OPINION OF ADVOCATE GENERAL JACOBS
delivered on 2 May 1996 *

1. In the present cases, which come to the Court by way of references for preliminary rulings from the Finanzgericht Köln, the Court is asked for the first time to interpret Council Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States ('the Directive'). [1] The Directive requires Member States *inter alia* to refrain from imposing a withholding tax on distributions of profits made by subsidiary companies located within their territories to parent companies located in other Member States. Member States have the option, however, of not applying the Directive to distributions made by subsidiary companies located within their territories whose parent companies do not maintain a qualifying holding in the subsidiary for a period of up to two years.

2. The main issue in the present cases is whether the Directive permits a Member State to apply a rule under which withholding tax must be deducted by a subsidiary company from distributions which it makes to its parent company in the first year following its acquisition by that company, so that the parent company is denied the exemption from withholding tax for the first year even where it ultimately maintains its holding beyond that period. If not, the national court asks whether the parent company may rely on the Directive before the courts of the State of the subsidiary.

3. In one of the cases the further question arises whether, in the event of the national rule in question being contrary to the Directive, a parent company which postponed receipt of a distribution until after the qualifying period on account of the rule may seek damages from the State of the subsidiary for loss of interest under the principles laid down in the judgment in *Francovich*. [2]

The relevant Community rules

4. The Directive is one of three instruments adopted on 23 July 1990 with a view to eliminating certain tax obstacles to cross-border grouping of companies established in the Community. The other instruments are Council Directive 90/434/EEC on the

* Original language: English.

1 — OJ 1990 L 225, p. 6.

2 — Joined Cases C-6/90 and C-9/90 [1991] ECR I-5357.

common system of taxation applicable to mergers, divisions, transfers of assets, and exchanges of shares concerning companies of different Member States ('the Merger Directive') [3] and the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises. [4]

5. The purpose of the Directive, according to its preamble, is to introduce rules which are neutral from the point of view of competition 'in order to allow enterprises to adapt to the requirements of the common market, to increase their productivity and to improve their competitive strength at the international level'. [5] Specifically, the Directive seeks to eliminate the tax disadvantages suffered by companies from different Member States, by comparison with companies of the same Member State, where they combine to form groups of companies. [6]

6. The need for the Directive arises from the double taxation to which groups of companies established in more than one country may be subject. Subject to specific relief granted by States either unilaterally or under bilateral agreements, the profits made by a subsidiary company are liable to be taxed both in the State of the subsidiary as trading income of the subsidiary and, upon distribution of the income to the subsidiary's parent company, as dividend income of the parent company in the latter's State of residence; the income may be subject to further taxation at the company level if the parent company is merely an intermediate holding company owned by a company in another State.

7. Moreover, States commonly impose taxes on the distribution of profits by companies, i. e. on dividends paid to shareholders. Such taxes normally take the form of a withholding tax, i. e. taxes collected at source by the paying company on behalf of the tax authorities. Withholding taxes are often used in a domestic context to ensure compliance and simplify collection; the tax withheld generally meets or is set against the liability of recipients who are resident taxpayers. Withholding taxes on cross-border dividends represent the imposition of an extra tax by the taxing State on non-residents for which the latter may not obtain relief in their State of residence.

8. In order to remove such tax obstacles for groups of companies established within the Community the Directive abolishes, subject to certain exceptions, withholding taxes on distributions of profits between subsidiary and parent companies located in different Member States of the Community and requires Member States to grant relief from double taxation to parent companies receiving distributions of profits from subsidiaries located in other Member States.

3 — OJ 1990 L 225, p. 1.
4 — OJ 1990 L 225, p. 10.
5 — First recital.
6 — Second and third recitals.

9. Article 1 of the Directive provides:

'1. Each Member State shall apply this Directive:

— to distributions of profits received by companies of that State which come from their subsidiaries of other Member States,

— to distributions of profits by companies of that State to companies of other Member States of which they are subsidiaries.

2. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse.'

10. Article 2 defines what is meant by 'company of a Member State'. It is not in dispute that the Dutch and German companies concerned in these proceedings qualify under Article 2.

11. Article 3(1) of the Directive provides:

'For the purposes of applying this Directive,

(a) the status of parent company shall be attributed at least to any company of a Member State which fulfils the conditions set out in Article 2 and has a minimum holding of 25% in the capital of a company of another Member State fulfilling the same conditions;

(b) "subsidiary" shall mean that company the capital of which includes the holding referred to in (a).'

12. The second indent of Article 3(2) of the Directive — the provision on which the contested national rule is based — provides that, by way of derogation from paragraph 1, Member States shall have the option of:

'not applying this Directive to companies of that Member State which do not maintain for an uninterrupted period of at least two years holdings qualifying them as parent companies or to those of their companies in

which a company of another Member State does not maintain such a holding for an uninterrupted period of at least two years'.

13. Article 4 imposes the obligation on the State of the parent company to grant relief from tax in respect of distributions received by parent companies from subsidiaries in other Member States.

14. Article 5 — also of immediate relevance to these proceedings — provides:

'1. Profits which a subsidiary distributed to its parent company shall, at least where the latter holds a minimum of 25% of the capital of the subsidiary, be exempt from withholding tax.

...

3. Notwithstanding paragraph 1, the Federal Republic of Germany may, for as long as it charges corporation tax on distributed profits at a rate at least 11 points lower than the rate applicable to retained profits, and at the latest until mid-1996, impose a compensatory withholding tax of 5% on profits distributed by its subsidiary companies.

...'

15. Articles 6 and 7 are not relevant to the present proceedings. By virtue of Article 8 the implementation date for the Directive was 1 January 1992.

The relevant national rules

16. Paragraph 43(1) of the Einkommensteuergesetz (German Income Tax Law, hereinafter 'the Law') provides for the charging of income tax in the form of a deduction at source from investment income referred to as investment income tax (Kapitalertragsteuer). Paragraph 20(1)(1) of the Law provides that investment income includes dividends from shares. By virtue of Paragraph 43a(1)(1) the investment income tax is fixed at 25% of the dividend income.

17. Paragraph 50d(3) of the Law provides for the application of reduced rates of investment income tax pursuant to double taxation

agreements concluded by Germany with other countries. It appears that, under the double taxation convention concluded between Germany and the Netherlands, a withholding tax rate of 15% is applicable to the distributions of profits in issue in the main proceedings.

18. Paragraph 44d(1) of the Law, which implements the reduction in withholding tax required of Germany by Article 5(1) and (3) of the Directive, provides that tax is to be charged at the rate of 5% on investment income paid to a parent company having neither its seat nor its central management in Germany from a capital company subject to unlimited tax liability in Germany (i. e. a resident subsidiary company).

19. However, Paragraph 44d(2) of the Law — the provision in issue in the main proceedings — states:

'"Parent company" for the purposes of Paragraph 44d(1) shall mean a company ... which at the moment when the investment income tax arises pursuant to Paragraph 44(1), second sentence, can show that it has held directly at least one quarter of the share capital of the capital company having unlimited tax liability for an uninterrupted period of at least 12 months.'

20. Thus, the effect of the German rules is that withholding tax is payable at the normal or tax treaty rate on dividends paid within the first 12 months following the acquisition of a German subsidiary company and is not repayable even if the parent company maintains its holding in the subsidiary company beyond that period. In these proceedings it is argued that the Directive requires Germany to apply a 5% rate of tax immediately following the acquisition.

The facts and the national court's questions

21. The plaintiffs in the main proceedings, Denkavit Internationaal BV (Case C-283/94), VITIC Amsterdam BV (Case C-291/94) and Voormeer BV (Case C-292/94), are all Netherlands companies which have holdings in German companies. All three cases are pending before the Finanzgericht Köln.

22. In Case C-291/94 VITIC increased its holding in the German company Wesumat

GmbH from 19% to 95% with effect from 2 January 1992. On 15 October 1991 it was decided to distribute Wesumat's profits for the year ended 31 December 1990 by a dividend payable on 15 January 1992. VITIC was entitled to 95% of the amount distributed. Investment income tax was withheld on the distribution at the normal rate of 25%, together with the solidarity supplement (i. e. the supplement levied as a contribution to the economic reconstruction of the new Länder). VITIC subsequently applied to the tax authority for reimbursement of the solidarity supplement and of the investment income tax in so far as it exceeded the rate of 5% permitted for Germany under Article 5(3) of the Directive. By a decision of 16 October 1992 the tax authority refunded the solidarity supplement in full, but refunded the investment income tax only in so far as it exceeded 15% of the dividend, i. e. the rate provided for in the Germany-Netherlands double taxation convention. It refused to apply the 5% rate provided for by Paragraph 44d(1) of the Law on the ground that the 12-month holding period laid down by Paragraph 44d(2) had not been completed. In its action before the Finanzgericht VITIC challenges that decision, claiming a further refund of DM 190 000.

23. Similar facts underlie the reference to the Court in Case C-292/94. Voormeer also seeks reimbursement of the investment income tax withheld by its subsidiary Framode GmbH in so far as it exceeds 5%, the tax authority having reimbursed only the solidarity supplement and the investment income tax in excess of 15% of the dividend. Voormeer claims that it is entitled to a further refund of DM 240 333.30.

24. The facts in Case C-283/94 are slightly different. Denkavit increased its holding in the German company Denkavit Futtermittel GmbH from 20% to 99.4% with effect from 14 July 1992. By an application of 6 October 1992 it sought a declaration that the 5% rate of withholding tax was applicable to dividends distributed by its subsidiary in accordance with Paragraph 50d, in conjunction with Paragraph 44d, of the Law. At the same time it gave an assurance to the tax authority that its holding in the subsidiary had since 14 July 1992 been greater than 25% and would remain so for an uninterrupted period of at least two years. However, the tax authority rejected Denkavit's application on the ground that the 12-month holding period laid down by Paragraph 44d(2) of the Law had not been complied with and merely granted the 15% withholding tax rate applicable under the tax treaty between the Netherlands and Germany for the period from 1 October 1992 to 30 September 1995. Following an unsuccessful administrative appeal and the commencement of proceedings by Denkavit, the tax authority amended its decision and authorized deduction of withholding tax at the rate of 5% from 15 July 1993 (i. e. one year after the qualifying holding was acquired) on condition that Denkavit continued to maintain a qualifying holding until after 30 September 1995. Denkavit then restricted the scope of its action to the period before 15 July 1993 and, modifying the nature of its claim, sought a

declaration that the decision was wrong in law. Its stated interest in securing such a declaration is to allow it to pursue a claim for damages in separate proceedings before other German courts. The tax authority's refusal of its application is said to have led Denkavit to postpone the distribution of profits originally scheduled for 16 October 1992, resulting in considerable loss of interest.

25. In the proceedings before the Finanzgericht Köln the companies argued that Paragraph 44d(2) of the Law was contrary to Article 3(2) of the Directive. Consequently, the Finanzgericht decided to seek a preliminary ruling from this Court on the following questions:

In Cases C-291/94 and C-292/94 (VITIC and Voormeer):

'1. Is 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 of 20 August 1990, p. 6), and in particular Article 3(2) thereof, to be interpreted as meaning that Member States are entitled to exclude a parent company resident in another Member State from the tax benefits set out in Article 5 in the case where the parent company, at the time of distribution to it of the profits referred to in that article, had not yet continuously held for a period of at least two years a minimum of one quarter of the share capital of the domestic subsidiary, but did, however, subsequently complete that minimum holding period?

2. If Question 1 is answered in the negative: is the above directive to be interpreted as meaning that a parent company which satisfies the conditions of Articles 2 and 3 of the directive can rely, as against the Member State of the subsidiary, directly on Article 5 of the directive as a basis for its right to claim exemption from or reduction in withholding tax there provided for and, if so, is protection of that right a matter for the national courts of the Member State of the subsidiary?'

In Case C-283/94 (Denkavit):

'1. Is 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 of 20 August 1990, p. 6), and in particular Article 3(2) thereof, to be interpreted as meaning that Member States are entitled to exclude a parent company resident in another Member State from the tax benefits set out in Article 5 in the case where the parent company, at the time of distribution to it of the profits referred to in that article, has not yet continuously held for a period of at

least 12 months a minimum of one quarter of the share capital of the domestic subsidiary, but has, however, given an undertaking to the relevant tax authorities of the Member State of the subsidiary that it will remain in possession of its holding in the subsidiary for a continuous period of at least two years from the date of acquisition?

2. If Question 1 is answered in the negative: is 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 be interpreted as meaning that a parent company which satisfies the conditions of Articles 2 and 3 of the Directive can rely, as against the Member State of the subsidiary, directly on Article 5 as a basis for its right to claim exemption from or reduction in withholding tax there provided for and, if so, is protection of that right a matter for the national courts of the Member State of the subsidiary?

3. If Question 1 is answered in the negative: if the Member State of the subsidiary has incorrectly transposed Article 3(2) of the Directive into national law in such a way that the minimum holding period set out in that provision must, under national legislation, already be completed before the profit distribution which is to benefit from Article 5 of the Directive, does the parent company referred to in Questions 1 and 2 have a right to compensation, according to the criteria established by the judgment of the Court of Justice of 19 November 1991 in Joined Cases C-6/90 and C-9/90 *Francovich and Others* [1991] ECR I-5357, under Community law or required by Community law against that Member State for the loss of interest which it has incurred by reason of the fact that it postponed the distribution of profits of the subsidiary, decided on during the abovementioned national minimum holding period, until the completion of that period?'

Question 1

26. The purpose of the national court's first question in all three cases is to ascertain whether Article 3(2) of the Directive permits a Member State to apply a rule denying a parent company in another Member State the withholding tax exemption in Article 5 of the Directive unless the parent company has possessed a 25% holding in the subsidiary concerned for a qualifying period. In Case C-283/94 the national court also wishes to know whether it makes any difference that the parent company has given an undertaking to maintain its holding for the requisite period.

27. Written observations have been submitted on this question by Denkavit (in Case

C-283/94) and by the Bundesamt für Finanzen, the Belgian, German, Greek, Italian and Netherlands Governments and the Commission (in all three cases). At the hearing argument was presented by Denkavit, by the French, German, Greek and Netherlands Governments and by the Commission.

28. Denkavit contends that its view that the German rule is contrary to Article 3(2) of the Directive finds support in the wording of that provision, which precludes an interpretation allowing a Member State to refuse the exemption from withholding tax until the minimum holding period has been met. That view is said to be consistent with the Directive's aim of facilitating cross-border cooperation, which would be impeded if the exemption could be refused for up to two years. It is also supported by the explanatory memorandum to the Proposal for the Directive, [7] which indicates that the purpose of Article 3(2) was to allow Member States to deny a company parent-company status retroactively where it ceased to qualify as such.

29. Denkavit is supported in its view by the Commission, which adds that Article 3(2), as a derogating provision, falls to be construed strictly and that the retroactive withdrawal of the exemption where a parent company ceases to qualify as such would not entail any significant administrative difficulties. The Commission also argues that the German rule, which presumes abuse until the contrary is proven, is contrary to the principle of proportionality.

30. The German Government, whose views are shared by the Bundesamt für Finanzen, considers that the wording of Article 3(2) is sufficiently broad to cover the German rule. The German rule would therefore be incompatible with the Directive only if a narrower view was required by the spirit and purpose of the Directive, which is not the case. The German Government considers that the tax relief granted by the State of the parent company under Article 4 of the Directive must be distinguished from the relief from withholding tax granted by the State of the subsidiary under Article 5. In the latter case the State of the subsidiary waives the withholding tax from the outset; it must therefore be clear at that point that the conditions for the withholding tax relief are met. Withholding tax is a mechanism for collecting tax whose recovery would otherwise entail considerable costs. While it would be possible for national law to provide for subsequent recovery of tax from the subsidiary or the parent company, that must be the exception rather than the rule.

31. The latitude given to Member States by the neutral wording of Article 3 may, according to the German Government, be explained by the difficulty which the State of the subsidiary would have in verifying whether the parent company complies with the minimum holding requirement. The

7 — COM(69) 6 final.

German Government acknowledges that other techniques might be employed such as not refunding the tax until after the minimum holding period has expired or granting provisional exemption from withholding tax subject to provision of a guarantee. However, in the German Government's view such solutions are incompatible with the nature of a withholding tax exemption and in any event are not required by the Directive.

32. The German Government is supported in these proceedings by the Belgian, French, Greek, Italian and Netherlands Governments. The Greek Government argues that Denkavit's interpretation does not meet the need for practical and rational rules in the tax sphere. Nor does it meet the need for legal certainty. The derogation was inserted to deny the advantages of the Directive to temporary groupings by restricting them to groupings of a long-term and strategic nature. That objective implies the laying down of criteria providing a degree of certainty and permanence. On Denkavit's view special administrative procedures would have to be put in place, undermining the simplicity of the rules and entailing disproportionate costs. Conditional or provisional relief would also give rise to uncertainty both for individuals and for the tax authorities and entail adverse financial consequences for Member States. The Greek Government adds that historical arguments based on the reasons given by the Commission for its proposal are of limited value given that the Directive was subject to lengthy negotiations lasting over 25 years.

33. The Netherlands Government observes that, although the Netherlands rules allow the withholding tax exemption to be granted immediately in certain circumstances if satisfactory undertakings are given by the subsidiary, the Directive permits the adoption of more restrictive rules. The Netherlands rules are less restrictive in order to create a favourable fiscal environment in the Netherlands.

34. Before examining those arguments it may be helpful briefly to summarize the use made by the Member States of the option granted by the second limb of the second indent of Article 3(2) of the Directive. It appears that, with the exception of Portugal (whose legislation does not deal with the point expressly), the ten Member States which have made use of the option (i. e. Austria, Belgium, Denmark, France, Germany, Italy, Luxembourg, the Netherlands, Portugal, Spain) expressly require that the qualifying period — which in some cases has been reduced from two years to one year — should in principle have been completed before the distribution is made. [8] However, under the Austrian legislation the subsidiary company or non-resident parent company may apply for a refund of the tax withheld once the holding period is completed. [9]

8 — Paragraph 94a of the Austrian Income Tax law; Article 106(5) of the Belgian Royal Decree of 27 August 1993; Article 2(5) of the Danish Law of 2 August 1994 on taxation of companies; Article 119b(2)(c) of the French General Tax Code; Paragraph 44d(2) of the German Income Tax Law, cited above; Article 2(1) of Italian Decree No 136/93; Article 147(1) of the Luxembourg Income Tax Law; Article 4a of the Netherlands Law of 1965 on the taxation of dividends; Article 17(2) of Spanish Law No 29 of 16 December 1991 and Article 46 of Law No 43 of 27 December 1995, reducing the holding period from two years to one.

9 — Paragraph 94a(2)(2) of the Austrian Income Tax Law.

Moreover, under the Netherlands rules the withholding tax exemption may be granted immediately if the subsidiary company lodges a security equal to the amount of the tax foregone. [10]

35. Although in these proceedings the Netherlands Government supports the German Government's position, it seems to me that there is a fundamental difference between the Netherlands and Austrian legislation and the German rule. Whereas the effect of the German rule is to impose tax definitively on any distribution made by a German subsidiary company within the first year following its acquisition by a non-resident parent company, the Austrian and Netherlands rules, although either imposing tax provisionally during the qualifying period or requiring the lodging of a security equal to the amount of the tax, ultimately grant exemption in respect of that period provided that certain conditions are met. They do not, as the Commission put it at the hearing, treat groups of companies in an identical manner regardless of whether the holding period is complied with.

36. Turning therefore to the interpretation of Article 3(2), I consider first of all that the wording of the provision is more consistent with the view of Denkavit and the Commission than with that of the Governments which have taken part in these proceedings. Article 3(2) gives Member States the option of 'not applying this Directive ... to those of their companies in which a company of another Member State does not maintain such a holding for an uninterrupted period of at least two years'. The effect of that wording, and in particular the use of the present tense ('does not maintain'), [11] is to authorize the Member States to refrain from applying Article 5 of the Directive in cases where the parent company fails to maintain its holding for two years. It does not give a Member State the option of refusing to grant the exemption at all in respect of the initial period, even in the case where the parent company does maintain its holding in the subsidiary for that period.

37. There is nevertheless an ambiguity in the wording of Article 3(2) in so far as it is unclear at what point a Member State should determine whether the holding requirement is met. In other words it is unclear whether a Member State must — as Denkavit and the Commission suggest — provisionally apply the Directive and, where it subsequently transpires that the requirement is not met, impose the tax retroactively or whether it may — like Austria — provisionally impose the tax (or, like the Netherlands, require the lodging of a security equal to the tax) until it is satisfied that the holding requirement has been complied with. As I shall explain

10 — Article 4b(1) of the 1965 Law on the taxation of dividends.

11 — See also, for example, the French ('ne conserve pas'), Dutch ('niet behoudt'), German ('nicht hält'), Italian ('non conservi'), Portuguese ('não conserve') and Spanish ('no conserve') language versions. The Danish version, which uses the past tense of the verb 'maintain' ('har besiddet'), appears to be out of line with the other language versions.

below, I consider it appropriate to allow Member States the discretion to choose between those two possibilities.

38. To go beyond that, however, by interpreting Article 3(2), contrary to its wording, as allowing Member States to impose withholding tax definitively at the normal rate for a period of up to two years in every case would be inconsistent with the purpose of the Directive. Contrary to the Governments' view, such an interpretation would be liable to constitute a barrier to cross-frontier cooperation, since the inability of a parent company to receive a dividend from a newly acquired subsidiary company for up to two years without incurring withholding tax is a disadvantage that would have to be taken into account in the context of any proposed restructuring or grouping operation. As Denkavit's case shows, liability to withholding tax constitutes an inducement to postpone the payment of a dividend until the end of the qualifying period. A parent company may however need to receive an immediate distribution from its subsidiary company in order to finance any loan, or provide an adequate return on equity capital, which it has raised in order to acquire the subsidiary. The provisional withholding of tax or the requirement to lodge a security is a less serious impediment since a distribution of profits may still be made in the knowledge that the withholding tax exemption will ultimately be granted provided that the holding requirement is met.

39. The interpretation proposed by the Governments that have taken part in these proceedings is moreover disproportionate to the aim of Article 3(2), which is to prevent the benefits of the Directive from being claimed in respect of short-term acquisitions not falling within the objectives of the Directive. As the Austrian and Netherlands rules show, that aim may be achieved by less restrictive measures, such as a requirement that the subsidiary should withhold tax provisionally during the qualifying period or that a security equal to the tax should be lodged.

40. I am not persuaded by the argument put forward by the Governments based on the nature of withholding tax or the administrative difficulty of applying less restrictive rules. I accept the German Government's point that one of the key features of a withholding tax is that of simplified administration and collection, particularly in the case of cross-border payments. However, while that might justify provisional collection of the tax until the parent company provides evidence that it has complied with the holding requirement, I do not think it is inherent in the nature of a withholding tax that there can never be a refund of tax where the tax deducted at source exceeds the liability of the recipient. The refund of taxes withheld on various categories of income is not uncommon in either a domestic or a cross-border context.

41. It may be true that in the case of cross-border dividend payments the two functions of a withholding tax normally coincide: the withholding tax meets the liability of the non-resident recipient in the State of the paying company as well as serving as the mechanism by which the tax is collected. Consequently, the amount collected is normally the amount definitively due, so that the question of a refund does not arise. The point is however that a company which complies with the holding requirement provided for by Article 3(2) of the Directive has no tax liability. In such circumstances the withholding tax can serve as no more than a means of provisional collection. The definitive imposition of a withholding tax is justified only in the case of companies which have such a liability because they do not meet the holding requirement.

42. I do not think that it would impose an intolerable burden on tax authorities if they were obliged to refund overpaid tax to parent companies demonstrating that they had complied with the holding requirement. Monitoring taxpayers' affairs and making any necessary adjustments forms part of the daily business of tax authorities, and it seems unlikely that such an obligation would add greatly to their workload. When specifically questioned on this point at the hearing the Governments failed to point to any significant difficulties, and indeed the German Government acknowledged that it would be technically possible to refund the tax. Support for that view is again provided by the Austrian rules, which allow reimbursement of tax upon application by the taxpayer in due form. Moreover, other solutions not involving actual refund of tax, such as the provision of bank guarantees, may be possible.

43. I do not accept the Greek Government's argument that the refusal to refund withholding tax paid within the first two years following an acquisition is justified by the need of tax authorities and taxpayers for legal certainty. As the Commission suggests, the presumption must be that a distribution by a subsidiary company to its parent company is covered by the Directive and is exempt from tax. Member States should, if necessary, plan their budgets on that basis. As far as the taxpayer is concerned, I fail to see how it can seriously be argued that the refund of tax upon completion of the holding period would infringe his interest in legal certainty.

44. It may even be doubted whether Member States can justify provisional taxation or requiring the lodging of securities equal to the tax. Provisional exemption might be the proper mode of implementation. I am not wholly persuaded by the argument that provisional exemption cannot be granted because Member States might encounter difficulty in recovering the tax forgone from subsidiary companies established within their territories. It would be open to Member States to provide that subsidiaries are jointly liable for the tax. It seems to me that recovery of the tax from a resident subsidiary company would be no more difficult

than recovery of other taxes on income and gains from resident taxpayers. Moreover, even in the event of liquidation tax authorities in some cases have preferential claims.

45. It is also difficult to reconcile that argument with the premise underlying the Merger Directive. [12] That directive requires Member States to defer taxation of gains on the disposal of assets in connection with *inter alia* mergers, divisions and transfers of assets involving companies belonging to two or more Member States. The Directive is expressly based on the assumption that the financial interests of the Member States can be preserved notwithstanding the deferral of taxation because such operations normally involve the transformation of the company transferring the assets into a permanent establishment, located within the territory of the State of the transferring company, of the company receiving the assets or in the assets becoming connected with a permanent establishment of the latter company. [13] In other words the State of the transferring company may grant deferral of taxation in the knowledge that the assets, despite being transferred to a company resident in another Member State, will continue to be connected with a permanent establishment of that company within its territory, allowing it to tax the ultimate disposal of the assets by that company. Thus in agreeing to the adoption of that directive the Member States evidently considered that the risk of not being able to recover the deferred tax from the permanent establishment of a non-resident receiving company was acceptable; it seems to me that the risk of loss of revenue arising from deferral of taxation in such circumstances is much greater than in the present context.

46. Nevertheless I accept the Governments' general proposition that Member States must be given some latitude to adopt arrangements under Article 3(2) that are workable and also effective in preventing abuse. In particular, as the Netherlands Government suggested at the hearing, recovery of tax might prove difficult in the case of an arrangement specifically devised to make improper use of the advantages conferred by the Directive. For that reason — and in view of the above-mentioned ambiguity of the wording of Article 3(2) — I do not share the view of Denkavit and the Commission that Article 3(2) should be interpreted as requiring a Member State to grant immediate exemption, thus compelling it to seek to impose the tax retroactively where it transpires that the holding requirement has not been met. As already explained, the provisional imposition of withholding tax, although impeding cross-border grouping, is likely to be a much less serious obstacle than the German rule in issue here. It seems to me therefore that a Member State should be free, if it considers it necessary, to withhold tax provisionally until it can be reasonably satisfied that the holding requirement has been met, or to require a security equal to the tax to be lodged, provided that the Member State does not apply its rules in an arbitrary

12 — Cited at note 3.

13 — See in particular the fifth and sixth recitals in the preamble.

manner. In accordance with the principle of equal treatment for claims based on Community law, interest should be payable on the refund of any tax withheld on the same terms as those applicable to refunds of tax under domestic rules.

47. Consequently, in reply to the national court's first question in the three cases, I consider that a Member State is not entitled to deny a parent company located in another Member State the withholding tax exemption provided for by Article 5 of the Directive where the minimum holding period has not yet expired at the moment of the distribution. It may however impose tax provisionally or require the lodging of a security equal to the tax until it receives evidence that the minimum holding period has been completed. It is not obliged to grant immediate exemption where the parent company gives an undertaking that it will comply with the minimum holding period.

Question 2

48. By its second question, which is to the same effect in all three cases, the national court seeks guidance on whether Article 5 of the Directive has direct effect and whether a parent company can rely on that provision before the courts of the State of the subsidiary.

49. Denkavit and the Commission propose an affirmative reply to that question. Denkavit observes that, notwithstanding Article 3(2), it is possible to identify minimum rights conferred by the Directive. The Commission considers that the Court's reply should be sufficiently broad to take account of the position of a subsidiary company.

50. The Bundesamt and the Governments have not expressed a view on the second question.

51. I share Denkavit's view that the wording of Article 5 is both unconditional and sufficiently precise. Moreover, as Denkavit points out, it is well established that the fact that a degree of latitude is left to Member States does not preclude the direct effect of a provision of a directive if it is possible to determine minimum rights. [14] It seems to me that the options granted to Member States by Articles 1(2), 3(2) and 5(2) to (4) of the Directive do not make it impossible to determine the minimum rights conferred by Article 5. Notwithstanding the second indent of Article 3(2) and Article 5(3), the Directive confers the minimum right on a parent company receiving a dividend from a German subsidiary company not to be required to

14 — See, for example, Case C-91/92 *Faccini Dori* v *Recreb* [1994] ECR I-3325, paragraph 17 of the judgment.

pay withholding tax at a rate of more than 5% provided that it maintains its holding in the subsidiary company for a period which may be fixed at no more than two years.

52. I do not think, moreover, that the direct effect of Article 5 is negated by Article 1(2) of the Directive, which provides that the Directive does not 'preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse'. It seems to me that the limits of the power conferred upon Member States by that provision are capable of judicial determination; the contrary view would severely undermine the effectiveness of the Directive. Article 1(2) has in any event not been directly relied upon in these proceedings.

53. The procedures for recovery of tax on the basis of the Directive are however a matter for national law. Subject to the overriding requirement of effective protection for rights based on Community law, it is therefore for national law to determine the procedures by which a parent company should exercise its rights under the Directive. In the framework of such procedures a parent company may rely upon Article 5 of the Directive before the courts of the State of the subsidiary.

Question 3

54. By its third question in Case C-283/94 the national court asks whether, on the assumption that the national rule in question is contrary to Article 3(2) of the Directive, a parent company which postponed the distribution of profits until the holding period had elapsed has a claim in damages for loss of interest against the State of the subsidiary under the principles laid down in *Francovich*.

55. Denkavit contends that the requirements laid down by the Court in *Francovich* are met: the result prescribed by Article 5(3) of the Directive entails the grant of rights to individuals; the content of those rights can be identified on the basis of the provisions of the Directive; and there is a causal link between the breach and the loss of interest.

56. The Commission observes that the obligation to make reparation for damage laid down by the Court in *Francovich* is of a subsidiary nature in relation to primary remedies available to individuals where a directive has not been correctly implemented. If the provision concerned has direct effect, the question of reparation by way of damages no longer arises.

57. The Bundesamt contends primarily that the action before the national court is not an action for damages, and hence the question put by the national court has no relevance to the dispute.

58. The Bundesamt observes further that, in contrast to the situation in *Francovich*, Germany has implemented the Directive; moreover, the German rules, if unlawful, do not entail a manifest infringement of Community law.

59. The German Government has not submitted observations on the third question. However, it questions how it is possible that Denkavit sustained a loss given that it was open to its German subsidiary to invest the funds which it retained.

60. Contrary to the Bundesamt's view, I do not think it can be concluded that the national court's question has no relevance to the proceedings before the Finanzgericht. The Court has consistently held that a request from a national court may be rejected only if it is obvious that the request bears no relation to the actual facts of the case or subject-matter of the main action. [15] The order for reference indicates that, following the amendment by the Bundesamt of its decision during the proceedings, Denkavit limited its action to the period prior to 15 July 1993 and altered its claim so as to seek a declaration from the Finanzgericht that the Bundesamt's decision was wrong in law. Its declared purpose in seeking such a declaration was to provide the basis for a claim for damages in separate proceedings before other German courts. Questioned by the Court at the hearing Denkavit explained that under the relevant German procedural rules it could obtain such a declaration from the Finanzgericht only if it had a legitimate interest in doing so; the Finanzgericht's third question was to be seen in that light. Thus, although Denkavit does not seek damages in the proceedings before the Finanzgericht, it cannot be concluded that the latter's question has no relevance to the facts of the case or the subject-matter of the main proceedings. I would add that it is not for the Court to inquire whether, under the German rules governing the procedure and organization of courts, Denkavit was entitled to amend its claim so as to seek the declaration in question in the proceedings before the Finanzgericht. [16]

61. On the other hand, I share the Bundesamt's view that Community law does not impose an obligation on Germany to pay compensation to Denkavit for any loss or damage which the latter may have incurred on account of the incorrect implementation

15 — See, most recently, Case C-446/93 *SEIM*, judgment of 18 January 1996, [1996] ECR I-73, paragraph 28.

16 — See for example Case C-10/92 *Balocchi* [1993] ECR I-5105, paragraphs 16 and 17 of the judgment.

of the Directive. As the Court held in *Francovich* [17] and *Brasserie du Pêcheur*, [18] the conditions under which a State incurs an obligation to make reparation for loss or damage depend on the nature of the breach. In its recent judgment in *British Telecommunications* [19] the Court laid down the principles governing the liability of the State in damages in circumstances where a Member State had sought to implement a directive in national law but had done so incorrectly. The Court held that, in view of the legislative discretion accorded to Member States in implementing a directive, a Member State incurred liability in damages on account of incorrect implementation only where the restrictive conditions laid down in *Brasserie du Pêcheur* were met, in particular where the infringement was sufficiently serious. An infringement was sufficiently serious where a Member State had, in the exercise of its legislative power, manifestly and gravely disregarded the limits placed on the exercise of those powers.

62. In *British Telecommunications* the Court, while acknowledging that it was in principle for national courts to verify whether the relevant conditions were met, took the view that it was in a position to appraise the facts of the case itself. Among the factors to be taken into account were the degree of clarity and precision of the rule infringed. The United Kingdom's interpretation of the provision concerned, although differing from that of the Court, was reasonable and was made in good faith. The interpretation was shared by other Member States and was not manifestly contrary to the wording of the Directive or its aim. Nor was there any guidance to be derived from the Court's case-law or from any position taken by the Commission. The Court concluded that in the circumstances the conditions were not met for the United Kingdom to incur liability in damages.

63. It seems to me that the same applies in the present case. The Court is in a position to verify itself whether the relevant conditions are met. Although I have suggested that the Court should not adopt Germany's interpretation of Article 3(2) of the Directive, I do not think that interpretation can be said to be manifestly contrary to the wording and aim of the Directive. Its view is shared by a number of other Member States. Moreover, there is as yet no case-law on the Directive.

64. Consequently, I do not think that Community law confers on Denkavit a right to compensation for any loss which it may have suffered as a result of the postponement of the distribution by its subsidiary. The position would be otherwise only if national law conferred such a right in comparable circumstances.

17 — Cited at note 2, paragraph 38 of the judgment.

18 — Case C-46/93, judgment of 5 March 1996, [1996] ECR I-1029, paragraph 38.

19 — Case C-392/93, judgment of 26 March 1996 [1996] ECR I-1631.

Conclusion

65. Accordingly I am of the opinion that the questions referred to the Court by Finanzgericht Köln in Joined Cases C-283/94, C-291/94 and C-292/94 should be answered as follows:

(1) Article 3(2) of Council Directive 90/435/EEC does not permit a Member State to deny a parent company the exemption from withholding tax on profits distributed by its subsidiary company granted by Article 5 of the Directive where the minimum holding period envisaged by the second indent of Article 3(2) has not yet been completed at the moment of the distribution. A Member State may however withhold tax provisionally or require the lodging of a security equal to the tax until the parent company provides evidence that the minimum holding period has been completed. A Member State is not obliged to grant immediate exemption from withholding tax to a parent company which gives an undertaking that it will remain in possession of its shares until the expiry of the minimum holding period.

(2) A parent company may rely directly upon Article 5 of the Directive against the authorities of the Member State of the subsidiary before the courts of that State in accordance with the procedures laid down by that State.

(3) Community law does not confer on a parent company a right to compensation in circumstances such as those of the present case for any loss of interest which it may have incurred as a result of the postponement of a distribution of profits.