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For more detailed information, please do not hesitate to contact:

Emmanuel Raingard de la Blétière –
PwC France
+33 (0) 1 56 57 40 14
emmanuel.raingard@pwcavocats.com

Or your usual PwC EUDTG contact

EU Direct Tax Newsalert

CJEU rules on incompatibility of French withholding tax on dividends received by loss-making non-resident companies with EU law

On 22 November 2018, the Court of Justice of the European Union (CJEU) issued its judgment in the French case *Sofina* (C-575/17). The CJEU held that the French legislation under which non-resident companies in a loss-making position are subject to a definitive withholding tax on the French sourced dividends is incompatible with the free movement of capital, and that no overriding reason of public interest may justify such restriction.

Background

Under French law, a resident company, which receives dividends from another French company, is subject to corporate income tax at 33.33% whereas a non-resident company is subject to a withholding tax of 30% (25% at the time of the case) except in those instances when the Parent-Subsidiary regime is applicable. A French resident company in a loss-making position can offset its losses against the dividends received. As a result, the French resident company is not effectively taxed in relation to this income during the relevant fiscal year while a non-resident company in a loss-making position is always subject to an immediate and definitive French withholding tax on its French sourced income.

Judgment

The CJEU ruled that the law created a restriction on the free movement of capital since:

- (i) the deferred taxation of the revenue which only applies to resident companies constitutes a disadvantage in terms of cash-flow, which infringes the free movement of capital;
- (ii) the existence (or lack thereof) of a difference in treatment must be analysed on the basis of each fiscal year; and
- (iii) in case the resident company ceases its activities, the tax deferral becomes a definitive tax exemption, which only applies to resident companies.

The CJEU established that a tax disadvantage borne by a non-resident cannot be compensated by another advantage such as a reduced withholding tax rate (i.e. when it

is lower than the applicable rate to residents), or by the fact that the legislation at stake does not infringe EU law in all situations.

As regards the justifications, the CJEU reiterated that residents and non-residents are comparable, and that the *Truck Center* (C-282/07) line of reasoning cannot be relied upon when the legislation at stake leads to an earlier or higher taxation for non-residents. Moreover, the CJEU considered that such legislation cannot be justified by overriding reasons in the public interest such as the balanced allocation of taxing powers among EU Member States or the effective collection of tax. In this respect, the CJEU held that if the advantage that arose for French resident loss-making companies due to the deferral of taxation would have been extended to loss-making non-resident companies, the restriction would have been eliminated without impeding the achievement of the aims pursued by French law.

Takeaway

The CJEU has refined its case law regarding withholding taxes applicable to non-resident companies. As this judgment will have to be applied in all EU jurisdictions having a similar tax system, EU Member States should now be required to offer the possibility to defer the taxation of revenue (and to exempt it where they ceased trading without becoming profitable after receiving it) also to non-resident loss-making companies. This judgment should also likely have an impact on other types of revenue for which withholding taxes apply in the source country (e.g. royalties, interest, and sometimes capital gains). Moreover, as the judgment is based on the free movement of capital (Art. 63 TFEU), it may have an impact with respect to non-resident companies established in a third country.

Even if the conditions of such regime need to be further defined (notably concerning the definition of a loss-making company, whether such deferral can be limited in time and in amount depending on the legislation applicable to resident companies, and the proof and administrative follow-up requirements), this judgment reopens great possibilities on the issue of withholding taxes within the EU.

