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CJEU Decision in Kronos case

Freedom of establishment – free movement of capital – company receiving dividends established in accordance with law of third state – difference in treatment in the case of tax loss

On September 11, 2014, the CJEU rendered its decision in the Kronos case (C-47/12) concerning German legislation which provided for different methods of eliminating double taxation of profits distributed by resident and non-resident subsidiaries that led to a cash-flow disadvantage in a cross-border situation where a receiving company was in a loss position. The Court held that the German rules were not in breach of the free movement of capital.

Background

Kronos was a loss-making holding company established in the U.S., but with its effective place of management in Germany, thus subject to unlimited tax liability in Germany. Given that in the case of distributions from German subsidiaries parent companies that incur tax losses may obtain a refund of the underlying corporate income tax, Kronos requested reimbursement of tax levied on its foreign (EU and non-EU) subsidiaries in the respective source countries. The German tax authorities denied the refund on the ground that the related dividend income was exempt from tax in Germany pursuant

to the DTT applicable in each case.

The referring court sought a ruling from the CJEU on, inter alia, the fundamental freedom applicable in this case, since although the legislation at issue applied to shareholdings of at least 10%, the case at hand concerned shareholdings exceeding 90% and, what is more, the receiving company had a third country connection, as well as compatibility of the double taxation relief system with EU law.

The CJEU's decision

The Court held that the German rules fall within the scope of Article 63 TFEU on the free movement of capital, regardless of the actual percentage of shareholdings in the distributing company, as the company receiving dividends, could not rely upon Article 49 TFEU on freedom of establishment because of the connection to the legal system of the third state.

The CJEU noted that it had already been held that the threshold of 10% does not necessarily imply decisive influence on the subsidiary's decisions, consequently national rules setting the above-mentioned threshold may fall within the scope of both freedoms. In order to establish which of these freedoms prevail in the case of dividends originating in a third state, it is sufficient to examine the purpose of national legislation so as to determine whether it falls within the scope of the free movement of capital, as national legislation relating to the tax treatment of non-EU dividends is not capable of falling within Article 49 TFEU.

In the case at hand the Court concluded that the above reasoning is also applicable, by analogy with the established case-law, where a company receiving dividends, which is not formed in accordance with the law of a Member State, cannot enjoy the freedom of establishment.

As to compatibility of the different mechanisms adopted to eliminate double taxation with Article 63 TFUE, the Court already held that exemption for domestic dividends and the imputation method for foreign dividends are in principle equivalent. By analogy with this case law, the application of the exemption method to foreign-sourced dividends does not result, from the point of view of its objective of preventing double economic taxation, in less favorable treatment of those dividends compared with domestic dividends, even if underlying corporate income tax is refunded to a loss-making parent in the latter case.

The CJEU noted that in the situation where the company receiving dividends incurs tax losses, reimbursement of tax paid by the distributing company could be regarded as a cash-flow advantage,

but in the case at hand, the difference in treatment of domestic and foreign dividends did not arise from the application of the relevant German legislation since Germany had relinquished its powers of taxation over the foreign-sourced dividends. As a consequence, Germany is not obliged by Article 63 TFEU to allow offsetting of the tax burden resulting from the exercise of the tax powers of another Member State or of a third state.

EU Tax Centre Comment

This decision is largely based on the previous case-law of the CJEU and to that extent seems uncontroversial. Notwithstanding the fact that the German rules led to a cash-flow disadvantage, they did not have a discriminatory character and thus were allowed by EU law.

Should you require further assistance in this matter, please contact the EU Tax Centre or, as appropriate, your local KPMG tax advisor.

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