Downloaded via the EU tax law app / web

JUDGMENT OF THE COURT (Fifth Chamber)

13 March 2014 (*)

(Reference for a preliminary ruling — Article 63 TFEU — Free movement of capital — Article 49 TFEU — Freedom of establishment — Tax on income of natural persons — Mechanism capping direct taxes by reference to income — Bilateral tax agreement for avoidance of double taxation — Taxation of dividends distributed by a company established in another Member State and already subject to a withholding tax — Failure to take into account or partial taking into account of the tax paid in the other Member State for the calculation of the tax cap — Article 65 TFEU — Restriction — Justification)

In Case C?375/12,

REQUEST for a preliminary ruling under Article 267 TFEU from the Tribunal administratif de Grenoble (France), made by decision of 26 July 2012, received at the Court on 6 August 2012, in the proceedings

Margaretha Bouanich

v

Directeur des services fiscaux de la Drôme,

THE COURT (Fifth Chamber),

composed of T. von Danwitz, President of the Chamber, E. Juhász, A. Rosas (Rapporteur), D. Šváby and C. Vajda, Judges,

Advocate General: M. Wathelet,

Registrar: A. Calot Escobar,

having regard to the written procedure,

after considering the observations submitted on behalf of:

– Ms Bouanich, by A. Jouanjan and S. Fouquet-Chabert, avocats,

– the French Government, by D. Colas and J.-S. Pilczer, acting as Agents,

– the United Kingdom Government, by J. Beeko, acting as Agent, and R. Hill, Barrister,

– the European Commission, by W. Roels and C. Soulay, acting as Agents,

– by the EFTA Surveillance Authority, by X. Lewis, G. Mathisen and A. Steinarsdóttir, acting as Agents,

having decided, after hearing the Advocate General, to proceed to judgment without an Opinion,

gives the following

Judgment

1 This request for a preliminary ruling concerns the interpretation of Articles 49 TFEU, 63 TFEU and 65 TFEU.

2 The request has been made in proceedings between Ms Bouanich and the Directeur des services fiscaux de la Drôme (Director of Tax Services of the Drôme) (‘the tax authorities’) concerning the authorities’ refusal to include the withholding tax paid by Ms Bouanich in Sweden in the total amount of direct taxes taken into account for the calculation of a tax cap by reference to income.

Legal context

French law

3 Article 1 of the General Tax Code (Code général des impôts, ‘the GTC’), as amended by Article 74 of Law No 2005-1719 of 30 December 2005 (JORF (Official Journal of the French Republic), 31 December 2005, p. 20597), applicable to taxes paid during 2006 on income from 2005, provided that direct taxes paid by a taxpayer might not exceed 60% of his income.

4 Article 11 of Law No 2007-1223 of 21 August 2007, promoting work, employment and purchasing power (JORF, 22 August 2007, p. 13945), applicable to taxes paid during 2007 and 2008 on income from 2006 and 2007 respectively, amended Article 1 of the GTC in that direct taxes paid by a taxpayer might not thereafter exceed 50% of his income.

5 The conditions applicable to that cap on direct taxes are defined by Article 1649-0 A of the GTC and include, inter alia, the right to restitution of tax levied above the threshold set by Article 1 of the GTC (‘the tax shield’).

6 Article 1649-0 A(1) to (5) of the GTC, applicable to the right to restitution acquired in 2007 by reference to income from 2005, as amended by Law No 2005-1719, provided:

‘1. The right to restitution of the portion of tax that exceeds the threshold referred to in Article 1 is acquired by the taxpayer on 1 January of the year following the year in which he paid the tax for which he was liable.

...

2. Providing that they are not deductible from a specific class of income and that they were paid in France and, in respect of the taxes referred to at (a) and (b), that they were regularly declared, the taxes to be taken into account for the determination of the right to restitution are:

(a) Income tax;

(b) Wealth tax;

(c) Property tax on buildings and property tax on land relating to the taxpayer’s principal residence ...;

(d) Residential tax levied for the benefit of local authorities …

3. The taxes referred to at 2 shall be reduced by income tax refunds or relief obtained during the course of the year of payment of those taxes.

…

4. The income to be taken into account to determine the right to restitution shall be the income received by the taxpayer in the year preceding that of the payment of the taxes, with the exception of income in kind which is not subject to income tax pursuant to Section II of Article 15. That income consists of:

(a) Income subject to income tax net of professional expenses …;

(b) Proceeds liable to a withholding tax;

(c) Income exempt from income tax obtained in the same year in France or outside France …

5. The following deductions shall be made from the income referred to in 4:

(a) Category-based tax losses which may be offset under Section I of Article 156;

(b) Amount of maintenance payments deducted pursuant to Section II, subsection 2, of Article 156;

(c) Premiums or contributions deducted pursuant to Article 163w.'

7 Article 1649-0 A(1) to (5) of the GTC, as amended by Law No 2008-776 of 4 August 2008 on the modernisation of the economy (JORF, 5 August 2008, p. 12471), applicable to the right to restitution acquired in 2008 and 2009 by reference to income from 2006 and 2007 respectively, provided:

'1. The right to restitution of the portion of tax that exceeds the threshold referred to in Article 1 is acquired by the taxpayer on 1 January of the second year following the year in which the income referred to at 4 was received.

...

2. Provided that they were paid in France and, firstly, for taxes other than those referred to at (e) and (f), that they are not deductible from a specific class of income and, secondly, for the taxes referred to at (a), (b) and (e), that they were regularly declared, the taxes to be taken into account for the determination of the right to restitution are:

(a) income tax due on the income referred to at 4;

(b) wealth tax levied for the year following the year in which the income referred to at 4 was received;

(c) property tax ...;

(d) residential tax …;

(e) the contributions and deductions provided for in Articles … of the Social Security Code …;

(f) the contributions and deductions provided for in Articles … of the Social Security Code …

3. The taxes referred to at 2 shall be reduced by income tax refunds received or by relief obtained during the year following the year in which the income referred to at 4 was received.

...

4. The income to be taken into account for the determination of the right to restitution shall be the income received by the taxpayer, with the exception of income in kind which is not subject to income tax pursuant to Section II of Article 15. That income consists of:

(a) Net income subject to income tax …;

(b) Proceeds liable to a withholding tax;

(c) Income exempt from income tax received in the same year in France or outside France …

5. The following deductions shall be made from the income referred to in 4:

…

(d) taxes equivalent to those referred to at (a), (e) and (f) of 2 where those taxes have been paid abroad.'

Franco-Swedish Agreement for the prevention of double taxation

8 Article 10(1) and (2) of the Agreement between the French Republic and the Kingdom of Sweden for the avoidance of double taxation and the prevention of tax avoidance in respect of taxes on income and capital, signed in Stockholm on 27 November 1990 ('the Franco-Swedish Agreement'), states:

'1. Dividends from a company resident in one contracting State to a person resident in the other contracting State are taxable in the latter State.

2. Those dividends may also be taxed in the contracting State in which the company paying the dividends is resident, under the legislation of that State, but if the recipient of the dividends is the beneficial owner, the tax thus levied may not exceed 15% of the gross amount of the dividends. ...'

9 Article 23 of that agreement provides:

'Double taxation shall be avoided as follows:

1. In the case of France:

(a) income arising in Sweden and taxable or taxable only in Sweden in accordance with the provisions of the Agreement shall be taken into account in calculating the French tax when the recipient is a resident of France and the income is not exempt from corporation tax under French law. In such case, the Swedish tax shall not be deductible from that income, but the recipient shall be entitled to a tax credit deductible from the French tax. This tax credit shall be equal:

…

(ii) for income referred to in paragraph 2 of Article 10 … to the amount of tax paid in Sweden in accordance with the provisions of those Articles; that tax credit shall not however exceed the amount of French tax on that income.

...'

10 The tax shield provision was abolished with effect from 1 January 2013 pursuant to Article

30 of Law No 2011-900 of 29 July 2011, amending finance law for 2011 (JORF, 30 July 2011, p. 12969).

The dispute in the main proceedings and the questions referred for a preliminary ruling

11 At the time of the facts in the main proceedings, Ms Bouanich, tax resident in France, was a shareholder of Ratos AB, a listed company established in Sweden.

12 Ms Bouanich declared, in respect of the years 2005, 2006 and 2007, income from investment capital in the gross amounts of EUR 812 148, EUR 3 303 998 and EUR 677 082 respectively. According to the order for reference, that income arose principally from dividends paid by Ratos AB.

13 Pursuant to Article 10 of the Franco-Swedish Agreement, those dividends were subject to a withholding tax in Sweden amounting to EUR 121 426 for 2005, EUR 692 296 for 2006 and EUR 119 130 for 2007.

14 In accordance with Article 23(1) of the Franco-Swedish Agreement, for the purposes of calculating the income tax to which Ms Bouanich is subject in France, the French tax authorities included the dividends from Sweden in the taxable base for the years 2005, 2006 and 2007.

15 After calculating the gross amount of income tax by applying the progressive scale to the taxable base, the tax authorities, pursuant to Article 23(1)(a)(ii) of the Franco-Swedish Agreement, set against that gross amount a tax credit equal to the amount of withholding tax to which Ms Bouanich had been subject in Sweden.

16 After that imputation and various other tax reductions, Ms Bouanich still owed a net amount of EUR 19 730 in income tax for 2005 and EUR 48 130 for 2006; no tax remained outstanding for 2007.

17 Ms Bouanich subsequently applied to be entitled to the right to restitution resulting from the application of the tax shield.

18 In her applications for restitution of tax, Ms Bouanich had included, in the taxes to be taken into account for the application of the tax shield, the amount of the tax credits corresponding to the amount of withholding tax levied on the dividends from Sweden. That method of calculation was however rejected by the tax authorities, on the ground that the withholding tax was not a tax paid in France.

19 By three successive applications concerning the calculation of the right to restitution acquired in 2007, 2008 and 2009 by application of the tax shield for the years 2005, 2006 and 2007 respectively, Ms Bouanich brought actions before the Tribunal administratif de Grenoble (Administrative Court, Grenoble) in order to obtain the inclusion, in the total taxes taken into account for the calculation of the tax cap, of the amount corresponding to the withholding tax levied on the dividends from Sweden, namely EUR 121 426, EUR 265 069 and EUR 59 565 respectively.

20 According to Ms Bouanich, Article 1 and Article 1649-0 A of the GTC, in their version applicable to the right to restitution acquired in 2007 on account of income from 2005, led the tax authorities to remove from the calculation of the cap the total amount of the withholding tax paid in Sweden on that income. Those provisions, as amended by Law No 2008-776 and applicable to the right to restitution acquired in 2008 and 2009, by allowing the deduction of the amount of the withholding tax from the income taken into account for the right to restitution, rather than adding it

to the total taxes used in the calculation, limit the resulting tax advantage to half of what it would have been if the dividends had been paid by a company established in France.

21 Before the referring court, Ms Bouanich claims that the French legislation constitutes an obstacle to the freedom of establishment and free movement of capital guaranteed by the FEU Treaty.

22 In those circumstances, having joined Ms Bouanich's three actions, the Tribunal administratif de Grenoble decided to stay the proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

'(1) Do Articles [49 TFEU, 63 TFEU and 65 TFEU] preclude legislation, such as that at issue in the main proceedings, under which, where a resident of a Member State of the European Union who is a shareholder of a company established in another Member State of the European Union receives dividends taxed in the two Member States and the double taxation is regulated by the imputation in the Member State of residence of a tax credit for the same amount as the tax paid in the State of the distributing company, the mechanism of capping tax at 60% or 50% of income received during a year does not take into account, or takes only partially into account, the tax paid in the other State?

(2) If that is the case, may such a restriction be justified by the need to maintain the coherence of the tax system, by a balanced allocation of powers of taxation between the Member States, or by any other overriding reason in the public interest?'

Consideration of the questions referred

23 By its questions, which it is appropriate to examine together, the referring court asks, in essence, whether Articles 49 TFEU, 63 TFEU and 65 TFEU preclude legislation of a Member State under which, where a resident of that Member State who is a shareholder of a company established in another Member State receives dividends taxed in the two Member States and the double taxation is regulated by the imputation in the Member State of residence of a tax credit of an amount corresponding to the tax paid in the State of the distributing company, a mechanism capping various direct taxes at a certain percentage of income received during a year does not take into account, or takes only partially into account, the tax paid in the State of the distributing company.

The freedom at issue

24 Since the questions referred for a preliminary ruling were raised in the light of Article 49 TFEU as well as Article 63 TFEU and Article 65 TFEU, it must be established whether the national legislation falls within the scope of freedom of establishment, free movement of capital or both freedoms.

25 Ms Bouanich, the French Government, the United Kingdom Government and the European Commission consider that the freedom at issue in the main proceedings is the free movement of capital, enshrined in Article 63 TFEU. For the EFTA Surveillance Authority, in so far as the contested national legislation is applicable regardless of the size of the shareholding giving rise to dividends, and leaving aside the question whether the holding is such as to give definite influence on the company's decisions and to allow the shareholders to determine its activities, the contested measures fall within the scope of both Article 49 TFEU and Article 63 TFEU. Their application must therefore be examined in parallel.

26 In this connection, it is to be noted that the tax treatment of dividends may fall within Article

49 TFEU on freedom of establishment and Article 63 TFEU on the free movement of capital (see Joined Cases C?436/08 and C?437/08 *Haribo Lakritzen Hans Riegel and Österreichische Salinen* [2011] ECR I?305, paragraph 33; Case C?35/11 *Test Claimants in the FII Group Litigation* [2012] ECR, paragraph 89; and Case C?168/11 *Beker* [2013] ECR, paragraph 23).

27 As regards the question whether national legislation falls within the scope of one or other of the freedoms of movement, it is clear from well-established case-law that the purpose of the legislation concerned must be taken into consideration (*Test Claimants in the FII Group Litigation*, paragraph 90 and the case-law cited, and *Beker*, paragraph 24).

28 In that respect, it has previously been held that national legislation intended to apply only to those shareholdings which enable the holder to exert a definite influence on a company's decisions and to determine its activities falls within the scope of Article 49 TFEU on freedom of establishment (see Case C?387/11 *Commission* v *Belgium* [2012] ECR, paragraph 34; *Test Claimants in the FII Group Litigation*, paragraph 91 and the case-law cited; and *Beker*, paragraph 25). On the other hand, national provisions which apply to shareholdings acquired solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking must be examined exclusively in the light of the free movement of capital (see *Commission* v *Belgium*, paragraph 34; *Test Claimants in the FII Group Litigation*, paragraph 92 and the case-law cited; and *Beker*, paragraph 26).

29 In the present case, the national legislation at issue in the main proceedings applies regardless of the amount of the shareholding held in a company. As the French Government notes, the application of that legislation does not depend on the size of the holdings acquired in a non-resident company and is not limited to situations in which the shareholder can exercise definite influence on the decisions of the company concerned and determine its activities.

30 Consequently, in so far as those rules relate to dividends which originate in a Member State, it cannot therefore be determined from their purpose whether they fall predominantly within the scope of Article 49 TFEU or Article 63 TFEU. In such circumstances, the Court takes account of the facts of the case in point in order to determine whether the situation to which the dispute in the main proceedings relates falls within the scope of one or other of those provisions (*Test Claimants in the FII Group Litigation*, paragraphs 93 and 94 and the case-law cited, and *Beker*, paragraphs 27 and 28).

31 However, neither the order for reference nor the documents before the Court provides information in that respect. Consequently, it must be held that national legislation such as that at issue in the main proceedings is liable to affect both the free movement of capital and the freedom of establishment and must, therefore, be examined in the light both of Articles 63 and 65 TFEU and of Article 49 TFEU.

Whether there is a restriction on free movement of capital

32 According to Ms Bouanich, the EFTA Surveillance Authority and the Commission, the tax shield penalises income from dividends distributed by companies established in a Member State other than the French Republic ('incoming dividends') as opposed to income from dividends distributed by companies established in France.

33 Since the withholding tax levied outside France is not taken into account, or is taken only partially into account, in the calculation of the income tax which may be reimbursed to the taxpayer to whom the tax shield applies, the amount corresponding to the foreign withholding tax remains permanently chargeable to the taxpayer, which systematically increases the tax burden on incoming dividends as opposed to that on French-source dividends.

34 That less favourable tax treatment for incoming dividends makes, for natural persons residing in France, investments in companies established in a Member State other than the French Republic less attractive than investments in French companies.

35 The French Government and the United Kingdom Government claim, by contrast, that the French legislation relating to the tax shield did not restrict the free movement of capital, since the French Republic did not exercise its tax jurisdiction in a discriminatory manner.

36 According to those governments, the refusal by the French Republic to include the withholding tax paid in Sweden in the total amount of direct taxes paid by the taxpayer is merely a disadvantage arising from the parallel exercise of tax jurisdiction by the Kingdom of Sweden and the French Republic. Free movement of capital does not require a Member State to prevent juridical double taxation of dividends resulting from a bilateral agreement, where the two States party to the agreement have the right to tax the income in question. Referring to Case C?513/04 *Kerckhaert and Morres* [2006] ECR I?10967, the United Kingdom Government claims that a difference of treatment due to the combined application of the legitimate exercise by two Member States of their tax jurisdiction, provided it is not discriminatory, does not constitute a restriction on the fundamental freedoms.

37 In that respect, it should be noted from the outset that the case in the main proceedings does not relate to the prevention of double taxation but to the national tax treatment in France of dividends distributed by a company established in Sweden, for the purposes of applying a mechanism capping various direct taxes.

38 That case deals with a difference in treatment, as regards the application of the tax shield, between, first, a taxpayer resident in a Member State of the Union who receives dividends from a company established in that State and, secondly, a taxpayer resident in that Member State who is a shareholder of a company established in another Member State and receives dividends taxed in both States, the double taxation being regulated by the imputation in the Member State of residence of a tax credit of an amount corresponding to the tax paid in the State of the distributing company.

39 Consequently, the case in the main proceedings differs from the *Kerckhaert and Morres* case. The national legislation at issue in *Kerckhaert and Morres* did not make any distinction between dividends from shares in companies established in the territory of the State concerned and dividends from shares in companies established in another Member State which had been subject to a tax levied at source in that other Member State, since that legislation subjected those dividends, within the context of income tax, to the same uniform rate of taxation (see, to that effect, *Kerckhaert and Morres*, paragraph 17). In such circumstances, the Court held that the adverse consequences which might arise from the application of an income tax system such as that at issue in that case would result from the exercise in parallel by two Member States of their tax jurisdiction (*Kerckhaert and Morres*, paragraph 20).

40 In order to reply to the first question, a distinction must be drawn between, first, the granting of a tax credit resulting from the Franco-Swedish Agreement and, secondly, the application of the tax shield at issue in the case in the main proceedings, because they constitute two separate tax

benefits.

41 The granting, in France, of a tax credit for the withholding tax levied in Sweden results from the Franco-Swedish Agreement and is part of the parallel taxation, by the Kingdom of Sweden and by the French Republic, of Swedish investment income. The French Republic reserves the right to tax Swedish income and grants a tax credit to limit, or avoid, double taxation.

42 By contrast, a provision such as the tax shield is unrelated to the parallel exercise of tax jurisdiction and concerns only the French Republic's tax jurisdiction. That tax provision has the purpose and effect of reducing the level of taxation of the income on which that Member State exercises its powers of taxation.

43 According to settled case-law, the measures prohibited by Article 63(1) TFEU, as restrictions on the movement of capital, include those which are such as to discourage non-residents from making investments in a Member State or to discourage that Member State's residents from doing so in other States (Joined Cases C?338/11 to C?347/11 *Santander Asset Management SGIIC and Others* [2012] ECR, paragraph 15 and the case-law cited).

44 Therefore, it must be examined whether the tax legislation at issue in the main proceedings, because of the difference in treatment which it establishes between taxpayers who receive dividends from a company established in France and taxpayers who receive dividends from a company established in another Member State, is discriminatory and liable to discourage the latter from exercising their right to the free movement of capital.

45 In accordance with settled case-law, discrimination in fiscal matters can arise only through the application of different rules to comparable situations or the application of the same rule to different situations (see Case C?279/93 *Schumacker* [1995] ECR I?225, paragraph 30; Case C?383/05 *Talotta* [2007] ECR I?2555, paragraph 18; and Case C?182/06 *Lakebrink and Peters-Lakebrink* [2007] ECR I?6705, paragraph 27). Accordingly, a difference in treatment between two categories of taxpayer may be categorised as discrimination within the meaning of the Treaty provided that the situations of those categories of taxpayer are comparable in the light of the taxation rules concerned (Case C?253/09 *Commission* v *Hungary* [2011] ECR I?12391, paragraph 51).

46 It is necessary therefore to examine whether the difference in treatment between a shareholder taxable in France who receives dividends from a company established in that Member State and another shareholder taxable in the same manner in France but receiving dividends from a company established in another Member State, in the present case Sweden, concerns situations which are objectively comparable.

47 As the EFTA Surveillance Authority and the Commission point out, the fact that the French Republic, first, taxes the incoming dividends received by Ms Bouanich on the basis of Article 10(1) and Article 23 of the Franco-Swedish Agreement and includes those dividends in Ms Bouanich's taxable base in France for the purposes of calculating her income tax and, secondly, takes account of those dividends for the purposes of applying the tax cap in Article 1 and Article 1649-0 A of the GTC places the taxpayer in the same situation as a taxpayer receiving dividends from a company established in France.

48 Consequently, individuals receiving dividends from a company established in France and those receiving dividends from a company established in Sweden are in objectively comparable situations as regards their tax liability.

49 As regards the dividends that a shareholder residing in France receives from a company

established in another Member State, such as the Kingdom of Sweden, which were subject to withholding tax in that other State and are included in the taxable base in France, the difference in treatment in the application of the tax shield is that the calculation of the right to restitution of the amount of direct taxes above the tax cap does not take into account the withholding tax levied in Sweden. There was a total failure to take into account the withholding tax in the context of the tax shield in the version applicable to the year 2007 with respect to income from 2005 and only a partial failure in the context of that provision as amended by Law No 2008-776, which applied to the years 2008 and 2009 in respect of income from 2006 and 2007.

50 As is apparent from the documents before the Court, the right to restitution of the amount of taxes which exceed the threshold defined in Article 1 of the GTC is determined on the basis of the ratio represented by the fraction consisting of, as numerator, the amount of direct taxes chargeable to the taxpayer and, as denominator, the total amount of income received by that same taxpayer during the year which precedes that of the payment of those taxes.

51 In the case in the main proceedings, as regards the tax shield applicable for 2007, the tax paid by Ms Bouanich in Sweden was not taken into account at all in the calculation of the cap on direct taxes at 60% of her income received during 2005. First, the amount of direct taxes taken into account did not include the amount of tax credit corresponding to the withholding tax levied by the Kingdom of Sweden. Secondly, the income taken into account included the gross amount of the dividends received by Ms Bouanich, thereby including the amount of that withholding tax.

52 That twofold process led to the reduction of the numerator and the increase of the denominator of the ratio to be established between direct taxes and income for the purpose of applying the tax shield, and thus to the reduction, or even the abolition, of the amount of direct taxes exceeding the limit of 60% for taxpayers resident in France who, like Ms Bouanich, receive dividends from abroad.

53 As the Commission states, the tax capping mechanism as it emerged from Law No 2008-776, applicable from 2008 to income received during 2006, removed the restriction on the free movement of capital in so far as it applied to the income taken into account for the calculation of the cap. Only the net dividends were subsequently taken into account in the amount of taxable income included in the denominator of the division done with a view to calculating the tax shield, regardless of the origin of those dividends. On the other hand, the withholding tax levied in Sweden was still not taken into account in the total taxes included in the numerator of that division and giving the right to restitution of the tax pursuant to Article 1 and Article 1649-0 A of the GTC.

54 The fact that the tax paid in Sweden is excluded from the taxes taken into account for the purposes of applying the tax shield amounts to less favourable tax treatment for taxpayers such as Ms Bouanich who reside in France and receive dividends from companies established in Sweden.

55 In circumstances such as those at issue in the main proceedings, such less favourable tax treatment is liable to discourage natural persons subject to unlimited income tax in France from investing their capital in companies established in another Member State. In so far as the conditions for the application of the tax shield with respect to French taxpayers who have invested their capital in another Member State are more restrictive than those applicable to a national situation, that fact may also have a restrictive effect in relation to companies established in a Member State other than the French Republic, in that they constitute an obstacle to the raising of capital in France.

56 In those circumstances, it must be found that legislation such as that at issue in the main proceedings, because of the difference in treatment it imposes between resident taxpayers depending on whether they receive dividends from a company established in the national territory

or from a company established in another Member State, constitutes a restriction on the free movement of capital prohibited, in principle, by Article 63 TFEU.

Whether there is a restriction on the freedom of establishment

57 Article 49 TFEU requires the abolition of restrictions on the freedom of establishment. Therefore, even though, according to their wording, the Treaty provisions on freedom of establishment are aimed at ensuring that foreign nationals are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation (see Case C?446/03 *Marks & Spencer* [2005] ECR I?10837, paragraph 31, and Case C?371/10 *National Grid Indus* [2011] ECR I?12273, paragraph 35).

58 It is also settled case-law that all measures which prohibit, impede or render less attractive the exercise of the freedom of establishment must be regarded as restrictions on that freedom (see Case C?380/11 *DI. VI. Finanziaria di Diego della Valle & C.* [2012] ECR, paragraph 33).

59 A difference in tax treatment of dividends received by taxpayers who are residents of a Member State on the basis of the location of the seat of the distributing company, such as that which results from the legislation at issue in the main proceedings and is set out in paragraphs 49, 51 and 52 above, is liable to constitute a restriction of freedom of establishment, prohibited in principle by Article 49 TFEU, in that it makes it less attractive for the national of that Member State to establish himself in another Member State.

60 It follows that legislation such as that at issue in the main proceedings also constitutes a restriction prohibited, in principle, by Article 49 TFEU.

Whether the restriction can be justified

61 Under Article 65(1)(a) TFEU, the provisions of Article 63 TFEU are to be without prejudice to the right of Member States to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested.

62 However, the derogation under Article 65(1)(a) TFEU, which is to be strictly interpreted, is itself restricted by Article 65(3) TFEU, which provides that the national provisions referred to in paragraph 1 of that article 'shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63 [TFEU]' (see Case C?319/02 *Manninen* [2004] ECR I?7477, paragraph 28, and Case C?194/06 *Orange European Smallcap Fund* [2008] ECR I?3747, paragraph 58).

63 Therefore, the unequal treatment permitted under Article 65(1)(a) TFEU must be distinguished from the discrimination prohibited by Article 65(3) TFEU. According to the Court's case-law, for a national tax provision which distinguishes between taxpayers depending on the place where their capital is invested to be capable of being regarded as compatible with the Treaty provisions on the free movement of capital, the difference in treatment applies to situations which are not objectively comparable or is justified by overriding reasons in the public interest (see, to that effect, Case C?35/98 *Verkooijen* [2000] ECR I?4071, paragraph 43; *Manninen*, paragraph 29; and *Orange European Smallcap Fund*, paragraph 59).

64 It has already been established, at paragraphs 47 and 48 above, that the different tax treatment under the French legislation at issue in the main proceedings for dividends of companies established in other Member States concerns situations which are otherwise objectively

comparable.

65 In those circumstances, a restriction on the free movement of capital or the freedom of establishment such as follows from the legislation at issue in the main proceedings is permissible only if it is justified by an overriding reason in the public interest. It is further necessary, in such a case, that the restriction is appropriate for ensuring the attainment of the objective in question and does not go beyond what is necessary to attain it (see *National Grid Indus*, paragraph 42; Case C?250/08 *Commission* v *Belgium* [2011] ECR I?12341, paragraph 51; and, to that effect, *Test Claimants in the FII Group Litigation*, paragraphs 54 and 55).

66 Therefore, it must be determined whether the restriction at issue in the main proceedings can be justified by the overriding reasons in the public interest relied upon by the various governments which presented observations to the Court, concerning the need to maintain the coherence of the French tax system and to ensure a balanced allocation of powers of taxation between the French Republic and the Kingdom of Sweden.

Need to maintain the coherence of the tax system

67 According to the French Government, the tax shield aims to avoid direct taxes being confiscatory in nature or imposing on a category of taxpayers a burden which is excessive in the light of their capacity to contribute. Having regard to that objective, a direct link exists between, on the one hand, the tax advantage granted, namely the refund to the taxpayer of the portion of taxes paid in France which exceeds the threshold defined in Article 1 of the GTC, and, on the other, the offsetting of that advantage with the direct taxes which the taxpayer paid in France.

68 According to that government, on the contrary there is no direct link between the tax paid abroad and the refund by the French State of that tax.

69 In that respect, it should be noted that, admittedly, the Court has previously accepted that the need to preserve the coherence of a tax system may justify legislation restricting fundamental freedoms (see *Test Claimants in the FII Group Litigation*, paragraph 57 and the case-law cited). However, for an argument based on such justification to succeed, a direct link has to be established between the tax advantage concerned and the offsetting of that advantage by a particular tax levy (see *Manninen*, paragraph 42, and *Santander Asset Management SGIIC and Others*, paragraph 51 and the case-law cited), the direct nature of that link falling to be examined in the light of the objective pursued by the rules in question (see, to that effect, Case C?418/07 *Papillon* [2008] ECR I?8947, paragraph 44; Case C?303/07 *Aberdeen Property Fininvest Alpha* [2009] ECR I?5145, paragraph 72; and *Test Claimants in the FII Group Litigation*, paragraph 58).

70 As the Commission noted, in order to examine the possible justifications of the legislation at issue in the main proceedings, a distinction must be drawn between the granting of a tax credit resulting from the Franco-Swedish Agreement and the granting of the right to restitution of tax through the tax shield.

71 As regards the tax credit resulting from the Franco-Swedish Agreement, there is a direct link between the tax advantage granted and the offsetting of that advantage by a particular levy, the one levied at source by the Kingdom of Sweden on Swedish investment income.

72 On the other hand, as regards the tax shield, there is no link between the tax advantage in the form of the restitution of tax which that measure may give rise to for the benefit of the taxpayer and the offsetting of that advantage by a particular levy.

73 Indeed, the tax advantage granted by way of the tax shield is not offset by any levy, in so far

as that tax provision merely has the purpose and effect of reducing the level of taxation of income on which the French Republic exercises its power of taxation.

74 As the EFTA Surveillance Authority noted, the amount of tax refunded as a result of the tax shield depends on the total amount of direct taxes paid by the taxpayer and on whether that amount exceeds the threshold set by the GTC. The tax advantage at issue in the main proceedings is not granted in correlation to a specific tax levied but is only granted if the total tax paid exceeds a certain percentage of taxpayers' income for the year. It follows that no direct link can be established between the tax advantage concerned and a particular tax levied.

The need to safeguard a balanced allocation of powers of taxation between the Member States

75 As regards the need to safeguard a balanced allocation of powers of taxation between the Member States, the French Government claims that, in the context of the Franco-Swedish Agreement, each of the two signatory States waives a right to a portion of the tax which it could levy if it were not bound by that agreement. On the one hand, the Kingdom of Sweden agrees to limit to 15% the rate of withholding tax on dividends paid to a person resident for tax purposes in France. On the other, the French Republic agrees to prevent double taxation of those dividends by the imputation on the French tax of a tax credit equal to the Swedish withholding tax.

76 According to that government, the tax shield gives due effect to that agreement-based regime and to the elimination of double taxation taken on by the French Republic as the taxpayer's State of residence. Thus, the calculation of taxes capable of being capped takes account of only the amount of direct taxes paid in France, after the imputation of a tax credit equal to the withholding tax paid in Sweden.

77 By its very nature, the tax shield has the purpose of limiting the exercise of the French Republic's tax jurisdiction by capping the total amount of direct taxes in theory payable, in that Member State, by the taxpayer at a fraction (60% or 50%) of his income. In so far as that provision falls within the sole competence of that Member State, it is relevant to include only the taxes paid in France in the calculation of the restitution from which the taxpayer may benefit.

78 The French Government considers that the taking into account of taxes paid abroad in that calculation would oblige, by contrast, the taxpayer's State of residence to bear the burden of the restitution of a tax which contributed not to its tax revenue, but to that of another Member State acting as the State from which the income originated.

79 Similarly, the United Kingdom claims that a balanced allocation of powers of taxation between the Member States implies that a Member State is entitled to exercise its jurisdiction to tax activities in its own territory without having to take into account another Member State's exercise of its own powers of taxation. According to the United Kingdom Government, to require the French Republic, for the purposes of determining the tax cap set in Article 1 of the GTC, to add any withholding tax levied in Sweden to the total direct tax paid by the taxpayer in France would require the French Republic to take into account the Kingdom of Sweden's exercise of its own powers of taxation and would compensate the taxpayer for any withholding tax paid in Sweden.

80 That justification cannot, however, be accepted.

81 A justification connected with the need to safeguard the balanced allocation of powers of taxation between the Member States may be accepted, in particular, where the tax system in question is designed to prevent conduct capable of jeopardising the right of a Member State to exercise its powers of taxation in relation to activities carried on in its territory (see Case C?347/04 *Rewe Zentralfinanz* [2007] ECR I?2647, paragraph 42; Case C?231/05 *Oy AA* [2007] ECR I?6373,

paragraph 54; *Aberdeen Property Fininvest Alpha*, paragraph 66; and Case C?284/09 *Commission* v *Germany* [2011] ECR I?9879, paragraph 77).

82 In the present case, the question of allocation of powers of taxation between the French Republic and the Kingdom of Sweden was dealt with in the Franco-Swedish Agreement under which each of those States is entitled to tax dividends acquired and received on its territory. In those circumstances, the French Republic retained the right to tax Swedish investment income and agreed to grant a tax credit to reduce the effect of that double taxation in favour of taxpayers resident in France. That Member State therefore freely accepted the allocation of powers of taxation as results from the very provisions of the Franco-Swedish Agreement.

83 That mechanism of allocation of taxation provided for by the Franco-Swedish Agreement cannot nevertheless justify the restriction resulting from the application of the legislation on the tax shield.

84 It must be recalled, in that respect, that, in accordance with settled case-law, although the Member States are free to determine the connecting factors for the allocation of fiscal jurisdiction in bilateral conventions for the avoidance of double taxation, that allocation of fiscal jurisdiction does not allow them to apply measures contrary to the freedoms of movement guaranteed by the Treaty. As far as concerns the exercise of the power of taxation so allocated by bilateral conventions to prevent double taxation, the Member States must comply with EU rules (see, to that effect, Case C?385/00 *de Groot* [2002] ECR I?11819, paragraphs 93 and 94; Case C?265/04 *Bouanich* [2006] ECR I?923, paragraphs 49 and 50; and Case C?303/12 *Imfeld and Garcet* [2013] ECR, paragraphs 41 and 42).

85 The restitution of tax granted under the tax shield is a tax advantage provided for by the French legislation, which limits the tax burden of taxpayers by applying a system of capping guaranteeing the restitution of tax paid above a certain percentage. Such a tax capping mechanism does not affect the possibility of the French Republic taxing the activities carried on in its territory, nor does it restrict the possibility of that Member State taxing income acquired in another Member State.

86 Therefore, as regards the conditions for the application of that tax provision, the question of any allocation of powers of taxation between Member States does not arise.

87 In those circumstances, the restriction which national provisions such as those at issue in the main proceedings place on the free movement of capital and on the freedom of establishment cannot be justified either by the need to safeguard the coherence of the national tax system or by the need to safeguard the allocation of powers of taxation between the Member States.

88 Therefore, the answer to the questions is that Articles 49 TFEU, 63 TFEU and 65 TFEU must be interpreted as precluding legislation of a Member State under which, where a resident of that Member State who is a shareholder of a company established in another Member State receives dividends taxed in the two Member States and the double taxation is regulated by the imputation in the Member State of residence of a tax credit of an amount corresponding to the tax paid in the State of the distributing company, a mechanism capping various direct taxes at a certain percentage of income received during a year does not take into account, or takes only partially into account, the tax paid in the State of the distributing company.

Costs

89 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the referring court, the decision on costs is a matter for that court. Costs incurred in

submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Fifth Chamber) hereby rules:

Articles 49 TFEU, 63 TFEU and 65 TFEU must be interpreted as precluding legislation of a Member State under which, where a resident of that Member State who is a shareholder of a company established in another Member State receives dividends taxed in the two Member States and the double taxation is regulated by the imputation in the Member State of residence of a tax credit of an amount corresponding to the tax paid in the State of the distributing company, a mechanism capping various direct taxes at a certain percentage of income received during a year does not take into account, or takes only partially into account, the tax paid in the State of the distributing company.

[Signatures]

* Language of the case: French.