OPINION OF ADVOCATE GENERAL

GEELHOED

delivered on 6 April 2006 (1)

Case C-513/04

Mark Kerckhaert

Bernadette Morres

v

Belgische Staat

(Reference for a preliminary ruling from the Rechtbank van Eerste Aanleg te Gent (Belgium))

(Interpretation of Article 56(1) EC – Restriction resulting from a national income tax provision – Domestic and foreign dividends – Uniform tax rate – Tax burden higher in regard to dividends from shareholdings in companies established in another Member State – Taxation at source – Not taken into account – Free movement of capital – Discrimination)

I – **Introduction**

1. In the present preliminary reference procedure, the Rechtbank van Eerste Aanleg te Gent (Court of First Instance, Ghent, Belgium) asks whether it is contrary to Article 56 EC for a Member State such as Belgium to subject dividends from resident and non?resident companies to the same tax rate, without in the latter case taking into account tax levied at source in that other Member State.

2. This raises again the questions of the scope of the Article 56 EC prohibition on restrictions on movement of capital as regards dividend taxation and, indirectly, whether the prohibition set out in this Article as such requires Member States to avoid juridical double taxation (that is to say, taxation of the same income twice in the hands of the same taxpayer).

II – **Legal framework**

A – *The France-Belgium Double Taxation Convention: background and relevant provisions*

3. At the relevant time, France operated a so?called 'imputation' system of dividend taxation (i.e., corporation tax at company level was fully or partially imputed onto the income tax due on the dividends at shareholder level, via grant of an '*avoir fiscal*' – an imputation credit – to shareholders). As such, the system was aimed at reducing economic double taxation, that is, taxation of the same income twice in the hands of different taxpayers. This can be contrasted with 'schedular' systems of dividend taxation (company profits are subjected to corporation tax, but

dividends are taxed as a separate category of income, meaning some reduction of economic double taxation), 'classical' systems of dividend taxation (company profits subjected to corporation tax, and distributed profit taxed once again at the shareholder level, meaning no relief of economic double taxation), and 'exemption' systems (dividend income exempted from income taxation, meaning no economic double taxation). (2)

4. Article 15(3) of the Double Taxation Convention concluded between France and Belgium on 10 March 1964, as modified (the 'France?Belgium DTC'), provides that dividends paid by a French?resident company that would give a right to an imputation tax credit ('*avoir fiscal*') if received by French residents, also give a right to this tax credit for Belgian?resident individuals, after deduction of withholding tax calculated at a rate of 15% on the gross dividend consisting of the amount of the distributed dividend increased by the tax credit.

5. Article 19A(1)(2) of the France?Belgium DTC provides that, when dividends are paid by a French?resident company to a Belgian resident other than a company subject to corporation tax, and when these dividends have been subjected to withholding tax in France, the Belgian tax due on the amount net of this withholding tax will be reduced by (1) any withholding tax ('*précompte mobilier*') imposed at the normal rate and (2) a fixed quota of foreign tax ('*quotité forfaitaire d'impôt étranger*' or 'QFIE') that is deductible in conditions fixed by Belgian law, provided that the quota may not be lower than 15% of this net amount.

B – *Applicable Belgian tax legislation*

6. At the relevant time, Belgium operated a 'schedular' system of dividend taxation within the meaning I have explained above. Thus, Article 171 of the CIR 92 (Belgian income tax Code of 1992) derogates from the normal Belgian income tax regime for individuals (i.e., that all income is considered together and subjected to progressive tax rates) and provides, for certain income categories, for two distinct tax rates. Article 171 provides in particular that dividends are in general (3) subject to a special tax rate of 25%.

7. Article 285 of the CIR 92 provided, inter alia, that imputation of a fixed quota of foreign tax would, in the case of dividends, only occur for dividends allocated or attributed by investment companies.

III – **Factual background and question referred**

8. Mr and Mrs Kerckhaert?Morres were, at all relevant times, Belgian residents subject to worldwide taxation in Belgium on the totality of their income, including dividend income.

9. In 1995 and 1996, they received dividends from the French?resident company Eurofers SARL, and received an imputation credit (*avoir fiscal*) on these dividends from the French tax authorities. Pursuant to Article 15(3) of the France?Belgium DTC, this imputation credit was treated as dividend income, from which a French withholding tax of 15% was deducted. After deduction of this withholding tax, the amount of imputation credit received was BEF 34 566 204 (EUR 856 873.81) for 1995 and BEF 7 137 702 (EUR 177 831.43) for 1996. No Belgian *précompte mobilier* was levied on this income.

10. In declaring this revenue in their tax returns for the years 1996 and 1997, Mr and Mrs Kerckhaert?Morres claimed, in an annex to their tax returns, the imputation of the QFIE (as referred to in Article 19A(1)(2) of the France?Belgium DTC), to the amount of 15%.

11. Pursuant to Article 171 of the CIR 92, this revenue was taxed at the rate of 25%. No imputation of a QFIE was granted.

12. Mr and Mrs Kerckhaert?Morres challenged this decision of the Belgian tax authorities (Gewestelijke Directie Antwerpen I) before the Rechtbank van Eerste Aanleg, Ghent, on the ground, inter alia, that it infringed Article 19A(1)(2) of the France?Belgium DTC as well as Article 56 EC.

13. By order of 1 December 2004, the Rechtbank van Eerste Aanleg referred the following question to the Court:

Must Article 56(1) EC (Article 73b(1) of the EC Treaty at the time of the relevant facts) be interpreted as prohibiting a restriction resulting from a provision in the income tax legislation of a Member State (in the present case Belgium) which subjects dividends from resident companies and dividends from companies resident in another Member State to the same uniform tax rate, without in the latter case providing for the imputation of tax levied at source in that other Member State?

IV – **Analysis**

14. As a preliminary remark, I note that the national court’s question only raises the compatibility of the Belgian legislative provisions at issue with Article 56 EC, and not with Article 43 EC. It is not clear from the order for reference what the nature of the shareholding held by Mr and Mrs Kerckhaert?Morres in Eurofers was at the relevant time. However, I would note that, as the Court has consistently held, a taxable person resident in one Member State with a holding in the capital of a company established in another Member State which gives him ‘definite influence over the company’s decisions’ and allows it to ‘determine its activities’ is exercising his right of establishment within the meaning of Article 43 EC. (4) It is for the national court to decide whether this criterion is made out in the case of the applicants in the main proceedings. If this test is not satisfied, then the legislation at issue falls for consideration for compatibility with Article 56 EC.

15. None the less, in the present case, the principles of analysis are in my view identical when applying both Articles 43 and 56 EC. Although I will refer principally below to compatibility of the Belgian legislation at issue with Article 56 EC (which is the question put by the national court), the same reasoning therefore applies when considering Article 43 EC.

16. The question is whether it is contrary to Article 56 EC for Belgium to apply a blanket 25% tax rate to all dividends received by Belgian residents, whatever their source, thus refusing in the present case to take into account the 15% withholding tax levied on dividends in the source state, France.

17. The Court has consistently held that, although direct taxation falls within their competence, Member States must none the less exercise that competence consistently with Community law. (5) As I observed in my Opinions in *Test Claimants in the ACT Group Litigation* and *Test Claimants in the FII Group Litigation*, (6) Articles 43 and 56 EC are infringed in a case where the different treatment applied by the relevant Member State to its tax subjects is not a direct and logical consequence of the fact that, in the present state of development of Community law, different tax obligations for subjects can apply for cross?border situations than for purely internal situations.

18. In other words, these Articles prohibit restrictions on free movement of establishment and capital going beyond those resulting inevitably from the fact that tax systems are national, unless these restrictions are justified and proportionate. (7) This means in particular that, in order to fall

under the free movement provisions of the Treaty, disadvantageous tax treatment should follow from direct or covert discrimination resulting from the rules of one jurisdiction, and not purely from disparities or the division of tax jurisdiction between two or more Member States' tax systems, or from the coexistence of national tax administrations. (8)

19. In the case of a Member State exercising worldwide (home state) tax jurisdiction, this principle means essentially that such a state must treat foreign?source income of its residents consistently with the way it has divided its tax base. In so far as it has divided its tax base to include this foreign?source income – i.e., by treating it as taxable income – it must not discriminate between foreign?source and domestic income. (9) In particular, its legislation should not have the effect that foreign?source income is treated less favourably than domestic?source income. For example, in so far as a home State chooses to relieve economic double taxation on its residents' dividends, it must provide the same relief for incoming foreign?source dividends as for domestic dividends, and must take foreign corporation tax paid into account for this purpose. (10)

20. In the present case, as at the relevant time Mr and Mrs Kerckhaert?Morres were Belgian residents, Belgium acted in a home state capacity when exercising tax jurisdiction over them.

21. It is clear that the Belgian rules in question do not directly discriminate between foreign?source and domestic?source dividends: by Article 171 of the CIR, all dividends were subject to the special income tax rate of 25%. (11) I would add that, in contrast to cases such as *Manninen*, *Verkooijen* and *Lenz*, (12) this is not a case where Belgium has chosen to relieve economic double taxation on domestic-source dividends, without granting similar relief to foreign-source dividends: rather, under the schedular system of dividend taxation adopted by Belgium, company profits are subjected to corporation tax and (domestic and foreign) dividends are subject to an additional tax as a separate category of income.

22. None the less, this still leaves the question whether the Belgian legislation amounts to indirect discrimination – that is, despite being equally applicable in law to foreign?source dividends, it has a discriminatory effect in fact. Put otherwise, do the rules restrict free movement of capital in a way that goes beyond the restrictions resulting inevitably from the fact that tax systems are national?

23. On this point, Mr and Mrs Kerckhaert?Morres argue that the overall tax burden on French?source dividends is in fact greater than that placed on Belgian?source dividends, as the former have been subject to 15% withholding tax at source (in France), and on top of that are subject to the standard 25% Belgian tax on dividends. In their contention, this restricts free movement of capital in a way contrary to Article 56 EC.

24. I do not find this argument convincing, for the following reasons.

25. First, on the facts put before us in the present case, I find it impossible to conceive how it can be argued that the effect of the Belgian tax regime, when viewed in the context of the underlying French tax regime, is that a Belgian resident receiving French?source dividends is treated less favourably than a Belgian resident receiving equivalent Belgian-source dividends. Rather, the contrary is true. As a matter of fact, and in accordance with Article 15(3) of the France?Belgium DTC, dividends paid by a French?resident company that would give a right to an *avoir fiscal* (imputation tax credit) if received by French residents also give a right to such a credit for Belgian?resident individuals. The *avoir fiscal* granted by France, which formed part of the French imputation system of reduction of double economic taxation of dividends, amounted to 50% of the distributed dividend. Although, therefore, the distributed dividend and the *avoir fiscal* were each subject to 15% withholding tax by France, the actual effect of the operation of the French system was that Belgian?resident shareholders received a higher amount in the case of

French?source dividends than in the case of exactly the same amount of dividends distributed from a Belgian company. This can be illustrated as follows, to take the example given by the Belgian Government:

French?source dividend

Belgian?source dividend

Gross dividend

1 000.00

1 000.00

1 000.00

15% French withholding tax

- 150.00

850.00

50% avoir fiscal

500.00

15% French withholding tax

- 75.00

425.00

Total amount subject to 25% Belgian dividend tax

1 275.00

1 000.00

25% Belgian dividend tax

- 318.75

- 250.00

Net dividend after tax

956.25

750.00

26. It is clear from the above that Belgian residents receiving French?source dividends are not worse off in comparison to those receiving Belgian?source dividends; on the contrary, the combined effect of the French and Belgian tax systems means that overall they are better off. There can therefore be no question of discrimination or restriction within the meaning of Article 56 EC. Rather, the present case is a good illustration of the dangers which may arise, in considering whether a Member State's legislation complies with the Treaty free movement provisions, when examining the situation of an individual economic operator in the framework of just one State's legislation, or just one facet of this legislation. Such an approach risks failing to capture the reality of the economic context in which that operator is acting, and the overall balance arrived at between home state and source state in dividing tax jurisdiction. (13)

27. While the actual (favourable) effect of the legislative framework for Mr and Mrs Kerckhaert?Morres is in my view decisive on the facts of the present case, I would make the following additional remark.

28. In the event that the French system had not provided for any *avoir fiscal* to be distributed to Belgian residents receiving French?source dividends, this would have resulted – *ceteris paribus* – in double juridical taxation of such residents, potentially meaning an overall greater tax burden for them in comparison with Belgian residents receiving Belgian?source dividends.

29. Such a potential disadvantage for Belgian residents receiving French dividends would not, however, result from any breach of the Treaty free movement provisions on the part of Belgium.

30. In this regard, I would recall that the free movement provisions of the Treaty do not as such oblige home states to relieve juridical double taxation resulting from the dislocation of tax base between two Member States.

31. As I observed in my Opinion in *Test Claimants in Class IV of the ACT Group Litigation*, the possibility of juridical double taxation, in the absence of priority rules between the relevant States, is an inevitable consequence of the generally accepted method under international tax law of dividing tax jurisdiction between States – that is, the distinction between home State taxation (worldwide taxation of residents) and source State taxation (territorial taxation of non?residents). (14) Under Community law, the power to choose criteria of, and allocate, tax jurisdiction lies purely with Member States, as governed by international tax law. At present, there are no alternative criteria to be found in Community law, and no basis for laying down any such criteria.

32. Thus, in *Gilly*, after observing that allocating fiscal jurisdiction on the basis of nationality cannot as such be regarded as constituting discrimination, the Court recognised that this 'flows, in the absence of any unifying or harmonising measures adopted in the Community context under, in particular, the second indent of Article [293] of the Treaty, from the contracting parties' competence to define the criteria for allocating their powers of taxation as between themselves, with a view to eliminating double taxation. Nor, in the allocation of fiscal jurisdiction, is it unreasonable for the Member States to base their agreements on international practice and the model convention drawn up by the OECD … .' (15) The Court has confirmed this reasoning in, inter alia, its *D* judgment. (16)

33. As the generally accepted international tax law rule of taxation priority is in principle that of 'source country entitlement' (i.e., priority of taxation right over source country income lies with the

source state), in so far as juridical double taxation is to be relieved, this is generally a matter for the home state. It is for this State to choose whether and how it wishes to provide such relief (17) – for example, by using an exemption or credit method. (18)

34. To this effect, in the *Gilly* case, the Court observed that the free movement provisions of the Treaty did not oblige a Member State to relieve double taxation:

'Whilst abolition of double taxation within the Community is … one of the objectives of the Treaty, it must none the less be noted that, apart from the Convention of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (OJ 1990 L 225, p. 10), no unifying or harmonising measure for the elimination of double taxation has yet been adopted at Community level, nor have the Member States yet concluded any multilateral convention to that effect under Article [293] of the Treaty.' (19)

35. To similar effect, the Court observed that the second indent of Article 293 EC – which provides that Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing, for the benefit of their nationals, the abolition of double taxation within the Community – was not directly effective. Rather, this provision merely indicated that the abolition of double taxation within the Community was an objective of the Treaty, without containing any absolute obligation for Member States to achieve this end. (20)

36. As a result, the mere fact that a home state such as Belgium might not have chosen to relieve juridical double taxation on dividends would not in itself be contrary to Articles 43 or 56 EC, as long as that State complied with the obligation not to discriminate between foreign-source and domestic?source dividends in exercising its tax jurisdiction, which obligation I outlined above. Any distortion of economic activity resulting from such a choice would result from the fact that different tax systems must, in the present state of development of Community law, exist side by side, which may mean disadvantages for economic actors in some cases, and advantages in other cases. (21)

37. I would add that the fact that Belgium may or may not be in breach of its obligations under the France?Belgium DTC in failing to allow imputation of the 15% French withholding tax makes, in my view, no difference to the above conclusion. Assessment of the compatibility of the Belgian provisions with this DTC, and the potential effects of a breach under national law, is purely a matter for the national court. (22) Needless to say, the fact that a Member State's legislation may be in accordance with, or required by, the terms of the applicable DTC does not in itself mean that such conduct accords with the Treaty free movement provisions: the Court has consistently held that, in exercising their power of taxation as allocated by DTCs, Member States must none the less abide by the prohibition on discrimination contained in Articles 43 and 56 EC. (23)

38. Nor can I accept the argument of Mr and Mrs Kerckhaert?Morres that it follows from the Savings Interest Directive that a failure on the part of Belgium to remedy juridical double taxation is contrary to Article 56 EC. (24) This Directive, Article 14(1) of which explicitly requires the Member State of residence of the beneficial owner of the savings to 'ensure the elimination of any double taxation which might result from the imposition of the withholding tax' referred to in Article 11 of the Directive, is a good example of the express elimination by the Community legislator of what I have elsewhere called a 'quasi?restriction' (a distortion resulting from the coexistence of discrete tax systems) in a particular direct taxation sector. As I observed in my Opinion in *Test Claimants in Class IV of the ACT Group Litigation*, the causes and character of these quasi?restrictions mean that they may only be eliminated through the intervention of the Community legislator, in the absence of which intervention they should be held to fall outside the scope of the Treaty free movement provisions. (25) In the present case, no relevant Community legislation removing quasi?restrictions exists.

39. As a final point I would note that, had no French *avoir fiscal* been granted to Belgian residents, France would in any event be subject to the source state obligation to ensure that, in so far as double economic taxation on outgoing dividends resulted from the exercise of its tax jurisdiction (for example, where a source State subjects company profits first to corporation tax and then to income tax upon distribution), equivalent relief was granted to such dividends as would be granted to dividends paid to French residents. This follows from the principle that tax benefits granted by the source State to non?residents should be equivalent to those granted to residents in so far as the source State otherwise exercises equivalent tax jurisdiction over both groups. (26)

V – **Conclusion**

40. For these reasons, I am of the view that the Court should give the following response to the question referred by the Rechtbank van Eerste Aanleg te Gent (Belgium):

Article 56(1) EC does not prohibit a restriction resulting from a provision in the income tax legislation of a Member State, such as the Belgian legislation at issue in the present case, which subjects dividends from resident companies and dividends from companies resident in another Member State to the same uniform tax rate, without in the latter case providing for the imputation of tax levied at source in that other Member State.

1 – Original language: English.

2 – See further, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, ‘Dividend taxation of individuals in the Internal Market’, COM (2003) 810 final, and my Opinion of 23 February 2006 in Case C?374/04 *Test Claimants in Class IV of the ACT GroupLitigation*, not yet reported in the ECR, paragraphs 4 to 7.

3 – With the exception of those covered by Article 269(2) and (3) of the CIR 1992.

4 – See Case C?251/98 *Baars* [2000] ECR I?2787, paragraph 22, and my Opinion of 23 February 2006 in Case C?374/04 *Test Claimants in Class IV of the ACT GroupLitigation*, paragraphs 26 to 30.

5 – See, for example, judgment of 13 December 2005 in Case C?446/03 *Marks & Spencer* v *David Halsey* [2005] ECR I?0000, paragraph 29, and cases cited therein.

6 – *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 32 onwards, and Opinion of 6 April 2006 in Case C?446/04 *Test Claimants in the FII Group Litigation*, paragraphs 37 onwards.

7 – See, for extended reasoning on this, paragraphs 31 to 54 of my Opinion in *Test Claimants in Class IV of theACT Group Litigation*, footnote 2 above.

8 – Ibid., paragraph 55.

9 – Ibid., paragraph 58.

10 – Ibid., paragraph 58. See Case C?319/02 *Manninen* [2004] ECR I?7477; Case C?35/98 *Verkooijen* [2000] ECR I?4071, and Case C?315/02 *Lenz* [2004] ECR I?7063.

11 – In the case of Belgian-source dividends, the ultimate 25% dividend tax rate was levied in the form of a *précompte mobilier* withheld by the distributing company. The ultimate dividend tax rate for foreign and domestic dividends was, however, identical.

12 – See for example *Manninen*, *Verkooijen* and *Lenz*, footnote 10 above.

13 – See my Opinion in *Test Claimants in Class IV of the ACT Group Litigation*, footnote 2 above, paragraph 72.

14 – See my Opinion in *Test Claimants in Class IV of the ACT Group Litigation*, footnote 2 above, paragraph 48 onwards.

15 – Case C?336/96 *Gilly* [1998] ECR I?2793, paragraphs 30 and 31. See, also, Case C?307/97 *Saint?Gobain* [1999] ECR I?6161, paragraph 57.

16 – See Case C?376/03 *D* [2005] ECR I?0000, paragraphs 50 to 53.

17– See my Opinion in *Test Claimants in Class IV of the ACT Group Litigation*, footnote 2 above, paragraph 51. See also the OECD Model Double Taxation Convention on Income and on Capital, with Commentaries to the Articles, OECD, Paris, 197, as revised.

18 – In the case of the exemption method, the taxpayer's state of residence exempts the foreign?source income of its residents, on the basis that this income has already been taxed in the 'source' state (i.e., the state in which the income was earned). In the case of the credit method of avoidance of double taxation, however, taxpayers earning foreign?source income are taxed in their state of residence on their worldwide income, including foreign?source income, but may credit the tax paid in the source state against the home state tax attributable to this foreign?source income.

19–

See *Gilly,* footnote 15 above, paragraph 23. See also, *D*, footnote 16 above, paragraphs 50 and 51.

20 – See *Gilly*, footnote 15 above, paragraph 16.

21 – See my Opinion in *Test Claimants in Class IV of the ACT Group Litigation*, footnote 2 above, paragraph 38.

22 – See, by analogy, the Opinion of Advocate General Ruiz?Jarabo Colomer in *Gilly*, footnote 15 above, paragraph 25, observing that the Court cannot give a ruling on the compatibility with Community law of the provisions of a DTC, or undertake to interpret such provisions, as part of 'a bilateral convention on a matter which is outside the Community's competence and which is regulated exclusively by the Member States'.

23 – See, for example, the conclusion of the Court in its judgment in Case C?265/04 *Bouanich* [2006] ECR I?0000, paragraph 56 and the judgments of the Court in Case C?385/00 *De Groot* [2002] ECR I?11819, paragraphs 93 and 94, and *Saint?Gobain*, footnote 15 above, paragraphs 57 and 58.

24 – Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, OJ 2003 L 157, p. 38.

25 – See footnote 2 above, paragraph 38.

26 – See my Opinion in *Test Claimants in Class IV of the ACT Group Litigation*, footnote 2 above, paragraphs 69 and 70; *Saint?Gobain*, footnote 15 above; Case C?270/83 *Commission* v *French* (' *Avoir Fiscal*') [1986] ECR 273, Case C?330/91 *Commerzbank* [1993] ECR I?4017, and Case

C?250/95 *Futura* [1997] ECR I?2471. As I noted in the *ACT* case, it would in my view be open to a Member State in France’s position to ensure the fulfilment of its obligations under the Treaty free movement provisions by means of provisions contained in a DTC (see paragraph 70 of that Opinion and the Court’s judgment in *Bouanich*, footnote 23 above, paragraph 51). However, it would be no defence to argue that the home State had been in breach of its DTC obligations by failing to relieve the relevant economic double taxation (see my Opinion in the *ACT* case, paragraph 71).