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Court Seeks Preliminary Ruling on Participation Exemption

by Marc Quaghebeur

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The Antwerp Court of Appeal on November 22 requested a preliminary ruling from the Constitutional Court on whether Belgium's tax regime for dividends received by a Belgian company — and in particular the limited carryforward of the unused surplus — is constitutional.

Participation Exemption

Belgium has changed several provisions of its Income Tax Code (ITC) to align the treatment of European Economic Area member states (in practice, Iceland, Liechtenstein, and Norway) with that of EU member states.

A notable example is the participation exemption. The Belgian participation exemption (a 95 percent dividends received deduction) implements the EU parent-subsidiary directive.[1] Article 4(1) of the directive provides that when a subsidiary in one member state distributes dividends to a parent company in another member state (that holds a participation of 10 percent in the subsidiary), the state of residence of the parent company must either refrain from taxing those dividends or, if it taxes the dividends, grant the parent company a tax credit for the corporation tax paid by the subsidiary (and any lower-tier subsidiary) on those dividends. Member states may, however, disallow a fixed amount of the management costs related to the participation, up to a maximum of 5 percent of the dividends. Moreover, profits distributed by a subsidiary to its parent company are exempt from withholding tax in both member states.

When implementing the directive, Belgium opted for the exemption method. If the parent company holds a participation that is at least 10 percent of the subsidiary's nominal share capital or, alternatively, a participation that has an acquisition value of at least €2.5 million, the dividends are eligible for a 95 percent exemption, provided that the participation has been held for at least one year and the subsidiary meets a "subject to tax" condition, since there are a number of specific antiavoidance exclusions.

In its *Cobelfret* decision, the European Court of Justice held that Belgium had failed to implement the parent-subsidiary directive correctly by limiting the carryforward of the unused balance of the dividends received deduction when the parent had no or insufficient taxable profits for the relevant period. (For the ECJ judgment in *Cobelfret v. Belgium* (C-138/07), see *Doc 2009-3117* or *2009 WTD 28-17*; for prior coverage, see *Doc 2009-3455* or *2009 WTD 35-4*.)

Belgium adapted its legislation for subsidiaries in EU member states in 2009 and, as mentioned above, for subsidiaries in the EEA in 2011. (For prior coverage of the 2009 changes, see *Doc 2009-10619* or *2009 WTD 89-11*.)

Subsidiaries Outside the EEA

When the legislation was changed, the Council of Ministers decided to deny the participation exemption for dividends from subsidiaries outside the EU. That was the subject of another preliminary ruling in the joined cases *KBC Bank NV* (C-439/07) and *Beleggen, Risicokapitaal, Beheer NV* (C-499/07), but the Court did not provide a clear answer on the issue. (For prior coverage, see *Doc 2009-15158* or *2009 WTD 127-3*.)

However, the tax authorities accept that dividends from non-EEA member states can qualify for a full carryforward if the state of the subsidiary has signed a tax treaty with Belgium that contains a nondiscrimination provision for dividends — in other words, a provision that dividends paid by the foreign subsidiary are

[1]Council Directive 90/435/EEC of July 23, 1990, on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states, [1990] OJ L 225/6, corrigendum in [1991] OJ L 23/35. The directive was amended by Council Directive 2003/123/EC of Dec. 22, 2003, O.J. L 7, 13.1.2004, pp. 41-44.

exempt under the condition that the exemption would apply if both companies were Belgian resident companies.[2]

Alternatively, the parent company can invoke article 63 of the Treaty on the Functioning of the European Union (TFEU), which guarantees the free movement of capital, if that article applies to the capital invested in the subsidiary paying the dividend and claim treatment equal to that of dividends from Belgian subsidiaries. This is a grandfathering clause that allows restrictions to the free movement of capital that existed on December 31, 1993 (article 64 TFEU).

Agfa-Gevaert

Agfa-Gevaert is a Belgian listed company (Euronext: AGFB) specializing in pre-press and industrial inkjet printing and medical imaging. It owned a participation in a Korean and Venezuelan company from which it received dividends that qualified for the 95 percent dividends received deduction. However, the company's profits were not sufficient to set off the entire 95 percent dividends received deduction, and it claimed a carryforward for the unused part of the deduction.

The tax authorities refused the carryforward because the subsidiary was not established in an EEA member state. They also stated that the treaties with Korea and Venezuela do not include a nondiscrimination provision and that article 63 TFEU does not apply since Agfa-Gevaert has majority participations (direct investments) in the subsidiaries.

Agfa-Gevaert appealed the tax authorities' decision, and on November 22 the Antwerp Court of Appeal requested a preliminary ruling from the Constitutional Court on the following questions (in translation):

- Does the Belgian ITC (article 205(3), implemented by the Law of December 21, 2009) infringe the principle of equal treatment of articles 10 and 11 of the Belgian Constitution insofar as it does not allow a carryforward for dividends that are granted or paid by a foreign subsidiary established in a third country as meant by article 202(1)(1) and (3) ITC and cannot be deducted by 95 percent because the parent company does not realize sufficient profits, while such a carryforward is possible if the dividends are paid by a subsidiary established in a member state of the EEA?
- Does article 205 ITC, read together with articles 63 and 64 TFEU, infringe the equality principle of articles 10 and 11 of the Belgian Constitution insofar as a Belgian parent company that receives dividends from subsidiaries that are established in Korea and Venezuela, in which it holds a direct investment, is not entitled to carry forward the unused part of the 95 percent dividend deduction with respect to those dividends, while the carryforward would be possible if the same Belgian parent company received dividends from a subsidiary established in Korea or Venezuela in which it owns an indirect investment?
- Does the law of September 19, 1996, ratifying the supplementary convention of April 20, 1994, amending the convention and deleting the protocol between the Kingdom of Belgium and the Republic of Korea, which contains article 22(2)(c) (avoidance of double taxation), infringe the equality principle of articles 10 and 11 of the Belgian Constitution insofar as those provisions do not allow the carryforward of unused parts of the 95 percent dividend deduction for dividends received from a subsidiary established in Korea based on article 205(3) ITC and article 77 of the royal decree implementing the ITC, while such a carryforward is allowed if the dividends are received from a Belgian subsidiary?
- Does the law of September 19, 1996, ratifying the supplementary protocol of April 23, 1993, to the income tax treaty between Belgium and Venezuela on the avoidance of double taxation and the prevention of tax avoidance, which contains article 23(2)(c) (avoidance of double taxation), infringe the equality principle of articles 10 and 11 of the Belgian Constitution insofar as those provisions do not allow the non-carryforward of unused parts of the 95 percent dividend deduction for dividends received from a subsidiary resident in Venezuela based on article 205(3) ITC and article 77 of the royal decree implementing the ITC, while such a carryforward is allowed if the dividends are received from a Belgian subsidiary? ◆

♦ *Marc Quaghebeur, partner, De Broeck Van Laere & Partners, Brussels*

[2]The tax authorities' position was indicated in an addendum to a circular letter issued in June 2009 (Oct. 12, 2009, addendum to Circular Ci.RH.421/597.150 (AOIF 32/2009) of June 23, 2009) and in a circular letter of the Administration des Affaires Fiscales (Circular AFZ/INTERN.IB.2006/0549 of Oct. 12, 2009). For prior coverage, see *Doc 2010-1200* or *2010 WTD 13-5*; see also *Doc 2009-24788* or *2009 WTD 246-8*.