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By PwC Deutschland | 11 June 2015

5% non-deductible deemed expense for foreign dividends can infringe freedom of establishment?

An ECJ advocate general has suggested the court hold that the 5% effectively connected expense add-back for foreign dividends infringes a company's freedom of establishment if an otherwise comparable domestic company could avoid the add-back by joining a tax group.

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Under the French General Tax Code, companies can form a tax group centred on the parent if they are linked by common shareholdings of at least 95%. Profits and losses within a group are combined so that the net result is taxed only once. Dividends received from non-group member subsidiaries are exempt, although the taxable income of the parent is increased by 5% of the tax-free dividend received to take account of non-deductible, directly connected expense. Allowing a subsidiary to join a tax group avoids this add-back, although that route is not open to a foreign subsidiary as not being subject to the general rules of (French) corporation tax. A French parent is thus penalised for investing in another member state.

An ECJ advocate general has now published her opinion on a case brought by a French parent with sub-subsidiaries in various other member states. Barring a foreign subsidiary from joining a domestic group is an infringement on the freedom of establishment if, as in this case, it forces the parent to accept an otherwise avoidable expense add-back. This infringement cannot be justified with the need to preserve the internationally agreed split of taxing rights as it is solely a French unilateral measure. The privilege for the domestic subsidiaries of tax groups cannot be justified on the basis of tax system coherence as there is no compensating disadvantage. The German government attempted to argue in support of the French provisions that the 5% add-back followed directly from the Parent/Subsidiary Directive, although the advocate general countered with the point that the directive authorised a member state to set the expense disallowance as a lump sum of 5% of the exempt dividend income, but did not authorise it to do so in a discriminatory manner.

This case is directly relevant to Germany as the same issues arise – exclusion of foreign subsidiaries from tax groups, deemed non-deductible expense of 5% of the dividend received and full expense deduction in respect of profits pooled within a group.

The ECJ case reference is C-386/14 *Groupe Steria* opinion of June 11, 2015.

Keywords

directly connected expenses, foreign dividend, tax group