Margaretha Bouanich v Directeur des services fiscaux de la Drôme. Court of Justice (comments by Maarten de Wilde)

The Court of Justice ruled the French rules concerning the calculation of the tax cap on direct taxes levied ('the tax shield') contrary to the freedom of establishment and the freedom of capital. The tax shield does not take into account, or takes only partially into account, taxes paid abroad on foreign source income items taxable in France, whereas taxes paid in France are taken into account in full. The case involves a French resident taxpayer individual who received taxable dividend income from a company established in Sweden. She was not eligible to include the Swedish dividend tax in calculating the right to restitution of taxes levied in excess of the tax cap under the tax shield, as the dividend tax was not a tax paid in France. The Court observed that the rules concerning the calculation of the tax cap discouraged French resident taxpayers individuals from investing in companies established in Member States other than France. The tax measure infringes the freedoms as its application systematically produces a higher tax burden in the cross-border scenario relative to the equivalent domestic scenario, for which no justification can be found.

Court of Justice of the European Union, 13 March 2014, no. C-375/12

Comment

Context; general remarks

The CJ ruled the former French rules concerning the calculation of a tax cap on direct taxes ('the tax shield') contrary to the fundamental freedoms. No Advocate General Opinion was issued. The case involved a French resident taxpayer, Ms Bouanich, who received dividends in 2005, 2006, and 2007 on a shareholding in a listed company established in Sweden. The foreign source dividends were subject to individual income taxation in France; they were included in the taxable base as income from investment capital and subject to the progressive tax rate. In Sweden, the dividends were subject to a withholding tax. Pursuant to the Franco-Swedish double tax convention, the dividend tax rate was reduced to 15%. France provided double tax relief by means of an ordinary tax credit. The Swedish dividend tax was fully creditable against the French income tax – the taxpayer presumably did not incur expenses relating to the dividend proceeds. Subsequent to the application of the credit and some tax reductions available under French tax law, the taxable years 2005 and 2006 left Ms. Bouanich an amount of income tax payable in France. No tax remained due for 2007.

The French tax cap

France had adopted a tax cap in the taxable years at hand. Pursuant to French tax law, direct taxes (income tax, wealth tax, property tax, residential tax) levied on income derived in 2005 may not exceed 60% of the taxpayer's income that year. Direct taxes levied in 2006 and 2007 were capped at 50%. The system provided for a right to restitution of direct taxes levied in excess of the cap. The rights to restitution concerning excess taxes on income derived in 2005, 2006 and 2007 were acquired on 1 January of 2007, 2008, and 2009 respectively. The direct taxes eligible to be taken into account to calculate the right to restitution included taxes paid in France only, i.e., despite the inclusion of worldwide income in the taxable base. Under the system in place for the tax year 2005, taxes levied abroad on taxable foreign source income derived were disregarded in calculating the tax shield for that year. Under the 2006/2007-system, direct taxes levied abroad on foreign income were merely eligible to be deducted from the taxable base in calculating the tax shields for those years. France abolished the tax cap as of 1 January 2013. In consequence, the effective tax burden may now exceed 50% of taxpayer income.

No inclusion of Swedish dividend tax under tax shield

Ms Bouanich applied to be entitled to the right to restitution under the tax shield. In her applications, she included the Swedish source tax as a direct tax eligible to be taken into account for determining the 60% (2005) and 50% (2006, 2007) tax caps. Applying the tax law, the French tax authorities, however, rejected the inclusion of the foreign tax in that manner, (i) as that tax had not been paid in France (2005), and (ii) as that tax could only be taken into account as a deductible item in determining the income for tax shield calculation purposes (2006, 2007). Ms Bouanich brought actions before the Tribunal administratif de Grenoble (Administrative Court, Grenoble – first instance) as she considered the tax treatment to infringe EU law. The issue led the Tribunal to request the CJ for a preliminary ruling as to the compatibility of the tax shield with the freedoms (received at the Court on 6 August 2012).

'Free movement of capital and freedom of establishment both apply'
The court considered both the free movement of capital and the freedom of establishment applicable. That is, (a) for the tax measure being of a generic nature as it applied to dividend income regardless of the shareholding size, and (b) since the facts of the case did not reveal the size of Ms Bouanich' shareholding interest in the Swedish company – which made it impossible to determine whether Ms. Bouanich exerted a definite influence on the company's decisions. The court extensively referred to its observations in *Test Claimants in the FII Group Litigation* (CJ 13 November 2012, C-35/11) and *Beker* (CJ 28 February 2013, C-168/11), presumably to ensure adopting similar reasoning as to the applicable freedom in both intra-EU and third country scenarios.

'*Tax shield restricts freedoms'*
The Court observed that the tax shield restricts the freedoms as its operation discourages resident taxpayer individuals from investing in companies established in Member States other than France. It systematically produces a higher tax burden in the cross-border scenario relative to the equivalent domestic scenario. That is, the shield does not take into account (2005), or only partially takes into account (2006, 2007) taxes levied outside France in calculating the amount eligible for restitution. The Court held the tax credit that France granted under the tax convention irrelevant. That is, the French tax measure did not relate to the prevention of juridical double taxation but to the differential national tax treatment of foreign source dividends relative to domestic dividends. In this regard, the Court referred to *Kerckhaert and Morres* (ECJ 14 November 2006, C-513/04) concerning a national tax measure which tax-treated the cross-border scenario on par with its domestic equivalent.

'No justification'
The Court saw no room for justifying the restriction imposed. Neither by reference to 'the need to maintain the coherence of the tax system' nor to 'the need to safeguard a balanced allocation of powers of taxation between the Member States'. The court observed that no direct link could be established between the tax shield and a particular tax levied. It also observed that the tax capping mechanism did not jeopardize the entitlement of France to exercise its taxing powers in relation to economic activity undertaken within its territories.

Court of Justice adopts home State neutrality reasoning
The Court basically embraced a notion of home State neutrality, or export neutrality in this home State case. Where EU law applies, the Member States are not allowed to subject resident taxpayers who derive foreign source dividend income to a higher effective tax burden than resident taxpayers who derive dividend income from domestic sources. The Court requires the tax burden in the cross-border scenario to be (at least) on par with that in the objectively comparable domestic scenario. An approach commonly found in the Court's home State case law.

Maarten de Wilde