EU Court: (former) French and German tax anti-abuse rules not in line with EU law

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The Court of Justice of the European Union (CJEU) issued two important judgments regarding abuse presumptions in relation to dividend distributions by French and German companies to parent companies resident in other EU Member States, of which the shareholders themselves were not entitled to a withholding tax exemption. In a pure domestic situation, the dividends would have been exempted from dividend withholding tax. In the cross-border situation at hand, an anti-abuse rule applied. Based on the CJEU judgments, the EU freedom of establishment as well as the EU Parent-Subsidiary Directive (PSD) does not allow an EU Member State to introduce domestic legislation that presumes abuse if certain pre-determined criteria are met. The CJEU states that, to be allowed to withhold the benefits of the EU freedoms or the PSD to an EU parent company, the tax authorities in the source country need to carry out an individual examination of the whole operation at issue to determine whether the operation pursues an objective of fraud or abuse and must be regarded as a wholly artificial arrangement which does not reflect economic reality.

Background of the cases

The judgments of the CJEU in the Eqiom and Enka case (C-6/16) (France) and the joined cases Deister Holding AG (C-504/16) and Juhler Holding A/S (C-613/16) (Germany) both concern non-resident EU holding companies receiving dividends from a domestic subsidiary in which they hold interests ranging from 26.5% to 100%, on which withholding tax was levied. Referring to the PSD and the EU freedoms, the companies applied for an exemption or claimed a refund of dividend withholding tax. In both cases, the requests had been refused.

The French case concerns an anti-abuse clause that denies the exemption if the dividends are paid to an EU parent company that is directly or indirectly controlled by one or more non-EU companies. However, the recipient of the dividends will qualify for the exemption if it can demonstrate that benefitting from the exemption is not (one of) the principal purpose(s) of the structure.

The German case also concerns an anti-abuse clause. An exemption or refund is denied if the non-resident EU parent company's shareholders of the interposed holding company would not be entitled to the exemption or refund if they had received the German dividends directly, and one of the following three conditions is satisfied:

1. there are no economic or other substantial reasons for the involvement of the non-resident parent company;
2. the non-resident parent company does not earn more than 10% of its entire gross income for the financial year in question from its own economic activity; or
3. the non-resident parent company does not take part in general economic commerce with a business establishment suitably equipped for its business purpose.

Decision of the CJEU

The CJEU concluded that the French and German anti-abuse provision both constitute an infringement of the EU PSD as well as the EU freedom of establishment. The CJEU concludes that the infringement can only be justified if its specific objective is to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, the purpose of which is unduly to obtain a tax advantage.

The CJEU further specified how this justification should be applied in practice, stating that the competent national authorities may not confine themselves to applying predetermined general criteria, but must carry out an individual examination of the whole operation at issue.

Our observations

If domestic measures contain a presumption of fraud or abuse and apply automatically, or do not require the tax authorities to provide prima facie evidence of fraud or abuse, these measures go further than is necessary for preventing fraud or abuse and therefore are not in line with EU law. Furthermore, the judgements make clear that a case-by-case analysis of the relevant situation is required, based on factors including the organizational, economic or other substantial features of the group and the structures and strategies of that group.

The Netherlands exempts dividend distributions to a parent company that owns 5% or more of the shares in a Dutch company, provided that (i) the parent company is the beneficial owner of the dividend, (ii) is a resident of an EU Member State or a tax treaty country, which tax treaty contains a dividend article and (iii) there is no abuse of law. If the parent company is an intermediate holding company, specific substance requirements apply (for more information: The Netherlands - Budget 2018 - Dividend withholding tax and non-resident taxation) if the main purpose or one of the main purposes of the interposed holding company was the avoidance of Dutch dividend withholding tax (or Dutch personal income tax). To determine the purpose of a holding structure, the Dutch tax authorities generally apply a look-through approach. If the Dutch tax burden would have been higher than without the interposed holding company, it is often presumed that there is a Dutch tax avoidance purpose. On basis of these EU judgements, it is questionable whether the Netherlands is allowed to apply such look-through approach and assume an avoidance purpose. Second, it is questionable to presume that the structure is wholly artificial, if one or more of the specific substance requirements are not met. On basis of these EU judgements, the Dutch tax authorities should carry out an individual examination of the whole operation to determine whether there is a situation of abuse or fraud.

A company that faces a Dutch tax levy on dividend distributions on basis of the new Dutch anti-abuse rule should carefully consider with his tax advisor whether the Dutch tax authorities have complied with these EU judgements.

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