The levying of dividend withholding tax on foreign shareholders is a topic of great importance throughout Europe. The recent decision in Société Générale by the Court of Justice of the European Union confirms that a foreign corporate shareholder should effectively not be taxed more heavily than a comparable domestic shareholder. On balance, however, one could wonder whether the outcome in this case is not just a mere Pyrrhic victory for corporate non-resident shareholders having portfolio investments in the Netherlands.

1. Introduction

On 17 September 2015, the Court of Justice of the European Union (ECJ) issued its ruling in the Société Générale case.[1] The Court concluded that non-resident corporate shareholders may not be subject to a higher effective tax burden on their Dutch dividends than that incurred by Dutch resident corporate shareholders on the same dividends, based on article 63 of the Treaty on the Functioning of the European Union (TFEU). This article analyses the Court's decision in more detail.

2. Withholding Taxes and TFEU Freedoms

2.1. Withholding taxes and TFEU freedoms from a taxpayer perspective

Many Member States have dividend withholding taxes in force. The basic rationale behind these withholding taxes may vary among Member States. As concerns dividends, a system of withholding tax may be based on the principle of source-country entitlement.[2] In addition, a system of withholding taxes may be explained by administrative concerns related to the determination and the collection of tax.[3] Lastly, withholding taxes are also regarded as an important tool during tax treaty negotiations.[4]

That being said, it follows from, for example, Bouanich,[5] Test Claimants in the ACT GLO,[6] Denkavit,[7] Amurta,[8] Aberdeen,[9] Commission v. Italy[10] and Commission v. Spain[11] that, where a Member State taxes not only resident shareholders, but also non-resident shareholders on dividend income paid out by a company resident in that Member State, the situation of those non-resident shareholders becomes comparable to that of resident shareholders. This implies that, first, a non-resident shareholder must – in the absence of valid grounds for justification – be offered the possibility

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[1] NL: ECJ, 17 Sept. 2015, Joined Cases C-10/14, C-14/14 and C-17/14 (Miljoen, X, Société Générale SA v. Staatssecretaris van Financiën), ECJ Case Law IBFD.
to deduct expenses that are directly linked to the received dividend income if such a possibility is also available for a comparable resident shareholder and only to the extent that the non-resident shareholder consequently suffers from a higher effective tax burden on its dividend income compared to a comparable resident shareholder.\footnote{12} When drawing this comparison, a possible reduction of withholding tax based on the applicable income tax treaty should be taken into account, as well.\footnote{13}

Second, from Denkavit it follows that the same approach applies where a comparable resident shareholder would effectively pay no tax at all on received dividend income paid out by a domestic company, for instance by virtue of a full exemption aiming at the avoidance of double taxation of distributed profits. In such a case, comparable non-resident shareholders should — in the absence of a valid justification ground — be entitled to the same exemption, as well.\footnote{14}

Nevertheless, it follows from Amurta that no discrimination exists where the restrictive effects of a discriminatory withholding tax applied by one Member State are neutralized under the applicable tax treaty by the Member State where the shareholder is a resident, for instance by means of a direct tax credit available in the residence state.\footnote{15} This exception is, however, subject to a number of strict conditions. First, where the dividends are not taxed, or are not sufficiently taxed in the hands of the shareholder in its state of residence as a result of which the sum withheld at source by the other Member State or part thereof cannot be set off, the restrictive effects of the discriminatory withholding tax are not neutralized under the applicable tax treaty.\footnote{16} Second, it follows from Amurta that unilateral relief granted by the state of residence of the shareholder does not neutralize the restrictive effects of a discriminatory withholding tax.\footnote{17} Relief must thus be based on a tax treaty.

The subsequent question arises regarding the extent to which a discriminatory withholding tax can be justified. From Commission v. Italy and Aberdeen one can infer that a discriminatory withholding tax can be justified on the basis of the need to combat tax evasion, but only where the tax system specifically aims at purely artificial arrangements which do not reflect economic reality and which are created solely with a view to escaping the tax normally due on the profits generated by activities carried out within national territory.\footnote{18} In the author’s opinion, an example would be practices involving so-called “dividend stripping”.\footnote{19} However, where all dividends distributed to companies established in other Member States are categorically made subject to a less favourable tax regime, such less favourable treatment cannot generally be justified by reference to the fight against tax evasion.\footnote{20}

With regard to the assertion of the need to preserve the balanced allocation of taxation powers, the ECJ has consistently held that a Member State cannot rely on this argument to justify a discriminatory withholding tax where it has chosen not to tax recipient companies established in its own territory in respect of dividend income.\footnote{21} This argument is confirmed in so far as dividends distributed by resident companies were already taxed at the level of the distributing companies as profits realized.\footnote{22} Finally, the argument to preserve the coherence of the tax system has also not been accepted by the ECJ to date as a valid justification to grant a full exemption to only resident shareholders because no sufficient direct link between the exemption, on the one hand, and a tax levy offsetting the exemption, on the other, could be established.\footnote{23}

### 2.2. A system of withholding taxes as such and TFEU freedoms

Regarding the question as to whether a system of withholding taxes as such may infringe the TFEU freedoms, a distinction must be made between the position of the taxpayer and the position of the withholding agent. From cases such as Commission v. Spain and Truck Center one can defer that a system of withholding taxes as such does not, from the

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perspective of the recipient, constitute a restriction, even if the taxpayer were to suffer a cash flow disadvantage.[24] This means that Member States are allowed to subject non-resident shareholders to a withholding tax system, even if resident shareholders are subject to a system of personal or corporate income tax.

From the perspective of the withholding agent, on the other hand, the obligation to withhold could constitute a restriction.[25] From the Scorpio case it nonetheless follows that such a restriction can be justified on the basis of the need to ensure the effective collection of tax.[26] As in this case, the Recovery Directive was not yet applicable, the question therefore was whether the outcome would be different if the Recovery Directive were to apply. This question was answered in the X case.[27] In that case, the ECJ held that, from the perspective of the withholding agent, reliance on the Recovery Directive could not be considered as a suitable and less-restrictive alternative for a system of withholding taxes as such. This means that from the perspective of the withholding agent, a system of withholding taxes as such is justified.

However, from the Commission v. Belgium case, it follows that under specific circumstances the conclusion may be different.[28] In that case, the ECJ held the obligation to withhold tax imposed on certain service recipients, to be disproportionate. In the author’s opinion, however, this ruling must be seen in light of the specific circumstances at hand and should therefore not be generalized.

3. The Société Générale Case

3.1. Facts of the case

Société Générale (the taxpayer) is a bank established in France that carries on a banking business in the Netherlands and a securities business in France. The taxpayer received Dutch portfolio dividends during the years 2000-2008 in the operation of its French securities business. These dividends were subject to Dutch dividend withholding tax at a rate of 15%, resulting in a total tax amount of more than EUR 80 million. On the basis of the free movement of capital as set forth in article 63 of the TFEU, the taxpayer sought a refund of this amount. According to the taxpayer, the dividends would have been subject to Dutch corporate income tax at a higher rate – but on a net basis – were the taxpayer established in the Netherlands. On balance, this would result in a lower amount of tax due. The taxpayer had been able to credit the Dutch dividend tax against its French tax liability in the years up to and including 2007. In 2008, there was no ability to credit the Dutch withholding tax due to the fact that the taxpayer was in a loss position that year.

The taxpayer argued that the levy of 15% Dutch withholding tax on a gross basis constituted a restriction of the free movement of capital. This is because a comparable domestic corporate investor would be subject to a final Dutch corporate income tax on the basis of which the dividend would be taxable on a net basis at a rate of 25%, against which the Dutch withholding tax of 15% on a gross basis could be credited, whereby any excess would be refundable. In other words, the taxpayer argued that the effective taxation on a net basis in a domestic situation would be lower than the imposed Dutch withholding tax at a 15% rate on a gross basis.

On 20 December 2013, the Dutch Supreme Court requested a preliminary ruling concerning the interpretation of article 63 of the TFEU. The questions submitted to the ECJ included:

- what the grounds of comparison are between a non-resident and resident where the dividend tax can be offset by the latter against its final corporate income tax liability;
- what expenses one may take into account when comparing (i) the gross dividend taxation against a low fixed rate in the cross-border situation with (ii) the dividend taxation in the domestic situation on a net basis against a higher rate; and whether a discriminatory withholding tax is neutralized if the taxpayer is factually entitled to a full credit or whether, by contrast, the ECJ requires that the tax treaty – legally speaking – guarantee that any discriminatory withholding tax is always fully credited in France; and

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24 BE: ECJ, 22 Dec. 2008, Case C-282/07, Belgian State v. Truck Center SA, ECR 10767, para. 41, ECJ Case Law IBFD; Commission v. Spain (C-487/08), para. 54.
25 Scorpio (C-290/04), para. 37; BE: ECJ, 9 Nov. 2006, Case C-433/04, Commission of the European Communities v. Kingdom of Belgium, ECR I-10653, ECJ Case Law IBFD.
26 Scorpio (C-290/04), para. 37. This conclusion is without prejudice to the fact that where relief for withholding tax is available (for instance under the applicable tax treaty), the procedures for claiming relief should be as little cumbersome as possible. See also European Commission, Recommendation on Withholding Tax Relief Procedures, 19 Oct. 2009, COM(2009)7924 final.
28 Commission v. Belgium (C-433/04), paras. 39-40.
with regard to 2008, whether carry-forward possibilities in the shareholder’s residence state (i.e. France) must be taken into account also when determining whether a discriminatory withholding tax is factually neutralized in the shareholder’s residence state.

3.2. The decision of the ECJ

The ECJ first held that the freedom of capital was restricted in the case where Dutch legislation imposed different treatment for resident and non-resident taxpayers. This occurred when the Netherlands refrained from extending to the latter the advantage of offsetting the tax withheld in that territory against the respective corporate income tax. In other words, when making the comparison with the taxation of resident corporate shareholders, the combined effect of the Dutch dividend withholding tax and Dutch corporate income tax of the latter should be taken into account.\[29\]

Subsequently, the ECJ decided that in order to determine whether the effective tax burden for non-resident corporate shareholders is higher than the effective tax burden for resident corporate shareholders, it is necessary to take into consideration any expenses directly related to the holding of shares from which the dividends are paid. In this regard, the Court held that such a link exists only if the expenses – which may, in some circumstances, be directly linked to a sum paid in connection with a securities transaction – are directly linked to the actual payment of that income.\[30\] It follows that only expenses which are directly linked to the actual payment of the dividends must be taken into account for the purposes of comparing the tax burden of companies. The Court thus rejected the taxpayer’s argument that it is not only the direct expenses attributable to the dividends which must be taken into account, but also the negative effects of rates and transactions on shareholdings and positions other than those from which the dividends arise, but with which there is nonetheless a connection.

As, under the Netherlands-France income tax treaty, the tax credit may not exceed the amount of the tax levied in France, the ECJ finally did not rule out that the full amount of the Dutch tax on dividends paid in the Netherlands would not be neutralized due to the loss position of the taxpayer in 2008. In such an event (which is for the Dutch referring court to determine), a restriction of the free movement of capital cannot be considered as justified.\[31\] On the contrary, the Court thus accepted that, as long as in a particular case a discriminatory withholding tax is – as a factual matter – fully neutralized in the state of residence of the shareholder on the basis of a tax treaty, no discrimination exists, even if the measure as such does not guarantee in the abstract that a discriminatory withholding tax is always fully neutralized in other cases, as well.

The ECJ held that the question as to whether carry-forward possibilities in the shareholder’s residence state must be taken into account also when determining whether a discriminatory withholding tax is factually neutralized in the shareholder’s residence state, was hypothetical, and therefore the Court refrained from providing an answer.\[32\]

4. Assessment of the Decision

4.1. Gross versus net basis comparison: Did the ECJ close the door?

The most striking aspect of the Société Générale decision is that the ECJ appears to adhere to a narrow concept of “directly related expenses” for purposes of calculating the effective net tax burden that would apply in the comparable domestic situation. The Court ruled that only expenses which are directly linked to the actual payment of the dividends must be taken into account for the purposes of comparing the tax burden of companies. The gross basis taxation of non-resident corporate shareholders at a 15% tax rate would exceed the net basis taxation of resident corporate shareholders at a 25% tax rate if the taxpayer has incurred at least 40% of expenses that relate to the Dutch dividends.\[33\] One may wonder, however, whether this 40% threshold will ever be reached under the strict ECJ definition.\[34\]

\[29\] Commission v. Belgium (C-433/04), para. 46 et seq.

\[30\] Commission v. Belgium (C-433/04), para. 59.

\[31\] Commission v. Belgium (C-433/04), para. 86.

\[32\] Commission v. Belgium (C-433/04), para. 88.

\[33\] In the case of dividend income of 100, a Dutch dividend withholding tax of 15 applies. If the attributable expenses exceed 40, the net investment income would be less than 60. Given a corporate income tax rate of 25%, the effective corporate income tax due would then be less than 15% (25% of 60 = 15). Only under these circumstances would the levy of Dutch withholding tax on a gross basis at a 15% tax rate be less favourable than the levy of corporate income tax on a net basis at a 25% rate.

\[34\] On 9 October 2015 (DB/2015/338U), the Dutch State Secretary for Finance reacted to the Société Générale ruling and also indicated that – given the narrow approach of the ECJ – the 15% Dutch withholding tax on a gross basis will constitute a discrimination for non-resident corporate investors only in rare cases.
This strict approach seems furthermore to be at odds with earlier ECJ case law. Notably, in the *Commission v. Finland* case, the Court placed deductible reserves of a Finnish pension fund on par with expenses relating to the Finnish dividend income received by a Finnish pension fund. As the effect of the deduction of reserves effectively boiled down to an exemption for Finnish dividends received by Finnish pension funds, the Court concluded that foreign pension funds should be entitled to the same deduction.[35] The Court did not explain how its decision in *Société Générale* relates to this previous case law.

Furthermore, under the Dutch rules for avoidance of double taxation of Dutch resident shareholders investing abroad, not only directly related expenses, but also indirectly related expenses are taken into account when calculating the amount for which the Netherlands will grant relief for double taxation. From that perspective, it would be logical and systematic to allocate not only directly related expenses, but also indirectly related expenses in the reverse case of Dutch-source dividend income received by non-resident corporate shareholders. Unfortunately, this argument was not considered by the ECJ.

To sum up, although the ECJ did not exclude, in principle, that the net basis taxation against a 25% tax rate for resident corporate shareholders may be more favourable than gross basis taxation against 15% for non-resident corporate shareholders, the Court seems in fact to close the door on a successful claim of discrimination, as it seems to adhere to a very narrow definition of directly related expenses. It is unclear, however, how this narrow approach relates to the Court’s earlier case law where it took a more liberal approach.

### 4.2. Neutralization and carry-forward possibilities

Although the neutralization exception is subject to strict conditions, it follows from the *Société Générale* decision that, as long as in a particular case a discriminatory withholding tax is – as a factual matter – fully neutralized in the state of residence of the shareholder under a tax treaty, no discrimination exists, even if the measure as such does not guarantee in the abstract that a discriminatory withholding tax is always fully neutralized in other cases, as well.[36] The opposite position had also been defended in the literature.[37] In the author’s opinion, the ECJ is right in rejecting this view. This is because accepting this view would render the *Amurta* justification ground virtually meaningless, as tax treaties normally only provide for ordinary credits and not for full credits.

The decision furthermore implies that the neutralization argument also cannot be invoked by a Member State if a tax treaty is applicable between the Member States concerned which provides for the exemption method (rather than for the credit method) for received dividends in the state of residence of the shareholder. The reason is that, in that case, the restrictive effects of the discriminatory withholding tax are not factually neutralized.[38]

The ECJ did not address the final question as to whether carry-forward possibilities in the shareholder’s residence state must be taken into account also when determining whether a discriminatory withholding tax is factually neutralized in the shareholder’s residence state. This is a pity, as the answer to this question cannot clearly be derived from the Court’s existing case law. From the *Haribo* decision one can infer that the state of residence is not obliged under the TFEU freedoms to provide for a carry-forward system of excess foreign direct tax credits.[39] This might imply that the obligation to remove double taxation shifts to the Member State that has levied the dividend withholding tax. This would then mean that a non-resident shareholder should be entitled to a reduction of withholding tax in the year in which such shareholder receives the dividend and cannot be required to wait until it is possible to utilize the excess foreign credit in future years.

[36] In the same vein, see W.F.E.M. Egelie, *Denkavit: over bronstaatbelemmering en woonstaatneutralisering*, Nederlands Tijdschrift voor Fiscaal Recht 2709 (2009), at 1-7; NL: DC Haarlem, 3 Aug. 2010, AWB 08/05180, para. 4.11.
[37] See e.g. M.V. Lambooij, *Woonstaatneutralisering*, NTFR-Beschouwingen 1 (2010), at 25 et seq.; S. Wolvers, *Een bronstaatbelemmering vereist een bronstaatneutralisering*, Nederlands Tijdschrift voor Fiscaal Recht 515 (2010), at 1 et seq. See also, although less explicitly, A. Rust, *Anforderungen an eine EG-rechtskonforme Dividendendesteuerung*, Deutsches Steuerrecht 50 (2009), at 2573 (seeming to suggest that the neutralization argument can be invoked only where the applicable tax treaty provides for a full tax credit, thus guaranteeing that in all possible situations the restrictive effects of a discriminatory withholding tax are removed).
[38] Nevertheless, the German Federal Tax Court (*Bundesfinanzhof*) in its decision of 22 April 2009 found no breach with the Treaty freedoms in such a case by holding that, by agreeing to the tax treaty which provided for the exemption method, Germany had done everything to avoid economic double taxation. The Court furthermore referred to the mutual allocation of taxing rights between the states concerned – which, according to the Court, was sufficient to neutralize the restriction of the free flow of capital caused by the imposition of German withholding taxes. DE: BFH, 22 Apr. 2009, I R 53/07, *Internationales Steuerrecht* 15 (2009), at 551-556, para. 4.
On the other hand, from *Marks and Spencer* one could infer, by analogy, that a discriminatory withholding tax is not neutralized only if the shareholder has exhausted its possibilities in its residence state to carry forward unutilized foreign direct tax credits.\[40\] However, this second approach would result in administrative difficulties and would create substantial legal uncertainty. In the author's opinion, the first approach must therefore be preferred.\[41\]

5. Conclusion

The levying of dividend withholding tax on foreign shareholders is a topic of great importance throughout Europe. The decision in *Société Générale* confirms that a foreign corporate shareholder should effectively not be taxed more heavily than a comparable domestic shareholder. However, the question as to whether a non-resident shareholder is subject to a higher effective tax burden for its Dutch dividends than that incurred by Dutch residents for the same dividends, cannot be answered in a general way, but needs to be answered on the basis of the specific facts and circumstances of the case at hand.

One may wonder, however, whether this 40% threshold will ever be reached under the strict ECJ definition of “directly related expenses” for purposes of calculating the effective net tax burden that would apply in the comparable domestic situation. Thus, the outcome seems to be a Pyrrhic victory for corporate non-resident shareholders having portfolio investments in the Netherlands.

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\[41\] In a similar vein, see P.J. Wattel, *Eén jurisdictionele- of overalltoepassing van EG-verboden op bronheffingen*, Weekblad Fiscaal Recht 6680 (2006), at 847 et seq.