

October 6, 2017

Landmark French Constitutional Court Decision on the 3% Tax on Dividend Distributions

The French Constitutional Court Ruled That the 3% Tax on Dividend Distributions Is Unconstitutional

SUMMARY

On October 6, the French Constitutional Court found the French 3% tax on dividend distributions to be unconstitutional in its entirety. This decision was rendered on a tax dispute involving a group led by the AFEP (*Association française des entreprises privées*), which is the main professional organization representing large French-listed companies, and 42 French-listed corporations, all represented by Sullivan & Cromwell LLP and another French tax firm.

BACKGROUND

In 2012, France introduced a 3% tax on all dividends distributed by entities subject to French corporate income tax.

In May 2016, the group led by the AFEP initiated an action before the French Administrative Supreme Court claiming that the tax was infringing the Parent Subsidiary Directive (the “Directive”). In June 2016, the French Supreme Court referred the question of the compatibility of the 3% tax to the European Court of Justice (ECJ).

In May 2017, the ECJ confirmed that the French 3% tax on dividend distributions was incompatible with the Directive, finding that, when levied on redistributions of dividends received from subsidiaries eligible for the participation exemption regime provided for by the Directive, the 3% tax was equivalent to a deferred corporate income tax of such dividends and was therefore infringing the Directive.

The ECJ decision exempted the redistributions of dividends received from subsidiaries established in another Member State of the EU only. The AFEP group initiated a claim before the French Administrative Supreme Court and the Constitutional Court to expand the exemption to all distributions made by French companies.

THE DECISION OF THE CONSTITUTIONAL COURT

The main argument developed by the AFEP group before the Constitutional Court is that the incompatibility of the 3% tax on the redistribution of dividends with the Directive creates a discrimination among taxpayers and that such discrimination infringes the equality of treatment principle guaranteed by the French Constitution. More precisely, when a taxpayer distributed dividends received from French subsidiaries or from non-EU subsidiaries, such distribution was subject to the 3% tax, while when a taxpayer distributed dividends received from EU subsidiaries, such distribution was exempted from the 3% tax in application of the ECJ decision.

This differential tax treatment depending on the source of profits distributed to shareholders (redistribution of EU-sourced dividends vs. redistribution of French-sourced or non-EU-sourced dividends) created a discrimination among taxpayers which is contrary to the objectives of the law.

The Constitutional Court welcomed these arguments and found the 3% tax to be contrary to the French Constitution. The Constitutional Court considered that the ECJ decision, by exempting from the 3% tax the redistributions of dividends received from EU subsidiaries, introduced a discrimination among taxpayers depending on the source of profits distributed to shareholders.

The Constitutional Court decision has an immediate effect and, therefore, the 3% tax is automatically repealed and can no longer apply to future distributions. For past distributions, taxpayers are entitled to be fully refunded the 3% tax paid, increased by a late payment interest of 4.8% per annum, subject to applicable statutes of limitation.

The amount of the refunds to be received by taxpayers in application of this decision is estimated at €8bn.

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