# 1. Introduction

As in previous years, the European Court of Justice (ECJ) is dealing with quite a number of cases that relate to French direct tax law. In this contribution, we will discuss two international distribution of dividend cases and one fundamental freedom case. The first case, decided, concerns the (gross or net) tax base to limit the deductible tax credit (*règle du butoir*) provided by Double Tax Treaty ("DTT") to avoid, as much as possible, juridical double taxation (*Société Générale* case)[1] (Section 2). The cases that are still pending deal with the advance payment of tax (*précompte mobilier*) related to the old French tax credit (*avoir fiscal*) designed to prevent economic double taxation and, with the obligation placed on tax lawyers, to report "cross-border arrangements" to tax authorities. Interestingly, both of these last two cases relate to a request for a preliminary ruling not only to interpret EU secondary acts but also to decide on their validity. There is potential incompatibility between (i) in the *Schneider Electric* case[2] (Section 4), the Parent-Subsidiary Directive ("PSD") and the free movement of capital, and (ii) in the *Conseil national des barreaux* case[3] (Section 5), the recently amended (1998) Directive on Administrative Cooperation ("DAC Directive") with the rights guaranteed by both the Charter of Fundamental Rights of the European Union ("CFREU" or "Charter") and the European Convention for the Protection of Human Rights and Fundamental Freedoms ("ECHR" or "European Convention").

# 2. Société Générale SA (C-403/19)

## 2.1. Facts and legal background

This is the first ECJ decision following a saga of French cases on the treaty rule limiting the imputation of tax credits attached to dividends in the event of a purchase and resale of securities:[4] a French bank Société Générale Asset Management (SGAM) Banque ("SGAM Bank"), belonging to a tax-integrated group of which *Société Générale* is the parent company, received dividends from companies resident in Italy, the United Kingdom and the Netherlands. An amount equal to those dividends was then paid to third parties pursuant to two different standard financial contracts: (i) securities lending transactions involving the remittance by

1 ECJ, 25 February 2021, C-403/19, *Société Générale SA v. Ministre de l'Action and des Comptes publics*, ECLI:EU:C:2021:136.

2 Opinion of Advocate General Kokott, 14 October 2021, C-446/20, *Schneider Electric SA, Axa SA, BNP Paribas, Engie, Orange SA, L'Air liquide, société anonyme pour l'étude et l'exploitation des procédés Georges Claude v. Premier ministre, Ministre de l'Economie, des Finances et de la Relance*, ECLI:EU:C:2021:857.

3 C-398/21, *Conseil national des barreaux, Conférences des bâtonniers, Ordre des avocats du barreau de Paris v. Premier ministre, Ministre de l'Economie, des Finances et de la Relance*, Request for a preliminary ruling from the Conseil d'Etat (France), lodged on 28 June 2021.

4 E.g. Conseil d'Etat (France), plen. session, 7 December, 2015, no 357189, *CIC Alsace-Lorraine*.

the borrower of securities intended to guarantee those lent by SGAM Bank, which thus temporarily became the owner of the remitted securities; (ii) fund structuring transactions consisting, in particular, in managing baskets of shares corresponding to management profiles set by its contracting partners, where SGAM Bank received the dividends attached to securities included in the equity baskets. These business operations are far from anecdotal since they concern many standardized financial transactions structured under the Overseas Securities Lender's Agreement (OSLA) model contract or equity swap contracts.

In accordance with the terms of these financial contracts entered into by SGAM Bank with its contracting partners, for the first above transaction, the bank was required to return to the borrower securities equivalent to those given as collateral, so that the borrower could benefit from the payment of the dividend attached to those securities and, in the absence of restitution, either pay it a sum of money or remit property to it of a value equal to the amount of those dividends. For the second above transaction, in respect of the performance sold to its contractual partners, SGAM Bankwas required to repay a sum corresponding to the amount of dividends received and any increase in the value of the securities. It is important to note at this stage that these payments were, therefore, expenses related to dividends. In return, the customers paid SGAM Bank a fixed remuneration fee for managing the equity basket.

As a reminder, when a dividend is paid by the resident of a State to a non-resident person, the provisions of the domestic law of that State often require the debtor to make a withholding tax on the payment to that person. This taxation technique is justified by the difficulty of recovering amounts due from a non-resident person. However, the income will also be taxable in the State in which the person who is the beneficiary resides. As a consequence, the dividends will have borne a double taxation on the beneficiary who is the only one to bear the tax costs: the foreign withholding tax and the French tax.

To avoid this double taxation, the ECJ case law accepts both the ordinary credit or the exemption, but the situation depends on the absence or existence of a DTT.

In the absence of a DTT, when the sums are paid by a non-resident person to a French company that is the beneficiary of the income, the withholding tax shall not be eligible for a tax credit but shall be deductible from its tax result under Article 39, 1, 4 of the French General Tax Code according to which "*The net profit is established after deduction of all expenses, which include (…) in particular (…) 4 Subject to the provisions of section 153, taxes payable by the company, collected during the financial year (…)*". However, this deduction does not eliminate double taxation, as the following example shows.

If we assume that a French company is a creditor of dividends in the amount of 100 and further assume that the parent-subsidiary regime is not applicable, the

withholding tax applied is 15, and the tax result will therefore be equal to 85. The corporation tax (in principle 25 % as of 1 January 2022, but previously usually 33.1/3 %) will then be 21.25 %. In the end, the overall tax rate will be 36.25 %.

## The Withholding Tax is a Deductible Expense

| | |
|---|---|
| Dividend gross amount | 100 |
| WHT | –15 |
| Taxable amount | 85 |
| Corporate tax (25 %) | 21.25 |
| Foreign tax paid | 15 % |
| French tax paid | 21.25 % |
| Overall tax paid | 36.25 % |

In the presence of a DTT, the right to tax dividends is allocated between the residence State (the State of the dividend beneficiary/shareholder) and the source State (the State of the distributing company). This source State applies a withholding tax at a given rate. Note that these are not primary or secondary taxation rights (or "rule versus exception" logic) as residence or source States are on an equal footing when it comes to the allocation of taxing rights by a tax treaty.[5]

For instance, Article 10 of the Franco-Italian DTT states:

> 1. Dividends paid by a company resident in one State to a resident of the other State shall be taxable in that other State.
> 2. However, such dividends may also be taxed in the State of which the company paying the dividends is a resident and according to the laws of that State.

To eliminate this juridical double taxation of dividends, France has chosen the credit method: each State retains the right to tax the dividends in accordance with the provisions of its national law under the conditions and limits laid down by the DTT, but the State of residence of the recipient company grants a tax credit generally equal to the amount of the withholding tax, deductible of the tax payable by that company. This method organizes a tax sharing without double taxation.

For instance, Article 24(1)(a) of the above DTT provides that double taxation is to be avoided in the following manner as far as France is concerned:

> Profits and other positive income arising in Italy and taxable there under the provisions of this Convention shall also be taxable in France where they accrue to a person resident in France. The Italian tax is not to be deductible for calculation of the taxable income in France. However, the recipient shall be entitled to a tax credit to be set against

5 M. Lang, DBA-Interpretation durch den EuGH, SI 2017, p. 507 (513.); Kerschner, Deutsche Genussscheinerträge: Debut des EuGH als DBA-Schiedsrichter, ecolex 2017, p. 1102 (1005).

> the French tax charged on the taxable amount which includes that income. This tax credit shall be equal:
> – For income referred to in Articles 10, 11, 12, 16 and 17 … to the amount of tax paid in Italy in accordance with the provisions of those articles. That tax credit shall not however exceed the amount of French tax on that income.

Resuming the previous example, although the overall tax rate is equal to the corporate tax rate, this tax is distributed between the two States: 15 % for the foreign State; 10 % for the French State.

### The Withholding Tax is Eligible for a Tax Credit

| | |
|---|---|
| Dividend Gross Amount | 100 |
| Theoretical Corporate Income Tax (25 %) | 25 |
| – **Tax credit** | –15 |
| Corporate Tax | 10 |
| Foreign Withholding Tax | 15 % |
| French Tax paid | 10 % |
| Overall Tax paid | 25 % |

However, this tax credit could be limited as provided by the final provision of the Article eliminating double taxation in DTT (for instance, Article 24(1)(a) in the Franco-Italian tax treaty). This latter provision stresses that:

> That tax credit shall not however exceed the amount of French tax on that income.

This is also the case, with a slightly different wording, of the Franco-British DTT (Article 24(b)(ii)) and of the Franco-Netherlands DTT (Article 24B(b)). This limitation of the tax credit echoes French domestic tax law.[6]

This rule prevents France from granting a higher tax credit and thus having to bear all or part of the foreign withholding tax.[7]

Therefore, and under this rule, the deductible tax credit is capped at the amount of "corporation tax theoretically payable" by the French company in respect of the income that has been withheld at source, less the expenses relating to that income. It is this *theoretical tax base* which determines the maximum deduction as provided for by DTT. It will be recalled, in the determination of this *theoretical tax base*, that this tax base adopted by France, and protected by the principle of tax sovereignty, consists of taking into account, in addition to the expenses directly *related* to the income received, all the expenses related to the acquisition, the retention and disposal of the product-generating asset, in accordance with Article 39(1) of the General Tax Code.

6 French General Tax Code, Article 220 paragraph 1.
7 Paragraph 22 *in fine* of the Société Générale decision.

For example, a corporation received dividends of a gross amount of 100 for which a withholding tax of 15 applied. Assuming that the parent-subsidiary regime is not applicable, the expenses associated with these dividends amount to 70.

### Theoretical Corporate Tax

| | |
|---|---|
| Dividends Gross Amount | 100 |
| Expenses | –70 |
| Dividend Net Taxable Amount | 30 |
| Theorical Corporate Tax (25 %) | 7.5 |
| | |
| Foreign Withholding Tax | 15 |
| Deductible Withholding Tax | 7.5 |

The withholding tax will be deductible on corporation tax only up to 7.5,[8] whereas it amounts to 15.

Having this background in mind, the main question in the *Société Générale* case was how to apply the rule for calculating the maximum deductible tax credit, given the expenses paid according to the two financial contracts and its consistency with the free movement of capital. How to treat these expenses related to the Italian, UK and Dutch dividends within the computation of the limitation of the tax credit (*règle du butoir*)? More precisely, the question was to determine if this *maximum deduction* of the tax credit was limited to the French corporate income tax corresponding to those dividends after deduction of these expenses (net amount) or before this deduction (gross amount).

In the context of the two types of financial transactions, the position of SGAM Bank was as follows: the bank received dividends paid by companies resident in Italy, the United Kingdom, and the Netherlands, less withholding tax paid on the dividends in those three countries respectively. Consequently, SGAM Bank offset – against the amount of corporate income tax due in France – the tax credits corresponding to those withholding taxes. As they had been subject to withholding tax in the source State on the gross amount, the French company deducted from the corporate income tax which it was liable for in France, the tax credits provided for by the DTTs concluded by France with these countries. The deduction amounted to the withholding taxes.

However, the tax authorities reassessed the French bank on the grounds that the amount paid, in accordance with the terms of the contracts entered into by the

8 Dividend Gross Amount (100) – Expenses (70) = Dividend Net Taxable Amount (30), upon which the Theoretical Corporate Tax (at a rate of 25 %) would be 7.5.

bank, was an expense connected to the dividends which should then be deducted from the *theoretical tax base* determining the maximum deduction as provided for by the three tax treaties. Such computation method (the so-called ordinary one by the OECD) reduced to almost nil the amount of the tax credits.

Before the *Conseil d'Etat* (France), *Société Générale* argued that this limitation contravened the free movement of capital enshrined in Article 63 of the TFEU (former Article 56 of the TEC). According to Société Générale, transactions made by companies subject to corporation tax in France involving the securities of foreign companies are at a disadvantage compared to those involving securities of French companies, because of the difference between the tax base applied by the Member State in which the dividends are paid and that of French corporation tax, which determines the maximum amount of the tax credit that can be deducted. The latter only allows for an insufficient amount of the foreign withholding taxes to be offset against the French corporation tax.

In the *Société Générale* case, the withholding tax paid in Italy, the United Kingdom, and the Netherlands has been calculated on the gross amount of those dividends without the possibility of deduction of expenses. Whereas French corporation tax is calculated on a net basis in which the French Republic allows the deduction of charges, the net income for the calculation of the tax credit is reduced by that deduction of charges.

In other words, a company established in France, placing transactions involving securities of non-resident companies has a disadvantage compared to companies placing transactions involving securities of resident companies. This results in a higher tax burden on foreign source dividends than on domestic source dividends.[9]

Assume that a bank receives, in the context of a securities lending transaction, dividends in the amount of 100 and has to return 100 % of the dividends received to its co-contracting party. This bank further receives additional income in the amount of 200. In this scenario, the French corporate income tax rate is 25 %.

If, on the one hand, the securities held temporarily are securities held in a French company, the situation will be as follows: the bank will record an income of 100 in respect of dividends received, an income of 200 in respect of other income, and an expense of 100, deducted under its contractual obligations under the securities loan. In total, it will therefore report a taxable income of 200. The corporation tax to which it is subject is 50, or an effective tax rate of 25 % (50/200).

9 Paragraph 36.

## Distribution from a FRENCH subsidiary

### *Corporate Tax*

| | |
|---|---|
| Dividends Gross Amount | 100 |
| Other Income | 200 |
| Expenses | –100 |
| Dividend Net Taxable Amount | 200 |
| Corporate Tax (25 %) | 50 |
| **Effective Tax Rate** | **25 %** |

If, on the other hand, the same bank placed transactions involving securities held in a company resident in another State which, under the DTT, it entered into with France, applies a withholding tax at the rate of 15 % on dividends, the situation shall be as follows: a withholding tax of 15 will be levied in the source State; the Bank will record an income of 100 (85 net dividend + 15 DTT tax credit) plus an income of 200 on other income, and deduct an expense of 100, which will bring its taxable income to 200, as in the case of the collection of dividends from French sources.

However, the *mini-P&L account* used to calculate the *theoretical corporate tax* determining the maximum deduction of the tax credit will take into account the amount of expenses repaid of 100, or a base equal to 0 (100 – 100), implying that the entire tax credit falls into default.

The total effective tax rate is 32.5 % ((15 + 50)/200).

## Distribution from a FOREIGN subsidiary

### *Theoretical Corporate Tax*

| | |
|---|---|
| Dividends Gross Amount | 100 |
| Other Income | 200 |
| Expenses | –100 |
| Dividend Net Taxable Amount | 200 |
| Theorical Corporate Tax (25 %) | 50 |
| | |
| Foreign Withholding Tax | 15 |
| Deductible Withholding Tax | |
| French Corporate Tax (25 %) | |
| Overall Effective Tax Rate ((15 + 50)/200) | 32.5 % |

It follows that, in the event of a distribution from a foreign source and with identical tax results, the beneficiary company bears a tax surcharge in relation to the situation where it would have received dividends from French sources.

The Conseil d'Etat (France) was well aware of the Court's case law, but was "unsure as to the margin of discretion left to Member States when adopting a mechanism for the elimination of double taxation." Therefore, it referred the question of whether the application of the above rule, limiting the credit to the amount which the first Member State would receive if those dividends alone were subject to corporate tax and thus creating a disadvantage to the detriment of transactions involving the securities of foreign companies, violated the free movement of capital under Article 63.

## 2.2. Judgment and comments

The Second Chamber of the ECJ delivered its decision on 25 February 2021.[10] The Court first observed that dividends distributed by a company established in one Member State to a shareholder resident in another Member State are liable to be subject to juridical double taxation where the two Member States choose to exercise their fiscal competence and to subject those dividends to taxation in the hands of the shareholder.[11]

The Court then repeated its previous case law that the disadvantages that may result from the parallel exercise of the tax powers of the various Member States do not constitute restrictions prohibited by the FEU Treaty in so far as such an exercise is not discriminatory.[12]

The Court then checked if French law was discriminatory and observed that all resident companies are subject to corporation tax on dividends received, regardless of whether such dividends are from domestic or foreign sources, and that such income is part of the total income of the company concerned, from which operating costs are deducted, without any reference to differential tax rates, and, lastly, that the same rules for allocating costs which derive from the French General Tax Code would apply to that income, regardless of its origin.[13]

Therefore, France makes no discrimination between domestic income and foreign income: the same tax base rules and rate apply in France, whatever the origin of the dividends.

In particular, the Court noted that the charges relating specifically to dividends deducted in making that calculation, in accordance with the case-law of the *Conseil d'Etat*, also appear to be deducted from the overall profits of the resident company in respect of domestic-source dividends.[14]

10 See supra fn no 1.
11 Paragraph 27.
12 Paragraph 28 citing *Haribo Lakritzen Hans Riegel* (2011) and *Baudinet and Others (*2016).
13 Paragraph 32.
14 Paragraph 34.