JUDGMENT OF THE COURT (First Chamber)

14 December 2006 *

In Case C-170/05,

REFERENCE for a preliminary ruling under Article 234 EC, by the Conseil d'État (France), made by decision of 15 December 2004, received at the Court on 8 February 2005, in the proceedings

Denkavit Internationaal BV,

Denkavit France SARL

v

Ministre de l'Économie, des Finances et de l'Industrie,

THE COURT (First Chamber),

composed of P. Jann, President of the Chamber, K. Lenaerts (Rapporteur), E. Juhász, K. Schiemann and E. Levits, Judges,

* Language of the case: French.

Advocate General: L.A. Geelhoed,
Registrar: K. Sztranc-Sławiczek, Administrator,

having regard to the written procedure and further to the hearing on 19 January 2006,

after considering the observations submitted on behalf of:

— Denkavit Internationaal BV and Denkavit France SARL, by B. Soubeille, avocat,

— the French Government, by G. de Bergues, J.C. Gracia and C. Jurgensen, acting as Agents,

— the Netherlands Government, by H.G. Sevenster and D.J.M. de Grave, acting as Agents,

— the United Kingdom Government, by C. White, acting as Agent, and by J. Stratford, Barrister,

— the Commission of the European Communities, by J.-P. Keppenne and R. Lyal, acting as Agents,

— the EFTA Surveillance Authority, by P. Bjørgan and N. Fenger, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 27 April 2006,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Article 43 EC for the purposes of French tax legislation which, at the time of the facts in question, imposed a withholding tax on the payment of dividends by a resident subsidiary to a non-resident parent company, whereas dividends paid by a resident subsidiary to a resident parent company were almost fully exempt from corporation tax.

2 The reference has been made in proceedings brought before the Conseil d'État (French Council of State) concerning the taxation of dividends paid by Denkavit France SARL ('Denkavit France') and Agro Finances SARL ('Agro Finances'), both of which are established in France, to their parent company, Denkavit Internationaal BV ('Denkavit Internationaal'), which is established in the Netherlands.

Legal framework

National legislation

3 Under Article 119a(2) of the French Code général des impôts (General Tax Code) (the 'CGI'), in the version in force at the material time, dividends paid by a resident company to a natural or legal person who was not resident in France for tax purposes or did not have its registered office there were subject to a withholding tax of 25%. In the case of dividends paid by a resident company to a resident shareholder, no withholding tax was levied.

4 By virtue of Articles 145 and 216 of the CGI, a parent company having its registered office or a permanent place of business in France was entitled under certain conditions to almost full exemption from corporation tax in respect of dividends paid by its subsidiary. Apart from a 5% share, such dividends did not form part of the net taxable profits of the parent company and were accordingly exempt from tax in its hands. The 5% share continued to form part of the net taxable profits of the parent company and was subject to tax at the rate applicable for corporation tax purposes.

The Franco-Netherlands Tax Convention

5 Article 10(1) of the Convention between the Government of the French Republic and the Government of the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Tax Evasion in respect of Taxes on Income and Wealth, signed at Paris on 16 March 1973, ('the Franco-Netherlands Convention') provides that dividends paid by a company which is resident in one

of the Contracting States to a resident of the other State are taxable in the latter State. However, by virtue of Article 10(2) of that convention, such dividends may, where the parent company owns at least 25% of the capital of the subsidiary, be taxed in the State in which the company making the distribution is resident, at a maximum rate of 5%.

6 Under Article 24A(1) and (3) of the Franco-Netherlands Convention, the Kingdom of the Netherlands may include income that is taxable in France under that convention in the tax base of its residents. As regards income that is taxable in France by virtue of Article 10(2) of the convention, the Kingdom of the Netherlands grants a credit equal to the amount of tax deducted in France, but that credit may not exceed the Netherlands tax payable in respect of that income.

The dispute in the main proceedings and the questions referred for preliminary ruling

7 At the relevant time, Denkavit Internationaal owned 50% of the capital of Denkavit France and 99.9 % of the capital of Agro Finances, which itself owned 50% of the capital of Denkavit France.

8 In the period between 1987 and 1989, Denkavit France and Agro Finances, which subsequently merged, paid dividends to Denkavit Internationaal of a total amount of FRF 14 500 000.

9 In accordance with the combined provisions of Article 119a(2) of the CGI and Article 10(2) of the Franco-Netherlands Convention, a withholding tax of 5% of the amount of those dividends was levied, corresponding to FRF 725 000.

10 Following an action brought before the Tribunal administratif de Nantes (Adminstrative Court, Nantes), Denkavit Internationaal was repaid the amount of the withholding tax. However, by judgment of 13 March 2001, the Cour administrative d'appel de Nantes (Administrative Appeal Court, Nantes) set aside the judgment of the Tribunal administratif de Nantes and reinstated the liability of Denkavit Internationaal to pay the sum of FRF 725 000.

11 Denkavit Internationaal and Denkavit France brought an appeal in cassation against that judgment before the Conseil d'État. They argue in those proceedings, in particular, that the French tax legislation at issue contravenes Article 43 EC.

12 As it took the view that the withholding tax under the French legislation at issue does not affect resident companies which pay dividends, but non-resident parent companies which are the beneficiaries of those dividends, whereas resident parent companies may be entitled to almost full exemption from corporation tax on dividends paid by their subsidiaries, the national court asks whether, in the light of that difference in tax treatment, a resident parent company and a non-resident parent company are in an objectively comparable situation as regards the operation of the withholding tax on dividends.

13 The national court is also unsure as to what effect the provisions of the Franco-Netherlands Convention may have on the assessment of the compatibility of the withholding tax with freedom of establishment.

14 First, because, by virtue of Article 24 of the convention, a parent company which is resident in the Netherlands and which receives dividends from a company which is resident in France may, in principle, set off tax paid in France against the amount of tax payable in the Netherlands, the national court asks whether the withholding tax, which is authorised under the Franco-Netherlands Convention subject to the setting of a maximum rate and the right of Netherlands shareholders receiving those dividends to offset that tax, may be regarded merely as a means of apportioning the taxation of those dividends between the French Republic and the Kingdom of the Netherlands without any effect on the overall charge to tax of the Netherlands parent company and, accordingly, on that company's freedom of establishment.

15 Secondly, the Conseil d'État asks whether it is necessary to take into account the fact that the company which is resident in the Netherlands can set off that tax only if the tax payable by it in the Netherlands is higher than the tax credit to which it is entitled by virtue of Article 24 of the Franco-Netherlands Convention.

16 Taking the view in those circumstances that, in order to reach a decision in the main case, an interpretation of Community law is required, the Conseil d'État decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

'(1) Is a provision which imposes the burden of taxation on a parent company in receipt of dividends which is not resident in France, while relieving parent companies which are resident in France of a similar burden, open to challenge in the light of the principle of freedom of establishment?

(2) Is such a withholding tax itself open to challenge in the light of the principle of freedom of establishment, or, where a tax convention between France and another Member State authorising that withholding tax provides for the tax payable in that other Member State to be set off against the tax charged in accordance with the disputed system, must that convention be taken into account in assessing the compatibility of the system with the principle of freedom of establishment?

(3) In the event that the second alternative set out [in Question 2] is held to apply, is the existence of the aforementioned convention sufficient to ensure that the disputed system may be regarded merely as a means of apportioning the taxable item between the two States concerned without any effect on the undertakings, or must the fact that a parent company which is not resident in France may be unable to set off tax as provided for by the convention mean that this system must be regarded as incompatible with the principle of freedom of establishment?'

The questions referred for preliminary ruling

17 The first point to be noted is that the dispute in the main proceedings relates to matters which occurred before the adoption of Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ 1990 L 225, p. 6). Accordingly, the answers to the questions referred will be based only on the relevant provisions of the EC Treaty.

Question 1

18 By Question 1, the national court essentially asks whether Article 43 EC precludes national legislation which imposes a liability to tax on dividends paid by resident subsidiaries to their parent company when that company is established in another Member State, whilst resident parent companies are almost fully exempt from that tax. Question 1 therefore falls to be understood as extending also to Article 48 EC.

19 First of all, it should be noted that, according to settled case-law, although direct taxation falls within their competence, the Member States must none the less exercise that competence consistently with Community law (Case C-279/93 *Schumacker* [1995] ECR I-225, paragraph 21; Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 19; and Case C-471/04 *Keller Holding* [2006] ECR I-2107, paragraph 28) and avoid any discrimination on grounds of nationality (Case C-80/94 *Wielockx* [1995] ECR I-2493, paragraph 16; Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, paragraph 19; and Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, paragraph 37).

20 Freedom of establishment, which Article 43 EC grants to Community nationals and which includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected, entails, in accordance with Article 48 EC, for companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the European Community, the right to exercise their activity in the Member State concerned through a subsidiary, branch or agency (Case C-307/97 *Saint-Gobain ZN* [1999] ECR I-6161, paragraph 35, and *Keller Holding*, paragraph 29).

21 The abolition of restrictions on freedom of establishment also applies to restrictions on the setting up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of another Member State (Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 13, and *Royal Bank of Scotland*, paragraph 22).

22 In the case of companies, it should be borne in mind that their registered office for the purposes of Article 48 EC serves, in the same way as nationality in the case of individuals, as the connecting factor with the legal system of a Member State (see *Metallgesellschaft and Others*, paragraph 42, and the case-law cited). Acceptance of the proposition that the Member State in which a resident subsidiary is established may freely apply different treatment merely by reason of the fact that the registered office of the parent company is situated in another Member State would deprive Article 43 EC of all meaning (see, to that effect, *Commission* v *France*, paragraph 18; Case C-330/91 *Commerzbank* [1993] ECR I-4017, paragraph 13; *Metalgesellschaft and Others*, paragraph 42; and Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, paragraph 37). Freedom of establishment thus seeks to guarantee the benefit of national treatment in the host Member State, by prohibiting any discrimination, even minimal, based on the place in which companies have their seat (see, to that effect, *Commission* v *France*, paragraph 14, and *Saint-Gobain ZN*, paragraph 35).

23 It is true that the Court has already held that, in tax law, the taxpayers' residence may constitute a factor that might justify national rules involving different treatment for resident and non-resident taxpayers. (*Marks & Spencer*, paragraph 37).

24 Different treatment of resident and non-resident taxpayers cannot therefore in itself be categorised as discrimination within the meaning of the EC Treaty (see, to that effect, *Wielockx*, paragraph 19).

25 However, a difference in treatment between those two categories of taxpayer must be categorised as discrimination within the meaning of the Treaty where there is no objective difference such as to justify that difference in treatment (see, to that effect, *Schumacker*, paragraphs 36 to 38, and *Royal Bank of Scotland*, paragraph 27).

26 In the present case, the national legislation at issue in the main proceedings gives rise, irrespective of the effect of the Franco-Netherlands Convention, to a difference in the tax treatment of dividends paid by a resident subsidiary to its parent company, according to whether the latter is resident or non-resident.

27 While resident parent companies may be entitled to almost full exemption from tax on dividends received, non-resident parent companies are, by contrast, subject to tax in the form of a withholding tax of 25% of the amount of dividends paid.

28 Accordingly, dividends paid to non-resident parent companies, unlike those paid to resident parent companies, are subject to a series of charges to tax under French tax legislation, in that, as the Advocate General pointed out at points 16 to 18 of his Opinion, those dividends are subject to tax, first, in the form of corporation tax levied on the resident subsidiary making the distribution and, second, in the form of the withholding tax levied on the non-resident parent company receiving the dividends.

29 Such a difference in the tax treatment of dividends between parent companies, based on the location of their registered office, constitutes a restriction on freedom of establishment, which is, in principle, prohibited by Article 43 EC and Article 48 EC.

30 The tax measure at issue in the main proceedings makes it less attractive for companies established in other Member States to exercise freedom of establishment and they may, in consequence, refrain from acquiring, creating or maintaining a subsidiary in the State which adopts that measure (see, to that effect, Case C-324/00 *Lankhorst-Hohorst* [2002] ECR I-11779, paragraph 32, and *Keller Holding*, paragraph 35).

31 However, the French Government argues that the opportunity of benefiting from almost full exemption from tax on dividends is also available to non-resident parent companies which have a fixed place of business in France. For the purposes of a withholding tax provision, such as the provision at issue in the main proceedings, the situation of non-resident parent companies which do not have a fixed place of business in France is not comparable to that of non-resident parent companies which do have a fixed place of business in France.

32 The French Government adds that, in accordance with the principle of territoriality, to exempt dividends paid by resident subsidiaries to non-resident parent companies which do not have a fixed place of business in France would allow the latter to avoid any liability to tax on their income, both in France and the Netherlands, and anwould undermine the allocation of taxing powers between the French Republic and the Kingdom of the Netherlands.

33 Those arguments cannot be accepted.

34 It is true that, in the context of measures laid down by a Member State in order to prevent or mitigate the imposition of a series of charges to tax on, or the double taxation of, profits distributed by a resident company, resident shareholders receiving dividends are not necessarily in a situation which is comparable to that of shareholders receiving dividends who are resident in another Member State (see, to that effect, Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, paragraphs 57 to 65).

35 However, as soon as a Member State, either unilaterally or by way of a convention, imposes a charge to tax on the income, not only of resident shareholders, but also of non-resident shareholders, from dividends which they receive from a resident company, the situation of those non-resident shareholders becomes comparable to that of resident shareholders (*Test Claimants in Class IV of the ACT Group Litigation*, paragraph 68).

36 In the present case, parent companies receiving dividends paid by resident subsidiaries, are, as regards the taxation in France of those dividends, in a comparable situation, whether they receive those dividends as resident parent companies or as non-resident parent companies which have a fixed place of business in France, or as non-resident parent companies which do not have a fixed place of business in France. In each of those cases, the French Republic imposes a liability to tax on dividends received from a resident company.

37 It must be held in that regard that the exemption in respect of dividends received by resident parent companies is designed to avoid the imposition of a series of charges to tax on the profits of subsidiaries which are distributed by way of dividend to the parent companies of those subsidiaries. As the Advocate General stated at point 22 of his Opinion, since the French Republic has chosen to relieve its residents of such a liability to tax, it must extend that relief to non-residents to the extent to which an imposition of that kind on those non-residents results from the exercise of its tax jurisdiction over them (see, to that effect, *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 70).

38 In that context, the withholding tax arrangements which apply only to dividends paid by resident subsidiaries to non-resident companies which do not have a fixed place of business in France cannot be justified by the need to prevent those companies from avoiding any liability to tax on those dividends in France and the Netherlands, because resident parent companies are also free of any subsequent liability to tax on those dividends.

39 In refusing to extend to non-resident parent companies the more advantageous national tax treatment accorded to resident parent companies, the national legislation at issue in the main proceedings amounts to a discriminatory measure which is incompatible with the Treaty, in that it imposes a heavier tax burden on dividends paid by resident subsidiaries to Netherlands parent companies than that imposed on dividends paid to French parent companies.

40 Since the French Government has not put forward any other arguments in justification of its position, it must be held that the national provisions at issue in the main proceedings constitute discrimination between parent companies having their registered office in France and those having their registered office in another Member State, contrary to Article 43 EC and Article 48 EC.

41 The answer to Question 1 must therefore be that Article 43 EC and Article 48 EC are to be interpreted precluding national legislation which, in imposing a liability to tax on dividends paid to a non-resident parent company and allowing resident parent companies almost full exemption from such tax, constitutes a discriminatory restriction on freedom of establishment.

Questions 2 and 3

42 By Questions 2 and 3, which should be treated together, the national court essentially asks whether a different answer to Question 1 should be given on the basis that, by virtue of the Franco-Netherlands Convention, a parent company which is resident in the Netherlands may, in principle, offset tax paid in France against its liability to tax in the Netherlands and, accordingly, the withholding tax is merely a means of apportioning the taxable item between the Member States concerned, which is not open to challenge under Article 43 EC or Article 48 EC, even though a parent company which is resident in the Netherlands is unable to set off tax as provided for by that convention.

43 In that regard, it should first of all be noted that, in the absence of harmonising measures at Community level and of conventions concluded between all the Member States for the purposes of the second indent of Article 293 EC, the Member States retain competence for determining the criteria for taxation on income with a view to eliminating double taxation by means, inter alia, of international conventions. In those circumstances, the Member States remain at liberty to determine the connecting factors for the allocation of fiscal jurisdiction by means of bilateral agreements (see, to that effect, *Saint-Gobain ZN*, paragraph 57, and Case C-265/04 *Bouanich* [2006] ECR I-923, paragraph 49).

44 The fact remains that, as far as the exercise of the power of taxation so allocated is concerned, the Member States may not, having regard to the principle referred to in paragraph 19 of this judgment, disregard Community rules (*Saint-Gobain ZN*, paragraph 58). In particular, such an allocation of fiscal jurisdiction does not permit Member States to introduce discriminatory measures which are contrary to the Community rules (*Bouanich*, paragraph 50).

45 In the present case, since the tax regime arising under the Franco-Netherlands Convention forms part of the legal framework applying to the main proceedings and has been presented as such by the national court, the Court of Justice must take it into account in order to provide an interpretation of Community law that is relevant to the national court (see, to that effect, Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 21; *Bouanich*, paragraph 51; and *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 71).

46 With regard to the tax treatment arising under the Franco-Netherlands Convention, it must be noted that a non-resident company, such as Denkavit Internationaal, is, in principle, authorised under that convention to offset the withholding tax of 5% on French-sourced dividends against its tax liability in the Netherlands. The amount offset cannot, however, exceed the amount of Netherlands tax otherwise payable on those dividends. It is not in dispute that Netherlands parent companies are exempted by the Kingdom of the Netherlands from tax on foreign-sourced dividends, and accordingly on French-sourced dividends, with the result that no credit is given in respect of French withholding tax.

47 It must therefore be held that the combined application of the Franco-Netherlands Convention and the relevant Netherlands legislation does not serve to overcome the effects of the restriction on freedom of establishment that was held to exist in the answer to Question 1.

48 Under the Franco-Netherlands Convention and the relevant Netherlands Convention, a parent company established in the Netherlands which receives dividends from a subsidiary established in France is liable to withholding tax, admittedly capped by that convention at 5% of the amount of the dividends in question, whereas, as mentioned in paragraph 4 of this judgment, a parent company established in France is almost fully exempt from tax on those dividends.

49 Irrespective of its extent, the difference in tax treatment resulting from the application of that convention and that legislation constitutes discrimination against parent companies on the basis of their registered office, which is incompatible with the freedom of establishment guaranteed by the Treaty.

50 A restriction on freedom of establishment is prohibited by Article 43 EC, even if it is of limited scope or minor importance (see, to that effect, Case 270/83 *Commission* v *France*, paragraph 21; Case C-34/98 *Commission* v *France* [2000] ECR I-995, paragraph 49; and Case C-9/02 *De Lasteyrie du Saillant* [2004] ECR I-2409, paragraph 43).

51 The French Government argues in this regard that, in accordance with the principles laid down under international tax law and as the Franco-Netherlands Convention provides, it is for the State in which the taxpayer is resident, and not for the State in which the taxed income has its source, to rectify the effects of double taxation.

52 That argument cannot be accepted, since it is irrelevant in the present context.

53 The French Republic cannot rely on the Franco-Netherlands Convention in order to avoid the obligations imposed on it by the Treaty (see, to that effect, Case 270/83 *Commission* v *France*, paragraph 26).

54 The combined application of the Franco-Netherlands Convention and the relevant Netherlands legislation does not serve to avoid the imposition of a series of charges to tax to which, unlike a resident parent company, a non-resident parent company is subject and, accordingly, does not serve to overcome the effects of the restriction on freedom of establishment that was held to exist in the answer to Question 1, as has been stated in paragraphs 46 to 48 of this judgment.

55 While resident parent companies benefit from a tax regime which allows them to avoid the imposition of a series of charges to tax, as pointed out in paragraph 37 of this judgment, non-resident parent companies are, by contrast, liable to an imposition of that kind on dividends paid by their subsidiaries established in France.

56 The answer to Questions 2 and 3 must therefore be that Article 43 EC and Article 48 EC are to be interpreted as precluding national legislation which imposes, only as regards non-resident parent companies, a withholding tax on dividends paid by resident subsidiaries, even if a tax convention between the Member State in question and another Member State, authorising that withholding tax, provides for the tax due in that other State to be set off against the tax charged in accordance with the disputed system, whereas a parent company is unable to set off tax in that other Member State, in the manner provided for by that convention.

Costs

57 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (First Chamber) hereby rules:

1. **Article 43 EC and Article 48 EC preclude national legislation which, in imposing a liability to tax on dividends paid to a non-resident parent company and allowing resident parent companies almost full exemption from such tax, constitutes a discriminatory restriction on freedom of establishment.**

2. **Article 43 EC and Article 48 EC preclude national legislation which imposes, only as regards non-resident parent companies, a withholding tax on dividends paid by resident subsidiaries, even if a tax convention between the Member State in question and another Member State, authorising that withholding tax, provides for the tax due in that other State to be set off against the tax charged in accordance with the disputed system, whereas a parent company is unable to set off tax in that other Member State, in the manner provided for by that convention.**

[Signatures]