Others* (2016).

13 Paragraph 32.

14 Paragraph 34.

With respect to the main argument relating to the difference in the tax base (gross amount for calculating the foreign withholding tax versus net basis for determining the amount of the French tax credit that can be deducted), the Court rejected it on three grounds.¹⁵

First, the Court observed that it is for each Member State to organize, in compliance with EU law, its system for taxing distributed profits and to define, in that context, the tax base and the tax rate which apply to the shareholder receiving them.¹⁶

Second, the Court repeated that the purpose of a convention for the avoidance of double taxation is not to ensure that the taxation to which the taxpayer is subject in one Member State is not higher than that to which he would be subject in the other Member State.¹⁷

Third, “in the absence of discriminatory exercise by a Member State of its tax jurisdiction, a disadvantage resulting from the double taxation of foreign-source dividends, arises from the parallel exercise of tax jurisdiction by the States of the source of those dividends and by the Member State of residence of the shareholder company.”¹⁸

Finally, the Court distinguished *Société Générale* from *Beker and Beker*¹⁹ and *Miljoen and Others*.²⁰ This latter case of 17 September 2015 questioned the euro-accounting of the withholding tax base in the source State (Dutch law having this particularity to provide for a withholding tax, including for domestic distributions). In this symmetrical or reversed situation of that of the *Société Générale* case, the Court had specified that “only expenses which are directly linked to the actual payment of the dividends must be taken into account”,²¹ and that the other expenses incurred by the recipient bank in the event of coverage of a financial risk did not meet this definition on the ground that the

deduction does not, therefore, concern expenses which are directly linked to the actual payment of the dividends arising from those shares. Secondly, the financing costs also mentioned by the referring court concern ownership of the shares per se, and therefore

15 Paragraph 37.

16 Paragraph 26 citing *Orange European Smallcap Fund* (2008) and *Baudinet and Others* (2016).

17 Paragraph 39.

18 Paragraph 40.

19 C-168/11, 28 February 2013, EU:C:2013:117. The Court of Justice invalidated a German mechanism for eliminating double taxation based also on a system of capping a tax credit. The special arrangements for calculating such cut-off limit had the effect of limiting the possibility for German taxpayers (individuals) receiving dividends from foreign sources to take into account, in calculating their tax, all deductions related to their personal situation, whereas they were entitled to all personal and family deductions when all their income was of domestic source. Such discrimination in Germany's exercise of its taxing power therefore justified the invalidation.

20 C-10/14, C-14/14 and C-17/14, 17 September 2015, EU:C:2015:608.

21 Paragraph 59.

they are also not directly linked to the actual payment of the dividends arising from those shares.²²

The first comment is that the *Conseil d'Etat* has already applied the February solution put forward by the ECJ, both in May and July this year.²³ In the 5 July 5 decisions, the *Conseil d'Etat* insisted that *all* charges relating to dividends must be deducted.

In the absence of a conventional interpretation of the terms *profits*, *income* and *other positive income* in the light of the French General Tax Code, all charges are taken into account in the tax base of the limitation.

However, in the *HSCB Bank Plc Paris Branch* decision, the *Conseil d'Etat* reached the same result, without applying Article 39 of the French General Tax Code, in the presence of DTTs providing themselves that the tax credit may not exceed the amount of French tax corresponding to the amount of this “net income” (e.g. French DTTs concluded with Spain, the US or Switzerland, as in the *HSBC Branch Plc Paris* case). On the contrary, one could therefore question a situation involving a tax treaty specifically providing a gross amount of income (see DTT concluded with China and relating to interest in its then applicable version where the Versailles Administrative Court of Appeal²⁴ agreed with the taxpayer). Nonetheless, to the extent that the DTTs concluded by France with Singapore, the Philippines, India or Thailand, the Court of Versailles upheld the administration reassessment. Finally, the same Court of Versailles found that the capping rule was in conformity with the ECHR.²⁵

Second, and historically, the European Commission took the view that double taxation should be prohibited by the fundamental freedoms.²⁶ However, the Court's Grand Chamber 2006 decision *Kerckhaert and Morres* did not share this view.²⁷ It was consistently repeated over the years and again with this *Société Générale* case. Still, this position seems more and more at odds with extensive internal market case law on the prohibition of double contributory burdens in the field of social security²⁸ and of double taxation in the context of VAT.²⁹

Third, a prohibition of double taxation under the freedoms would not excessively limit Member States' tax sovereignty, as Member States would, in any event, be

22 Paragraph 60.

23 *Conseil d'Etat* (France), *HSBC Bank Plc Paris Branch* decision of 11 May 2021, and three decisions *Société Générale*, *CIC* and *BNP Paribas* of 5 July 2021.

24 16 December 2020, No. 19VE02589, *Sté BNP Paribas*, concl. J. Illouz.

25 Versailles Administrative Court of Appeals, 7 July 2021, no 18VE00222, *Sté CIC*, paragraph 34.

26 Answer given by Mr. Bolkestein on behalf of the Commission to Written Question E-2287/99 by Karin Riis-Jorgensen (ELDR) concerning “Right to freedom of movement and Danish tax rules”, [2000] OJ C 225 E/87, and the position taken by the Commission concerning Petition 626/2000 by Mr. Klaus Schuler (German), concerning the dual taxation of an inheritance (25 January 2007), p. 4.

27 ECJ, 14 November 2006, C-5&4/04, *Mark Kerckhaert and Bernadette Morres*, EU:C:2006:713.

28 Inter alia, ECJ, 23 November 1999, C-369/96 and C-376/96, *Jean-Claude Arblade*, EU:C:1999:575.

29 E.g. ECJ, 21 May 1985, C-47/84, *Gaston Schul* (“*Schul II*”), EU:C:1985:216, paras. 12 et seq.

free to allocate taxing powers among them and determine the criteria for direct taxation *with a view of eliminating double taxation*.

Fourth, one could question the asymmetry when the Court protects Member States from taxpayers' double use of losses³⁰ but does not equally protect taxpayers from Member States' double taxation of their profits – since in a true internal market it is questionable if either would be acceptable. Indeed, one could argue the reverse, since a State is forced to offset a foreign loss without being able to tax the symmetrical foreign profit. The same could be argued for EU Tax Policy: ATAD II addresses double non-taxation in hybrid situations but does not likewise address instances of double taxation.³¹

This *Société Générale* decision was delivered without an Advocate General's Opinion as the ECJ decided that there was no new point of law. This is not the case for the next decision, *Schneider Electric*, where Advocate General Kokott recently delivered her opinion.

3. Schneider Electric SA and others v Premier Ministre, Ministre de l'Economie, des Finances et de la Relance – Preliminary Ruling (C-556/20)

3.1. Facts and legal background

The *Schneider Electric* background is not unknown to the Court, which already discussed³² part of the old French legislation designed to avoid economic double taxation through a tax credit and its corollary, the advance payment of tax (*précompte mobilier*). Both were repealed more than 16 years ago, at a time where French corporate income tax was at a rate of 33.1/3 %.³³

Indeed, one of the justifications for the advance payment was this 50 % French tax credit intended to offset economic double taxation, since the income distributed and taxed came from profits that had borne corporation tax at the normal rate. There were products which had not borne this tax (profits from foreign branches) or which had borne the tax only at a reduced rate. In these situations, maintaining the tax credit would equal to grant a rebate on a tax that was not paid by the distributing company. A correction was therefore necessary. It was not intended that the shareholders needed to make laborious distinctions according to the origin of the dividends they received. For a practical reason, the shareholders

30 E.g., ECJ, 15 May 2008, C-414/06, *Lidl Belgium*, EU:C:2008:278, paragraph 35.

31 Council Directive (EU) 2017/952 of 29 May 2017, amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries, [2017] OJ L 144/1.

32 C-310/09, 15 September 2011, *Min. v. Accor SA*; C-416/17, 4 October 2018, *Commission v. France*.

33 French Finance Act for 2004, dated 30 December 2003.

always benefitted from the tax credit, regardless of the origin of the profits from which the dividends were drawn.

The servitudes were deferred to the distributing companies since they had to make the advance to the Treasury of the tax credit in the form of this so-called *advance payment*. Such advance payment was, therefore, equal to the amount of the tax credit. It was a substitute for corporate tax that had not been paid. It had to be taken from the same accounting entry that was put into distribution (the so-called *distribution envelope*). It was equal to one-third of the total distribution. It was also equal to one third of the total dividend, including tax credit, from which the shareholder benefits.

Where a French company holds at least 5 % in the capital of a foreign company, it benefits from the parent-subsidiary regime. This means that the dividends paid by the foreign subsidiary are exempt from French corporate tax. Therefore, the advance payment becomes payable if the parent company redistributes these dividends to its own shareholders.

The implementation of this principle varied according to whether or not a DTT existed. If the subsidiary was located in a State which had not signed DTT with France, the advance payment was due without mitigation. However, if the subsidiary was located in a State which had entered into a double-taxation agreement with France, withholding tax levied abroad would be eligible to a tax credit of the same amount which would be offset against the advance payment. In this case, the advance payment is calculated on the dividend received, plus the tax credit.

Assume that a French parent company receives a dividend of 100 from its Italian subsidiary, which it then redistributes to its own shareholders. The Franco-Italian DTT provides for a 15 % withholding tax, reduced to 5 % if the shareholding of the French company is at least of 10 % in the share capital of the Italian company. Assume a 5 % withholding tax applies.

Dividend Gross Amount	100
Italian WHT 5 %	5
Net dividend received by French parent	95
Advance payment: $100 \times 33,1/3 \%$	33
Tax credit	5
Advance payment to pay	28
Net redistributed dividend	66

If the corporation wants to avoid the advance payment, it must distribute only three times the amount of the tax credit:

Distribution envelop (including tax credit)	15
Advance payment: $15 \times 33,1/3 \%$	5
Tax credit	-5
Advance payment to pay	0
Net redistributed dividend	15

In the *Schneider Electric* case, the French claimants received dividends from subsidiaries established in other Member States (tax exempt under the parent-subsidiary regime) and then redistributed this financial profit to their own shareholders.

Since this dividend income was not taxed at the level of the parent company, the latter paid an advance payment (to correct the tax credit at the level of its shareholder), but did not have a tax credit of its own. Indeed, since the dividend was received from subsidiaries established in other Member States, the French parent company was not entitled to a tax credit. This reduced the amount that the parent company could distribute to its own shareholders.

On the contrary, in a purely domestic situation (a French company receiving a dividend from its French subsidiary), the parent company would automatically receive a tax credit amounting to 50 % of the dividend. The parent company could then offset its tax credit against the advance payment under Article 146(2) of the French General Tax Code. Thus, ultimately, there was no extra tax burden at the level of the parent company because the tax credit and advance payment always cancelled each other out.

This resulted in a difference in treatment of dividends in cross-border situations. Therefore, the taxpayers considered the advance payment paid was contrary to the PSD and claimed a refund for the years 2000 to 2004.

It is precisely that disadvantageous treatment of the cross-border situation compared with the purely domestic situation that the Court had already held to be contrary to the freedom of establishment and free movement of capital in *Accord*, and confirmed in *Commission vs. France*.³⁴

However, it remains to be ascertained whether and how that entitlement to a tax credit can now be offset against the advance payment.

The applicant companies submitted that the provision of the French general tax code instituting the advance payment is incompatible with the PSD which provide:

³⁴ See supra.

4(1) Where a parent company or its permanent establishment, by virtue of the association of the parent company with its subsidiary, receives distributed profits, the State of the parent company and the State of its permanent establishment shall, except when the subsidiary is liquidated, either:

- refrain from taxing such profits, or
- tax such profits while authorizing the parent company and the permanent establishment to deduct from the amount of tax due that fraction of the corporation tax related to those profits and paid by the subsidiary and any lower-tier subsidiary, subject to the condition that at each tier a company and its lower-tier subsidiary meet the requirements provided for in Articles 2 and 3, up to the limit of the amount of the corresponding tax due.

(...)

4(2) However, each Member State shall retain 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. Where the management costs relating for the holding in such a case are fixed as a flat rate, the fixed amount may not exceed 5 % of the profits distributed by the subsidiary.

5(1) Profits which a subsidiary distributes to its parent company shall be exempt from withholding tax.

Further, the applicant companies take argument of PSD Article 7(2) which read as follows:

This Directive shall not affect the application of domestic or agreement-based provisions designed to eliminate or lessen economic double taxation of dividends, in particular provisions relating to the payment of tax credits to the recipients of dividends.

According to the claimants, such PSD Article 7(2) allows only derogations from the prohibition of withholding tax (Article 5 – no withholding tax) and does not allow an advance payment of tax (Article 4 – no tax at the parent company level).

Although the case is still pending, the opinion from Advocate General Kokott gives indication of what the Court’s decision could be.

3.2. Opinion of Advocate General Kokott and comments

Advocate General Kokott proposes to validate the French advance payment on three grounds.

First, when a parent company receives distributed profits from its subsidiary, France has opted for the tax exemption method and a fixed amount of 5 % of the profits representing charges is not deducted.³⁵ Thus, the French System is not in conflict with PSD Article 4.

Second, the advance payment must be made not by the holder of the shares (that is, the recipient of the distribution) but by the distributing company. Therefore, it does not amount to a withholding tax prohibited by PSD Article 5(1).

³⁵ French General Tax Code, Article 216.