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EU tax alert

CJEU rules French 3% dividend surtax on EU-source redistributions violates parent-subsidiary directive

On 17 May 2017, the Court of Justice of the European Union (CJEU) ruled that dividends distributed by a French company that represent a redistribution of dividends the company previously had received from its EU subsidiaries cannot be subject to the French 3% surtax on profit distributions. The court concluded that subjecting such dividends to the surtax would be a form of a double taxation prohibited by the EU parent-subsidiary directive (PSD).

Background

Introduced in 2012, the 3% surtax is levied on French entities subject to corporate income tax, including French permanent establishments of foreign companies. The surtax is levied at the level of the distributing company and is calculated on the gross amount of the dividend, with the tax due at the time of the distribution. The surtax is levied on most dividend distributions (including deemed dividends). French tax law does not provide a mechanism to avoid a double (or multiple) levying of the surtax where dividends are distributed up a chain of companies.

The surtax has been the subject of considerable controversy, and the scope of the exemption from the surtax was broadened as from 1 January 2017 (for prior coverage, see the **tax alert dated 23 December 2016**).

On 27 June 2016, France's Administrative Supreme Court requested a preliminary ruling from the CJEU on whether the 3% surtax on dividend distributions is compatible with the PSD (for prior coverage, see the *World Tax Advisor* **article dated 9 September 2016**). The CJEU has now issued its decision, which generally follows the opinion of Advocate General (AG) Kokott issued on 17 November 2016 in a case concerning the Belgian fairness tax (which is very similar to the French 3% surtax). In that case, AG Kokott concluded that the fairness tax was incompatible with the PSD to the extent redistributed qualifying dividend income would be subject to the fairness tax. (The CJEU also issued its decision in the Belgian fairness tax case on 17 May 2017, essentially following the opinion of AG Kokott.)

Decision of the CJEU

The CJEU ruled that, since the purpose of the PSD is to prevent double taxation on profits distributed by an EU subsidiary to its EU parent company, member states may not subject a parent company to a tax burden on profits received from its EU subsidiaries that exceeds taxation of 5% of the profits distributed by the subsidiary (i.e. the ceiling provided in article 4(3) of the PSD).

Under the French participation exemption regime, dividends are 95% exempt in the hands of the parent company (with 5% representing deemed taxable expenses). Therefore, when a French parent company redistributes dividends it has received from an EU subsidiary, those profits are subject to a total tax burden (tax on the deemed taxable expenses, plus the 3% surtax on the same dividends) that is higher than the maximum ceiling permitted by the PSD.

The court held that, under these circumstances, the 3% surtax creates double taxation at the level of the parent company, which is in breach of the PSD.

The CJEU considered that it was not necessary to answer the related question referred by the French court on whether the 3% surtax should be considered a withholding tax prohibited by article 5 of the PSD. However, in its decision concerning the Belgian fairness tax, the court ruled that because the taxable person that owes the fairness tax is not the recipient of the distribution, but rather the company distributing the profits, the fairness tax cannot be considered a withholding tax. The French 3% surtax also is imposed on the distributing company, so the same rationale should apply to the surtax.

Comments and consequences of decision

French parent companies that have distributed profits received from their EU subsidiaries should be able to obtain reimbursement of the excess 3% surtax paid from the French tax authorities. To do so, they will have to provide evidence on which amounts should have been excluded from the taxable base as redistributed dividends. To protect their rights to a refund, affected companies should submit their claims promptly and, in any case, before 31 December 2017 for the tax paid in 2015, to avoid being barred by the statute of limitations.

As noted above, the 3% surtax has been subject to considerable controversy, and the CJEU decision does not answer all the remaining questions. In particular, in light of the decision, the application of the surtax on redistributions of dividends from French and non-EU subsidiaries also could be criticized (on the grounds of the equality principle of the French constitution). Other arguments that the surtax infringes the EU freedom of establishment or France’s tax treaties still must be examined by the tax courts.

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