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Subject-to-tax requirement of the Parent-Subsidiary Directive

The subject-to-tax provision of the Parent-Subsidiary Directive, whereby distributed dividends are exempt from withholding tax, requires that the dividends are taxed in the hands of the parent company. In practice, this necessitates actual payment of the tax.

In 1999 and 2000, a Belgian Real Estate Investment Company distributed dividends to its two Dutch parent companies qualifying as “fiscal investment institutions” (FII) subject to a zero rate of corporation tax in the Netherlands. The Belgian tax authorities refused to grant the Parent-Subsidiary-Directive (PSD) withholding tax exemption for these dividends claiming that FIIs do not fulfil the subject-to-tax requirement of the PSD.

The ECJ agreed and held, that the PSD does not merely require that a company should fall within the scope of the tax in question but also seeks to exclude situations involving the possibility that despite being subject to tax, the company is not actually liable to pay that tax. Although FIIs are formally not exempt from tax in the Netherlands, they are practically in a situation in which they are not liable to pay that tax. The entitlement to be taxed at a zero rate is according to the ECJ tantamount to not subjecting those companies to corporation tax.

Such an interpretation is in accordance with the overall objective of the PSD ensuring tax neutrality of the distribution of profits by a subsidiary to its parent company through the elimination of a possible double taxation of those profits. Where a parent company is entitled to a zero rate of taxation for all its profits the risk of double taxation of profits is ruled out altogether.

The ECJ case reference is C-448/15 *Wereldhave Belgium and Others* judgment of March 8, 2017

Keywords

Parent/Subsidiary Directive, subject-to-tax requirement, withholding tax exemption