OPINION OF ADVOCATE GENERAL SHARPSTON

delivered on 24 January 2008 [1]

1. The present reference from the French Conseil d'État (Council of State) seeks an interpretation of Articles 4 and 7(2) of the Parent/Subsidiary Directive [2] ('the Directive').

2. The Directive is best understood against the background of the broader problem it seeks to address.

Taxation of intra-group dividends

3. A subsidiary company pays dividends to its parent. Dividends are paid out of profits. Where all companies in a group are tax resident in the same Member State, the subsidiary will be taxed on the profits out of which the dividend is paid and the parent (like any other shareholder) will be taxed on the dividend as income. The same income is thus taxed twice in the hands of different taxpayers. This is economic double taxation.

4. In order to remedy this double taxation, some Member States have adopted 'imputation systems' under which shareholders are granted a tax credit representing all or part of the company tax paid on the profits out of which the dividend is paid. The tax credit is set against the shareholders' tax liability on the dividend, thus eliminating or reducing the double taxation. France formerly provided for this type of domestic tax credit, the *avoir fiscal*. [3]

5. Member States granting such tax credits in respect of dividends will want to be sure that company tax has in fact been paid on the

1 — Original language: English.

2 — Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ 1990 L 225, p. 6). The Directive has subsequently been amended but (according to the applicant) the main proceedings concern the original version only.

3 — Provided for in Article 158 bis of the Code général des impôts (General Tax Code).

profits out of which the dividends are paid. Imputation systems therefore provide for the imposition of a special, usually advance, tax on companies paying dividends which attract a tax credit. France formerly had such an imputation tax, the *précompte mobilier*. [4]

6. Where a group of companies comprises a parent company established in one Member State and one or more subsidiaries established in one or more other Member States, the cross-border payment of dividends by subsidiary to parent will obviously raise different tax issues.

7. Most Member States tax companies resident within their territory on their foreign income, which has historically included dividends paid by foreign subsidiaries. Most Member States also tax income of non-residents arising within their territory, and have historically deducted tax at source on cross-border dividends. Such withholding tax ensures that the Member State of the subsidiary receives tax payable by shareholders whom it cannot reach by direct assessment.

8. When a parent company receives dividend income from a foreign subsidiary, the income has therefore usually already been taxed twice — it has been subject to, first, the foreign corporation tax on the profits of the subsidiary out of which the dividend is paid, payable by the subsidiary, and, second, foreign withholding tax on the dividend itself, representing the tax payable by the parent company (but actually deducted at source and remitted to the foreign tax authorities by the subsidiary). This again is economic double taxation. If the dividend is subject to both withholding tax in the Member State of the subsidiary and corporation tax in the Member State of the parent company, that company will pay tax on the same income in two Member States. This is juridical double taxation.

9. In order to reduce or eliminate such economic and/or juridical double taxation of the dividend, most Member States have historically granted relief to recipients of dividends resident for tax purposes in their territory, either unilaterally or pursuant to a double taxation convention, using either the exemption method or the credit method.

10. Under the exemption method, qualifying foreign income is completely exempted from domestic corporate or income tax. Under the

4 — Provided for in Article 223 sexies of the Code général des impôts.

credit method, a country continues to tax the foreign income but permits credit to be given for certain foreign taxes paid on the income (i.e. the tax on the profits underlying the dividend and/or the withholding tax on the dividend), which can then be set off against the domestic liability.

11. Under the tax treaties concluded by France with other Member States, such a foreign tax credit (the *crédit d'impôt étranger*) is given to a parent company established in France on the distribution of profits by a subsidiary established in another Member State where that distribution has been subject to a withholding tax levied by the other Member State. The foreign tax credit is equal to the amount of the withholding tax.

The Directive

12. The Directive seeks to eliminate the tax disadvantage suffered by companies from different Member States, by comparison with companies of the same Member State, where they seek to cooperate by forming groups of parent companies and subsidiaries. [5]

13. Article 3(1)(a) requires Member States to attribute the status of parent company at least to any company [6] which is resident for tax purposes in one Member State and has a minimum holding of 25% [7] in the capital of a company of another Member State (defined in Article 3(1)(b) as a 'subsidiary').

14. Article 4(1) provides that, where a parent company resident in one Member State receives a dividend from a subsidiary resident in another Member State, the Member State of the parent company is either to refrain from taxing the dividend (the exemption method) or to tax it but to authorise the parent company to deduct from the amount of tax due that fraction of the corporation tax paid by the subsidiary which relates to the profits distributed via that dividend (the credit method).

15. By virtue of Article 4(2), however, Member States may provide that any charges relating to the holding and any losses resulting from the distribution of the profits

5 — Second and third recitals in the preamble.

6 — More precisely, any company which takes one of the forms listed in the Annex to the Directive and which is subject to one of the taxes listed in Article 2(c).

7 — That minimum has been reduced to 20% with effect from 2 February 2004 and to 15% with effect from 1 January 2007, and is to be reduced to 10% with effect from 1 January 2009: Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC (OJ 2004 L 7, p. 41).

of the subsidiary may not be deducted from the taxable profits of the parent company. If, in such a case, the management costs relating to the holding are fixed as a flat rate, the fixed amount 'may not exceed 5% of the profits distributed by the subsidiary'.

16. Article 5(1) requires Member States to exempt from withholding tax profits which a subsidiary distributes to its parent company. Greece, Germany and Portugal, however, benefit from derogations which permit them, during different transitional periods, to impose withholding tax on 'profits distributed' by subsidiaries to parent companies of other Member States. [8]

17. Article 7(2) provides:

'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.'

18. By virtue of Article 1(2), the Directive 'shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse'.

19. The Directive required implementation by 1 January 1992, subject to the transitional provisions in Article 5.

Relevant national legislation [9]

20. France has opted for the exemption method under Article 4(1) of the Directive. Accordingly, Article 216 of the Code général des impôts [10] ('Article 216 CGI') provides that net income from holdings giving entitlement to application of the tax regime for parent

8 — Article 5(2), (3) and (4) respectively. The transitional provisions were deleted by Directive 2003/123, cited in footnote 7.

9 — As described by the referring court, which was hearing an application for annulment brought on 22 December 2003. The avoir fiscal and the précompte mobilier have since been abolished (with effect from 1 January 2005).

10 — In the version resulting from Article 43(I) of the Finance Law for 1999 (no 98-1266 of 30 December 1998, JORF 20050), as amended by Article 20 of the Finance Law for 2000 (no 99-1172 of 30 December 1999, JORF 19914).

companies [11] which is received by a parent company in the course of a financial year may be deducted from the net total profits of that company, after deduction of a proportion of costs and charges, fixed at 5% of the total revenue from the holdings, including tax credits. [12] The effect of this provision is that the 5% in question is added back to the parent company's taxable income; I shall refer to it as 'the 5% add-back'.

21. An administrative circular [13] ('the administrative circular') states that the tax credit referred to in Article 216 CGI comprises both the domestic tax credit (*avoir fiscal*) for income arising in France and the foreign tax credit (*crédit d'impôt étranger*) for income from subsidiaries with their seat in a country with which France has a double taxation treaty.

22. Pursuant to Article 146(2) of the Code général des impôts ('Article 146(2) CGI'), if the distribution by a parent company to its own shareholders of dividends received from a foreign subsidiary leads to application of the *précompte mobilier*, tax credits may be set off against the *précompte mobilier* only where they are attached to dividends paid in the last five years. By virtue of an extra-statutory concession, those tax credits may, where appropriate, also be set off against the withholding tax payable on the redistribution of dividends by the parent company to persons not resident for tax purposes, or not having their seat, in France.

The reference in the present case

23. Banque Fédérative du Crédit Mutuel ('Banque Fédérative') brought proceedings before the Conseil d'État for annulment of the administrative circular. It maintained that, by including in the basis of calculation for the 5% add-back foreign tax credits paid pursuant to the tax treaties concluded by France with other States, that circular failed to comply with Article 4 of the Directive, which limits the amount of the expenses which are not deductible from the taxable income of the parent company, when set at

11 — Article 145 of the Code général des impôts, which provided at the material time that the tax regime for parent companies was applicable to companies subject to corporate tax at the normal rate holding at least 5% of the capital of the company in question.

12 — Subject to a cap: it may not exceed, for each tax period, the total amount of the costs and expenses of any nature incurred by the holding company in the course of the same period.

13 — Of 25 June 1999, published in the *Bulletin officiel des impôts* 4 H-4-99; see in particular paragraph 15.

a fixed level, to 5% only 'of the profits distributed by the subsidiary'. [14]

24. The Conseil d'État notes that under the tax treaties concluded by France with other Member States a tax credit is given to a parent company established in France on the distribution of profits by a subsidiary established in another Member State where that distribution of profits has been subject to a withholding tax levied by the other Member State. [15] That tax credit is equal to the amount of the withholding tax thus deducted. The 5% add-back places the parent company in a situation identical to that in which it would have been if there had been no withholding tax provided that the tax credit can be entirely set off against the tax payable by the parent company. It follows from Articles 146(2) and 216 CGI and the administrative circular that tax credits granted on the occasion of the distribution of dividends to a parent company by its subsidiary established in another Member State may be set off against tax payable by the parent company only where those dividends are redistributed in the following five years. In that case, the 5% add-back does not affect the principle of fiscal neutrality of the cross-border distribution of profits.

25. On the other hand, if the parent company does not redistribute its dividends within that period, the Conseil d'État agrees that the 5% add-back has the effect of raising its taxable income above the limit fixed by Article 4 of the Directive and of affecting, to that extent, the fiscal neutrality of the cross-border distribution of profits. It considers that the question arises whether, in that case, the resulting increase in corporation tax paid by the parent company may be permitted under Article 7(2) of the Directive.

26. The Conseil d'État has accordingly referred the following question to the Court:

'The add-back to the taxable income of a parent company established in France of 5% of the tax credits attributed upon the distri-

14 — Banque Fédérative also argued before the Conseil d'État that: (i) Article 216 CGI infringed Article 4(2) of the Directive in providing that the 5% add-back could not exceed, for each tax period, the total amount of the costs and expenses of any nature incurred by the holding company in the course of that period; and (ii) the inclusion of the *avoir fiscal* (in the case of subsidiaries established in France) and the *crédit d'impôt étranger* (in the case of subsidiaries established in third countries) in the basis on which the 5% add-back was calculated discriminated against parent companies established in France contrary to Articles 43 and 56 EC. The Conseil d'État dismissed both those arguments and has not referred any questions concerning them.

15 — Clearly this situation should no longer arise, since Article 5(1) of the Directive requires that profits distributed by a subsidiary to its parent company in another Member State should be exempt from withholding tax. The present reference arises out of an application for annulment of national legislation rather than a dispute concerning a specific tax assessment. It is therefore possible that the Court's ruling will affect earlier years of assessment when the transitional provisions of Article 5(2), (3) and (4) were still applicable.

bution of profits by a subsidiary established in another Member State of the European Union where those distributed profits have been subject in that other State to a withholding tax, has no effect on the taxation level of the parent company if the latter is able to set off all the tax credits against the tax payable. Where the parent company did not decide to redistribute those profits to its own shareholders within five years, and in consequence is no longer able to use the fiscal advantage represented by those tax credits, can the taxation — additional to corporation tax — which results from the add-back of 5% of the tax credits to its taxable income be regarded as permitted under Article 7(2) of Directive 90/435/EEC of 23 July 1990, in view of the small amount of such a tax and the fact that it was established directly in conjunction with payment of tax credits, introduced in order to mitigate the economic double taxation of dividends, or must it be regarded as contrary to the objectives of Article 4 of Directive 90/435?'

27. Written observations have been submitted by Banque Fédérative, the French and German Governments and the Commission, all of whom, with the exception of the German Government, were present at the hearing.

28. The referring court's question assumes that, unless permitted by virtue of Article 7(2), the national legislation as interpreted by the administrative circular will be contrary to Article 4(2) of the Directive in so far as the tax credits cannot be used because the parent company does not redistribute the profits within five years of payment. The French and German Governments, however, argue that the legislation is compatible with Article 4(2) without recourse to Article 7(2). I accordingly propose to consider, first, the logically prior question whether the national legislation at issue is in principle contrary to Article 4(2) of the Directive before turning, second, to the question whether, if so, it is none the less lawful by virtue of the derogation in Article 7(2) thereof (and/or, as the French Government submits, by virtue of Article 1(2)).

Article 4(2) of the Directive

29. Banque Fédérative and the Commission submit that the national legislation as interpreted in the administrative circular is contrary to Article 4(2) of the Directive. The two governments take the opposing view.

30. Article 4(2) of the Directive provides that, where a Member State fixes at a flat rate the management costs relating to the holding which may not be deducted from the taxable profits of the parent company, that fixed amount may not exceed 5% of 'the profits distributed by the subsidiary'. The parties submitting observations are divided over the question whether 'profits distributed by [a] subsidiary' means, in circumstances where the dividend is subject to withholding tax, the net amount of the dividend actually received by the parent company (after deduction of withholding tax) or the gross amount of the dividend, namely the amount actually received increased by the amount of the tax credit made available by France to compensate for the withholding tax.

31. The Conseil d'État and all the parties submitting observations make extensive reference to *Océ van der Grinten*, [16] in which the Court was asked, inter alia, whether a 5% charge imposed on the aggregate amount of the dividends paid by a UK-resident subsidiary to its Netherlands-resident parent company and the tax credit to which that distribution conferred entitlement amounted to withholding tax contrary to Article 5(1) of the Directive.

32. It was explicitly argued in that case that the tax credit should be regarded as forming part of the profits distributed by the subsidiary. [17] The Court rejected that argument, stating:

'The part of the 5% charge applying to the tax credit to which distribution of the dividend confers entitlement does not possess the characteristics of a withholding tax on distributed profits, in principle prohibited by Article 5(1) of the Directive, because it is not imposed on the profits distributed by the subsidiary.

The tax credit is a fiscal instrument designed to avoid double taxation, in economic terms, first in the hands of the subsidiary and then in the hands of the parent company in receipt of the dividends, of the profits distributed as dividends. Thus it does not constitute income from shares.' [18]

33. It must be borne in mind that the tax credit at issue in *Océ van der Grinten* was for

16 — Case C-58/01 [2003] ECR I-9809.

17 — See paragraphs 38 and 42.

18 — Paragraphs 55 and 56.

the amount of advance corporation tax paid by the company distributing the dividend in respect of that dividend. It was hence (as explained by the Court) designed to relieve economic double taxation. [19] In the present case, the tax credit at issue seeks to compensate the shareholder for withholding tax on the dividend, and is hence designed to relieve juridical double taxation. [20] Accordingly I do not agree with the Commission, whose very succinct observations [21] state simply that it follows from *Océ van der Grinten* that the tax credit cannot be regarded as distributed profits.

34. On a literal interpretation, I cannot see why 'profits distributed by [a] subsidiary' should not equate to the amount of the dividend actually received increased by the amount of the tax credit made available by France to compensate for the tax deducted at source. From the perspective of the subsidiary, if it declares a dividend of, say, EUR 100, it distributes profits of EUR 100. If there were no withholding tax, that amount would leave the subsidiary and go directly to the parent company. I do not see why that analysis should be affected by the fact that the Member State of the subsidiary requires it to withhold from that payment an amount representing tax payable by the parent and account for that amount directly to the tax authorities of that Member State. As the Court stated in *Athinaiki Zythopoiia*, [22] in the case of a withholding tax 'the company distributing dividends must withhold part of the dividends, which it pays to the tax authorities'. Moreover that interpretation seems to me to be confirmed by Article 5 of the Directive which authorises Germany, Greece and Portugal to levy a withholding tax on 'profits distributed'.

35. To my mind, and as the French Government has argued, the French legislation simply amounts to calculating the 5% add-back by reference to the total amount of the dividend declared; the reference to the tax credit is simply a means of ensuring that this figure is arrived at. I do not therefore accept the argument advanced by Banque Fédérative that, since a tax credit provided for by a double tax convention in order to compensate for the reduction in the amount of the dividend due to withholding tax takes the

19 — Taxation of the same income twice, in the hands of two different taxpayers: see point 3 above.

20 — Taxation of the same income twice, in the hands of the same taxpayer: see point 8 above.

21 — The Commission devotes four short paragraphs to whether the national legislation as interpreted by the administrative circular is compatible with Article 4(2) of the Directive.

22 — Case C-294/99 [2001] ECR I-6797, paragraph 7.

form of a credit by the State, it cannot be in the nature of a dividend or, therefore, of a distributed profit within the meaning of the Directive. Moreover I note that, in the context of an argument which I will not address since it explicitly seeks to put in issue the interpretation of national law on which the Conseil d'État has based its reference to this Court, Banque Fédérative submits that, although legally payable by the company making the distribution, withholding tax is in reality borne by the recipients of the dividend. That submission appears to me to support my proposed interpretation.

36. I also agree with the German Government that the objective of the Directive does not undermine that analysis. In order to ensure fiscal neutrality, Article 5(1) of the Directive prohibits Member States from imposing withholding tax on profits which a subsidiary distributes to its parent company. In the present case, the lack of fiscal neutrality is due to the withholding tax in the State of the subsidiary. Total fiscal neutrality may not be achievable for so long as the transitional provisions can be invoked. That does not mean that an interpretation which results in imperfect or incomplete fiscal neutrality is for that reason incorrect. It is in the nature of transitional derogations that, during their currency, the objectives of the legislation from which they derogate may not be entirely achieved. To require France to give full credit for withholding taxes imposed during the transitional period when it has opted for the exemption rather than the credit method would furthermore be tantamount to requiring it to provide for both methods whereas the Directive requires Member States to opt for one or the other.

37. I am accordingly of the view that, where a Member State has opted under Article 4(2) of the Directive to provide that any charges relating to a parent company's holding in a subsidiary of another Member State 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, it is not contrary to that provision for the management costs relating to the holding to be fixed as 5% of the total revenue from the holdings, including tax credits compensating for withholding tax levied on the dividend in accordance with Article 5(2), (3) or (4) of the Directive.

38. On that basis it is unnecessary to consider whether the legislation may be justified by reference to other provisions

of the Directive. I shall none the less briefly consider the relevance of those provisions.

Article 7(2) of the Directive

39. If the national legislation as interpreted by the administrative circular is contrary to Article 4(2) of the Directive, the national court asks whether it might be permitted by virtue of Article 7(2) thereof on the basis that, since the only effect of the 5% add-back is partially to reduce the tax credit attributed to the parent company on the occasion of the distribution of dividends, it may be regarded as belonging to a body of provisions relating to the payment of tax credits to beneficiaries of dividends and aiming, by the same token, at the mitigation of double taxation.

40. Article 7(2) states that the 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'.

41. Banque Fédérative and the Commission consider that the derogation in Article 7(2) of the Directive is inapplicable. The French Government takes the contrary view in its written observations, although at the hearing it argued that the legislation was compatible with Article 4(2) so that Article 7(2) was not relevant. The German Government makes no submissions on Article 7(2).

42. It is clear to my mind that Article 7(2) can have no relevance to the present case, since the national legislation at issue is not designed to eliminate or lessen *economic* double taxation. Although the question referred mentions the fact that the additional taxation which results from the 5% add-back 'was established directly in conjunction with payment of tax credits, introduced in order to mitigate the economic double taxation of dividends', it is clear from the order for reference as a whole that the tax credits (*crédits d'impôt étranger*) in question seek to mitigate the juridical double taxation of the same divi-

dend in the hands of the parent company in both the Member State of the subsidiary and the Member State of the parent company.

Article 1(2) of the Directive

43. The French Government has submitted that the Court should consider, in addition to Articles 4(2) and 7(2) of the Directive, specifically mentioned by the referring court, Article 1(2), which states that the Directive is not to preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse. The French Government notes that the national provision which gave rise to the main proceedings provides that a parent company can set off tax credits obtained from subsidiaries resident in another Member State against the *précompte mobilier* payable in respect of dividends redistributed to its shareholders only where the distribution is made within five years. That limitation to five years reflects a concern by the French Government to combat fraud. The risk of fraud and the difficulty of fiscal supervision would be exacerbated if undertakings could set off tax credits linked to dividends received 10 or 20 years earlier. The administration would not be able to verify whether the credits were genuine and hence to prevent the risk of fraud linked to the setting-off of fictive tax credits.

44. I cannot accept that argument. As the Court stated in *Leur-Bloem*, a general presumption of tax evasion or tax fraud cannot justify a fiscal measure which compromises the objectives of a directive. [23] It may be noted that that case concerned a provision in national legislation which sought to prevent, pursuant to Article 11 of the Merger Directive, [24] the tax advantages for which that directive provided from being granted for operations having as their principal objective tax evasion or tax avoidance. The same principle should clearly apply where, as here, a directive permits a Member State to derogate from its provisions on the grounds of fraud or abuse. If the French authorities wish to verify whether given tax credits are genuine, they may invoke the Mutual Assistance Directive [25] in order to obtain from the competent authorities of another Member State all the information which is necessary to allow them to effect a correct assessment of corporation tax.

23 — Case C-28/95 [1997] ECR I-4161, paragraph 44.

24 — Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (OJ 1990 L 225, p. 1).

25 — Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (OJ 1977 L 336, p. 15).

Conclusion

45. For the reasons given above I conclude that the question referred for a preliminary ruling by the Conseil d'État, France, should be answered as follows:

'Where a Member State has opted (under Article 4(2) of Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States) to provide that any charges relating to a parent company's holding in a subsidiary of another Member State 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, it is not contrary to that provision for the management costs relating to the holding to be fixed as 5% of the total revenue from the holdings, including tax credits compensating for withholding tax levied on the dividend in accordance with Article 5(2), (3) or (4) of that directive.'