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ECJ refrains from formal ruling on Belgian participation exemption as regards Belgian and non-EU dividends

On 4 June 2009, the European Court of Justice (ECJ) delivered its decision in the cases *KBC v Belgium* (C-439/07) and *Beleggen, Risicokapitaal, Beheer NV v Belgium* (C-499/07), which involve the compatibility of the Belgian dividends received deduction (DRD) regime with the EC Parent-Subsidiary Directive and with the freedom of establishment and the free movement of capital principles in the EC Treaty.

Not surprisingly, the ECJ simply confirmed its February 2009 decision in the *Cobelfret* case, in which it concluded that the DRD - as it applies to EU dividends - is not compatible with the EC Parent-Subsidiary Directive. *Cobelfret* did not encompass the treatment of dividends received from subsidiaries resident in third (i.e. non-EU) countries or dividends received in a purely domestic (Belgian) situation. In *KBC* and *Beleggen*, however, the ECJ declined to issue a formal ruling on whether dividends received by Belgian companies from other Belgian companies or from companies resident in third countries can be treated less favorably than EU dividends. Instead, the ECJ referred these questions back to the Belgian courts to decide.

EC Parent-Subsidiary Directive

The EC Parent-Subsidiary Directive establishes a common system of taxation applicable to parent companies and subsidiaries of different EU Member States to prevent the double taxation of dividends. When a subsidiary in one Member State distributes dividends to its parent company in another Member State, the country of the parent company must either: (1) refrain from taxing the dividends; or alternatively (2) grant a tax credit for the corporate income tax paid by the subsidiary on the underlying profits.

Belgian DRD regime

In its implementation of the Parent-Subsidiary Directive, Belgium elected to refrain from taxing previously taxed profits/dividends distributed by the subsidiary (i.e. the first option). Belgium currently grants a 95% deduction for dividends on participations representing at least 10% of the subsidiary's nominal share capital or, alternatively, participations with an acquisition value of at least EUR 1.2 million, provided the participation has been held for at least one year and it qualifies as fixed financial assets.

However, because of the domestic tax rules relating to the determination of a Belgian company's taxable base, in certain cases Belgian parent companies may not be effectively entitled to a full 95% DRD on dividends received. This is especially the case for Belgian taxpayers (companies and branches) with a taxable income lower than

95% of the dividends received or a current-year tax loss, as the latter are also not allowed to carry-forward or carry-back any “excess DRD”.

Facts of the case

The facts of the cases concerned two Belgian resident companies that received dividends from Belgian and EU companies, and one of the companies also received dividends from non-EU resident companies. Because of an insufficient taxable basis, part of the DRD was lost, since no carry-forward was allowed to subsequent years.

Questions referred to the ECJ

In addition to the issue of the compatibility of the Belgian DRD regime with the Parent-Subsidiary Directive as regards Belgian and EU-dividends (as the DRD does not allow a full 95% deduction in all cases), two additional questions were referred to the ECJ, namely, whether the freedom of capital should allow a claim for an “excess” DRD for non-EU dividends and whether the DRD regime should provide for a 100% exemption from Belgian taxation (similar to the Belgian exemption rules for permanent establishments located in treaty countries).

Decision of the ECJ

Intra-EU dividends: The ECJ reiterated its decision in the *Cobelfret* case, concluding that Belgium failed to implement the Directive correctly because it does not effectively refrain from taxing dividend income in all situations.

Domestic dividends: Because the ECJ has jurisdiction only to examine the meaning of European law, it does not take a position with respect to domestic dividends; instead, the ECJ referred the question back to the Belgian courts who will need to decide whether domestic dividends must be treated in the same manner as intra-European dividends.

Non-EU dividends: The ECJ decided that, if dividends from third countries are treated less favorably than Belgian dividends, it is up to the national courts to determine whether the free movement of capital is applicable and whether this principle precludes the difference in the treatment of the dividend distributions.

According to the ECJ, it may be possible to justify a restriction of the free movement of capital with respect to non-EU countries, even though such a restriction may not be justified with respect to EU Member States. In this respect, the ECJ refers to the extensive administrative cooperation between the tax authorities of the Member States.

100% dividend exemption: According to the ECJ, the different treatment of EU branch profits and EU (100% exemption versus a 95% deduction) does not constitute a violation of the freedom of establishment, at least if Belgian-source profits are treated the same as profits from other EU Member States.

Comments

As expected, the ECJ simply confirmed its decision in *Cobelfret* with respect to intra-EU dividend distributions, but to the surprise of many, the ECJ did not reach a formal conclusion with respect to domestic and non-EU dividends, by referring the questions back to the national courts.

The outcome of the proceedings, while unexpected, can be considered as positive in the sense that the ECJ did not strike down the position of the taxpayers.

Also, since the Belgian legislator did not distinguish between EU and domestic dividends when implementing the Parent-Subsidiary Directive, we believe that the national courts should in principle conclude that the principles of the *Cobelfret* decision also apply in the case of domestic dividends. Since the Belgian government has prepared a draft administrative circular that extends the *Cobelfret* decision to domestic dividends, a formal analysis by

national courts may not be required on this issue.

Although we will need to await a decision by the national courts on the issue of dividends from third countries, it is difficult to imagine on what basis a national court could allow the different treatment of intra-EU and non-EU dividends, especially considering that the Belgian DRD regime is not dependent on a cooperation or exchange of information between the tax authorities of the different states involved. Even if cooperation would be considered an important element from a technical perspective, it may not always lead to a different conclusion since most of Belgium's tax treaties include an exchange of information clause. However, given the underlying technical basis (free movement of capital), the treatment applicable to EU (and domestic) dividends could, in principle, only apply to non-EU dividends from non-controlling shareholdings (in principle, shareholdings representing less than 50% of capital or voting rights)..

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