May 17, 2017

Landmark ECJ Decision Concerning the French 3% Tax on Dividend Distributions

The Court of Justice of the European Union Holds That the French 3% Tax on Dividend Distributions Infringes the European Union Parent-Subsidiary Directive

SUMMARY

On May 17, the European Court of Justice (ECJ) ruled in favor of a group composed of several CAC 40 corporations and the AFEP (*Association française des entreprises privées*), which is the main professional organization representing large French listed companies, finding the French 3% tax on dividend distributions to be incompatible with the European Union's Parent-Subsidiary Directive. The ECJ decision applies to redistributions of dividends received from subsidiaries within the scope of the Parent-Subsidiary Directive, i.e., dividends received from subsidiaries established in another Member State of the EU. Further steps are about to be taken by the same litigation group before the French Constitutional Court to expand the scope of the invalidity of the 3% tax. Sullivan & Cromwell LLP and another French tax firm represented the French corporate plaintiffs and the AFEP in the ECJ proceedings.

THE DECISION OF THE EUROPEAN COURT OF JUSTICE

In 2012, France introduced a 3% tax on dividends distributed by entities subject to French corporate income tax. In July 2016, the French Administrative Supreme Court ruled that there were serious doubts regarding the conformity of this tax to the EU Parent-Subsidiary Directive, and referred the matter to the ECJ.

Article 4 of the Parent-Subsidiary Directive provides for an exemption for dividends received from subsidiaries eligible for the participation exemption regime, and French law provides that eligible dividends are exempt from corporate income tax when received, in accordance with the Parent-Subsidiary Directive. However, pursuant to the 2012 law, when such dividends would be redistributed by a French parent company, such redistribution would become subject to the 3% tax.

The main argument developed by the claimants was that the French 3% tax levied on the redistribution of dividends received from eligible subsidiaries was equivalent to a deferred taxation of such dividends, and that such taxation is contrary to the exemption rule derived from Article 4 of the Directive. The French State's position was that the Parent-Subsidiary Directive only prevents Member States from taxing dividends upon receipt by the parent company, and not upon subsequent redistribution and, accordingly, the 3% tax on dividend distributions was not captured by the prohibition set forth in Article 4 of the Directive.

On May 17, the ECJ ruled in favor of the claimants, and found the French 3% tax on distributions to be incompatible with Article 4 of the Parent-Subsidiary Directive and thus inapplicable to redistributions of dividends received from subsidiaries eligible for the participation-exemption regime.

The ECJ decision only applies to redistributions of dividends received from subsidiaries within the scope of the Parent-Subsidiary Directive, i.e., dividends received from subsidiaries established in another Member State of the EU.

NEXT STEPS

Further steps are expected to be taken by the same litigation group before the French Constitutional Court to expand the scope of the invalidity of the 3% tax to the redistribution of French source dividends and dividends paid by subsidiaries located outside of the EU and, potentially, to any other distribution, including with respect to other income (e.g. operating profits).

It must be noted that the Constitutional Court could limit the benefits of its decision to taxpayers having brought a claim before the French tax authorities before the date of its decision. It is therefore recommended to file claims in this respect in a timely manner.

In any event, a favorable decision of the French Constitutional Court might not bring to an end the litigation on the 3% tax. Many technical issues will still have to be resolved, in particular :

- In the case of a company having both operating profit and profit resulting from dividends paid by subsidiaries, the redistribution of the operating profit may be subject to the 3% tax while the redistribution of the dividends received would not. Questions will arise as to which sourcing rule will apply;
- allocation among gross or net income;
- allocation of distribution between current earnings and profits, and retained earnings;
- impact of losses carried forward; and
- impact of interim dividend distributions.

* * *

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, three offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future related publications from Michael B. Soleta (+1-212-558-3974; soletam@sullcrom.com) in our New York office.

CONTACTS

Paris

Gauthier Blanluet	+33-1-7304-6810	blanluetg@sullcrom.com
Nicolas de Boynes	+33-1-7304-6806	deboynesn@sullcrom.com
Marie-Aimée Delaisi	+33-1-7304-5832	delaisima@sullcrom.com
Alexis Madec	+33-1-7304-5834	madeca@sullcrom.com