

Belgian Dividend Treatment Does Not Violate EU Law, ECJ Says

by Werner Heyvaert

The European Court of Justice has ruled in *Kerckhaert-Morres* (C- 513/04) that an EU member state is not required to grant its resident taxpayers an income tax credit for withholding tax levied by another member state in connection with dividends distributed by a company resident in the latter member state.

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The European Court of Justice on November 14 ruled in *Mark Kerckhaert and Bernadette Morres v. Belgium* (C-513/04) that an EU member state is not required to grant its resident taxpayers an income tax credit for withholding tax levied by another member state in connection with dividends distributed by a company resident in the latter member state. (For the judgment, see *2006 WTD 220-10* [📄](#) or *Doc 2006-23075* [[PDF](#)].) The ECJ said it is up to the member states to alleviate double taxation on dividends by means of bilateral tax treaties.

The judgment confirmed the April 6 opinion of Advocate General Leendert A. Geelhoed, but has been questioned by the European Commission. (For the advocate general's opinion, see *2006 WTD 67-10* [📄](#) or *Doc 2006-6639* [[PDF](#)]; for prior coverage of the European Commission's position on the judgment, see *Tax Notes Int'l*, Nov. 20, 2006, p. 596, *2006 WTD 221-3* [📄](#), or *Doc 2006-23238* [[PDF](#)].)

Summary of Facts

In 1995 and 1996, a Belgian resident married couple received substantial dividends from shares in Eurofers SARL, a French resident company, as private income (not business income). The dividends received by the taxpayers came with a tax credit granted by the French government as compensation for the double taxation that occurs when an individual taxpayer is taxed on a dividend that is subject to French corporate income tax at the level of the distributing company. That French tax credit is called the *avoir fiscal*.

Under article 15(3) of the Belgium-France bilateral tax treaty of 1971, the *avoir fiscal* is granted to Belgian resident shareholders, too. The treaty states that the *avoir fiscal* granted to a Belgian resident shareholder constitutes a dividend under the treaty.

The taxpayers reported the French-source dividends (including the *avoir fiscal*) as taxable income in their Belgian income tax returns for 1995 and 1996 and claimed use of the foreign tax credit provided for by the treaty (article 19.A(1)(2)) against their Belgian income tax due for those tax years. Regarding the FTC, the treaty does not distinguish between individual taxpayers for whom the dividend income represents personal income (taxable in Belgium at a flat rate of 25 percent) and individual taxpayers for whom the dividend income constitutes business income (taxable in Belgium at progressive income tax rates). However, article 19.A(1) states that taxpayers are entitled to the FTC "in accordance with conditions set by Belgian law." In practice, dividends constitute personal income for individual shareholders (subject to the flat 25 percent income tax rate); only in exceptional cases do dividends constitute business income.

The Belgian tax authorities denied the FTC on the basis that after the treaty entered into force, Belgian national law abolished the FTC for dividends earned by Belgian-resident

taxpayers as personal income.

Taxpayers' Arguments to the ECJ

The core of the taxpayers' position was that because of the French withholding tax on the dividends they had earned from Eurofers SARL and the Belgian tax authorities' denial of the FTC provided for under the treaty, they suffered a heavier income tax burden than they would have if they had invested in shares of a Belgian company that is subject to Belgian corporate income and dividend withholding taxes. If Eurofers SARL had been a Belgian resident company, the Belgian dividend withholding tax imposed on the dividends distributed would have been the final and only income tax payable by the taxpayers. Consequently, they claimed that their right of free movement of capital within the European Union was illegally curtailed. In other words, because of the double taxation between France and Belgium -- which in turn resulted from the denial of the FTC by the Belgian tax authorities -- it is more beneficial, from a tax perspective, for Belgian individual taxpayers to invest in shares of Belgium-based companies, as compared to shares of a French company.

It is noteworthy that the European Commission endorsed the taxpayers' position that Belgium's refusal to allow the treaty-based FTC constitutes an illegal impediment of right of free movement of capital under article 56 of the EC Treaty (article 73b(1) at the time of the facts).

Advocate General's Position

The advocate general said the Belgian treatment of foreign-source dividends does not constitute direct discrimination because Belgium imposes the same income tax rates for domestic and foreign-source dividends earned by Belgian resident taxpayers (either the flat rate of 25 percent or progressive income tax rates, depending on whether the dividends constitute personal or business income) and grants no tax credit for underlying corporate income tax, either for Belgian-source dividends or for foreign-source dividends.

The advocate general also said there is no indirect discrimination between French-source dividends received by Belgian individual taxpayers and Belgian-source dividends, chiefly because of the reimbursement by the French government of the *avoir fiscal*, a regime that is not available to Belgian resident shareholders investing in shares in Belgian companies.

However, he added, even if France did not grant the *avoir fiscal* to Belgian resident individual shareholders, there still would be no violation of the principle of free movement of capital. "The mere fact that a home state such as Belgium might not have chosen to relieve juridical double taxation on dividends would not in itself be contrary to Article [. . .] 56 EC, as long as that State complied with the obligation not to discriminate between foreign-source and domestic-source dividends in exercising its tax jurisdiction. . . . I would add that the fact that Belgium may or may not be in breach of its obligation under the France-Belgium [tax treaty] in failing to allow imputation of the 15% French withholding tax makes, in my view, no difference," the advocate general said.

The ECJ Judgment

The ECJ's first point was that, unlike in previous cases such as *Verkooijen* (C-35/98), *Lenz* (C-315/02), and *Manninen* (C-319/02), in the *Kerckhaert-Morres* case there is no discrimination by the home state (Belgium), as it does not tax dividends from domestic companies and dividends from companies resident in other member states differently. Both types of dividends are taxed at the same rates and without a credit for underlying

corporation tax. (For the ECJ judgments in *Verkooijen*, *Lenz*, and *Manninen*, see 2000 WTD 119-16 [📄](#) or *Doc 2000-16738*; 2004 WTD 138-7 [📄](#) or *Doc 2004-14606* [[PDF](#)]; and 2004 WTD 174-17 [📄](#) or *Doc 2004-17814* [[PDF](#)], respectively.)

The ECJ said that in circumstances such as those in the case at issue, the adverse tax consequences that might arise from the application of an income tax system such as the Belgian system result from the simultaneous exercise by two member states of their tax sovereignty. In the ECJ's view, bilateral tax treaties are designed to eliminate or mitigate the negative effects of the functioning of the internal market resulting from the coexistence of national tax systems. EU law, in its current state and in a situation such as the one at issue, establishes no general criteria for the attribution of areas of competence between the member states in relation to the elimination of double taxation within the European Union. Apart from some specific sets of rules (such as the parent-subsidiary directive of 1990), no uniform or harmonized measure to eliminate double taxation has been adopted at the EU level. Thus, it is for the member states to take the measures necessary to prevent situations such as the one at issue, specifically by applying the apportionment criteria followed in international tax practice, the ECJ said.

In other words, article 56(1) of the EC Treaty does not preclude the income tax legislation of a member state from making dividends from shares in domestic companies subject to the same tax regime as dividends from shares in companies established in other member states without providing a tax credit for withholding taxes imposed by those other member states.

Comments

On a technical level, both the ECJ and the advocate general are correct, in that the case deals with Belgium's application of the same tax rules to domestic and French dividends. At first it seems logical that no discrimination can exist when dividends from domestic companies and dividends from other EU-based companies receive the same Belgian income tax treatment (for a Belgian resident individual taxpayer).

However, that alleged same tax treatment appears to violate the principle of free movement of capital when it makes it much less attractive for a Belgian individual to invest in French shares than in domestic (Belgian) shares, and much more difficult for a French company to raise equity capital in Belgium, as compared to a Belgian company. That is because a Belgian individual shareholder receiving dividends from French shares is subject to the French dividend withholding tax plus the Belgian income tax without a credit for the French dividend withholding tax, whereas for dividends from Belgian shares, the same shareholder will be subject to only one layer of taxation (normally, the Belgian withholding tax of 25 percent).

Because a Belgian-source dividend normally is subject to Belgian dividend withholding tax, and that withholding tax constitutes the only and final income tax for a private Belgian taxpayer, a credit for dividend withholding tax is not relevant; otherwise, the Belgian individual taxpayer would pay no income tax at all on his dividend income. However, for a dividend distributed by a foreign company established in a member state where dividend withholding tax is effectively levied from dividends paid to individual shareholders resident in Belgium, there is an additional layer of tax (the withholding tax levied in the member state where the distributing company is established). That the source country does not refrain from levying that withholding tax and that the home country of the shareholder grants no credit for the withholding tax both result in a higher level of taxation for cross-border dividends, as compared to domestic dividends.

Whether legal or illegal, that difference in tax treatment constitutes an impediment for investing cross-border in shares of companies established outside the home country of the investor.

In the case at hand, the ECJ argued that eliminating that different tax treatment is the responsibility of the member states, through their use of bilateral tax treaties. However, if member states do not use their tax sovereignty to eliminate the heavier tax on cross-border dividend distributions, no EU rule can be invoked to force them to take adequate measures.

Therefore, the question is whether the member states, in not eliminating the double taxation of cross-border dividends, are exercising their tax sovereignty in a manner consistent with EU law. The ECJ's answer is yes, based on the argument that "the abolition of double taxation within the Community was an objective of the Treaty, without containing any absolute obligation for Member States to achieve this end."

That the ECJ finds no harm in the Belgian tax treatment of French-source dividends is all the more astonishing because Belgium unilaterally amended its domestic tax credit rules (which had provided for a foreign tax credit for dividends received by a Belgian resident taxpayer) years after concluding its bilateral tax treaty with France. It is appalling that the ECJ did not address whether such a unilateral amendment of Belgium's domestic legislation, which seriously affected the division of taxing power under the Belgium-France treaty, runs afoul of the EC Treaty rule that member states must exercise their fiscal (tax) sovereignty in a manner that is consistent with the EC Treaty, including the free movement of capital rule in article 56(1).

With its judgment in *Kerckhaert-Morres*, the ECJ has narrowed the notion of discrimination down to an illegitimately different treatment of similar situations and illegitimately equal treatment of different situations. However, the judgment fails to look at the free movement principle from the investor's and taxpayer's perspective. If dividends from shares in a nondomestic company are subject to more burdensome income taxes, an investor will be more inclined to invest in a domestic company. By the same token, a company established in one member state will find it more burdensome to attract investors from other member states if the dividends it distributes are taxed more heavily for those investors than dividends distributed to the same investors by companies established in the same member state. It would seem that this also amounts to an impediment of the free movement of capital.

The ECJ does not address whether the situation could be challenged by Eurofers as being discriminatory under the EC Treaty or article 25(1)(a) of the Belgium-France tax treaty on the basis that Belgium, by denying the FTC to Belgian resident shareholders, makes it more difficult for Eurofers to raise capital from Belgian resident investors.

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For the April 6 opinion of Advocate General Leendert A. Geelhoed in *Kerckhaert-Morres*, see 2006 WTD 67-10  or Doc 2006-6639 [[PDF](#)].

For the ECJ judgments in *Verkooijen* (C-35/98), *Lenz* (C-315/02), and *Manninen* (C-319/02), see 2000 WTD 119-16  or Doc 2000-16738; 2004 WTD 138-7  or Doc 2004-14606 [[PDF](#)]; and 2004 WTD 174-17  or Doc 2004-17814 [[PDF](#)], respectively.