



Euro Tax Flash from KPMG's EU Tax Centre



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CJEU decision in the Egiom and Enka case

Freedom of establishment — Parent-Subsidiary Directive – Withholding tax on dividends paid to non-resident – Prevention of tax evasion and abuse - Burden of proof

On September 7, 2017, the Court of Justice of the European Union (CJEU) rendered its decision in the Egiom and Enka case ([C-6/16](#)). The case concerned the refusal by France to grant an exemption from withholding tax on dividend distributions by a resident subsidiary to its parent company located in the EU, which is controlled by shareholders in third States. The exemption was refused on the grounds of preventing tax evasion or abuse.

The Court ruled that the French rules were contrary to Article 1(2) of the Parent-Subsidiary Directive and the EU freedom of establishment.

Background

Article 5 of the Parent-Subsidiary Directive provides for an exemption from withholding tax on distributions of dividends by a resident subsidiary to its non-resident parent company located in the EU. However, under Article 1(2) of the Parent-Subsidiary Directive, in the version applying at the time, the withholding tax exemption can be refused under domestic or treaty provisions for preventing fraud or abuse.

In the present case, the French tax authorities refused to exempt dividends distributed in 2005 and 2006 by a French resident company to its Luxembourg parent company which was, in turn, indirectly controlled by a company resident in Switzerland. This refusal was based on a French provision that attempts to avoid 'directive shopping' by requiring the taxpayer parent – if it is controlled by non-EU residents – to prove that the principal purpose or one of the principal purposes behind the structure is

not to take advantage of the exemption. The questions referred to the CJEU addressed in particular whether the French rules were compatible with, on the one hand, Article 1(2) of the Parent-Subsidiary Directive and, on the other, the EU fundamental freedoms.

The CJEU decision

In principle, any national measure in an area which has been the subject of exhaustive harmonization at the level of the European Union must be assessed in the light of the provisions of that harmonizing measure, and not in the light of the provisions of primary EU law.

However, referring to its earlier case law, the Court noted that Article 1(2) of the Parent-Subsidiary Directive is not intended to achieve exhaustive harmonization since it recognizes only the right of Member States to apply domestic or treaty provisions required to prevent fraud or abuse. It therefore follows that the French rules under examination have to be assessed in the light of Article 1(2) of the Parent-Subsidiary Directive as well as the relevant provisions of primary EU law i.e. the fundamental freedoms.

Referring to its earlier case law, the Court noted that this derogation from the withholding tax exemption rule must be interpreted strictly. The Court also noted that Article 1(2) only allowed such a derogation if 'required' to prevent fraud or abuse. Recalling its earlier case law, the Court noted that in order for domestic legislation to be justified by the need to avoid tax evasion and abuse, its specific objective must be to prevent conduct consisting of the creation of wholly artificial arrangements which do not reflect economic reality, with a view to unduly obtaining a tax advantage. Thus a general presumption of fraud or abuse cannot justify a tax rule that conflicts with a directive.

In the present case, the Court concluded that the French rules generally covered all situations in which a parent company located outside France is controlled directly or indirectly by shareholders in third States, and were not specifically designed to exclude from the withholding tax exemption purely artificial arrangements designed to benefit from that exemption. The Court, following the conclusions of the Advocate General, ruled that such a general presumption that this will involve fraud and abuse is not permissible under the Directive. In practice, the tax authorities may not confine themselves to applying predetermined general criteria, but must carry out an individual examination of the whole operation in order to determine whether an operation pursues an objective of fraud and abuse. The automatic application of a general tax measure excluding certain categories of taxpayers from the tax advantage without the tax authorities being obliged to provide *prima facie* evidence of tax evasion goes further than is necessary for preventing fraud and abuse.

The Court thus ruled that the French rules were contrary to Article 1(2) of the Parent-Subsidiary Directive.

As regards the freedom of establishment and whether this was restricted, the Court ruled that adopting an initial presumption of abuse where the EU parent company is controlled by shareholders in third States, while the withholding tax exemption is granted automatically to a French parent company even though it is controlled by shareholders in third States, constitutes a restriction on the freedom of establishment.

The Court noted that the objective of combating fraud and tax evasion could potentially justify such a restriction, but reached a similar conclusion regarding the proportionality of the rules to that mentioned above for Article 1(2) of the Directive, i.e. that the rules went further than necessary.

The Court therefore ruled that the freedom of establishment also precludes a national provision such as the disputed French provision that makes the granting of a withholding tax exemption on dividends distributed by a resident subsidiary to a parent company controlled by shareholders in third countries subject to the requirement to prove that the principal purpose behind the structure is not to take advantage of the exemption.

EU Tax Centre comment

The CJEU decision is in line with the AG's Opinion (please see [ETF 312](#)) and with previous CJEU decisions in cases dealing with the circumstances in which a Member State may refuse a tax advantage provided by virtue of an EU Directive on grounds of preventing tax evasion or abuse.

The decision is likely to impact the application of the new GAAR clause of the Parent-Subsidiary Directive, which took effect as of January 1, 2016. While the Parent-Subsidiary Directive still contains a provision similar to that of Article 1(2) of the Directive as it applied at the time of this case, the new provisions explicitly require Member States to deny its benefits to arrangements whose main purpose or one of its main purposes is to obtain an advantage contrary to the object of the Directive and without valid commercial reasons reflecting economic reality. It will be interesting to follow the practical implementation of this judgment by tax authorities in tax audits, in particular as regards the evidence required to justify an initial refusal of the withholding tax exemption.

Should you have any questions, please do not hesitate to contact [KPMG's EU Tax Centre](#), or, as appropriate, your local KPMG tax advisor.



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