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Our ref.: JB

Brussels, 30 April 2011

Dear Sir, Madam,

Consultation on the taxation problems that arise when dividends are distributed across borders to portfolio and individual investors and possible solutions

About the Federation of Enterprises in Belgium

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The Federation of Enterprises in Belgium (FEB-VBO) is the only multi-sector employers' organisation representing companies in all three regions of Belgium. Its members, Belgium's leading **sectoral federations**, represent companies in key industrial and service sectors.

FEB has 33 full members, all of which are professional sectoral federations, as well as a number of applicant and corresponding members. All in all, it represents more than **30,000 businesses**, of which **25,000 are small or medium-sized enterprises**.

FEB represents approximately **1.5 million workers** in the private sector.

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FEB reply to the consultation on the Taxation problems that arise when dividends are distributed across borders to portfolio and individual investors and possible solutions

On January 28, 2011, the European Commission (the Commission) launched a public consultation paper on taxation problems that arise when dividends are distributed across borders to portfolio and individual investors and possible solutions



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to these problems. The aim of the Consultation is to ensure that the principle of non-discrimination is upheld and that any double taxation as a result from withholding taxes on dividends is fully eliminated.

The Federation of Enterprises in Belgium (FEB) thanks the European Commission for the opportunity to give its views again on this important topic (see in annex the FEB answer to the previous consultation on double taxation problems).

The FEB fully agrees with the Commission that withholding taxes on dividends represent an obstacle to cross-border investments within the EU and welcomes the opportunity to respond to the consultation.

Dividends constitute a significant flow of funds within the EU. In order to accommodate an effective functioning of the Internal Market it is important to eliminate any existing double taxation in cross border dividend situations. Equally important is to mitigate the many time consuming administrative difficulties in connection with claiming a credit for foreign withholding taxes or to obtain a refund.

The Commission has outlined the following possible solutions on how to prevent double taxation and discrimination of portfolio and individual investors in connection with cross border payments of dividends:

- Option 1: Abolition of withholding taxes on cross-border dividend payments to portfolio/individual investors;
- Option 2: The residence State grants full credit for the withholding taxes levied in the source State;
- Option 3: Net rather than gross taxation in the source Member State;
- Option 4: Application of a general EU-wide reduced rate of withholding tax with information exchange (Neumark solution);
- Option 5: Limitation of both source and residence taxation of dividend income;
- Option 6: No WHT in the State of source and no taxation of foreign source dividends in the State of residence.

In addition to these options, the Commission also indicates a solution whereby the Member State of source levies a final withholding tax on dividend payments to non-resident portfolio investors, at the same rate as that applicable in the Member State of residence. The Member State of source would then transfer the funds to the Member State of residence without reporting the payments.

First of all, the FEB would like to note that, when compared to the current situation, any of the suggested solutions would likely constitute a significant improvement. However, as pointed out by the Commission, each of the proposals has its advantages and disadvantages.



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All in all, the FEB finds options 1 and 6 to be the most appropriate proposals to tackle the various taxation problems in connection with cross-border payments of dividends. The reasoning behind this is that those alternatives provide simple solutions while at the same time eliminating juridical taxation and cash-flow disadvantages.

Option 6 would effectively extend the scope of the Parent-Subsidiary Directive, thus also eliminating any economic double taxation. We agree with the Commission that the logic for exempting payments between related companies may not necessarily apply in relation to individual portfolio investors. However, while there may be legitimate concerns not to extend the scope of the Parent-Subsidiary Directive to individuals this should not be the case for corporate investors. Consequently, option 6 would be the solution preferred by the FEB for corporate portfolio investors.

In relation to individual portfolio investors one can perhaps draw inspiration from the developments regarding withholding taxes on cross-border interest. Over the last 20 years many countries have abolished withholding taxes on outbound interest (while in most cases withholding tax on domestic interest has been retained). Also, since Member States are exchanging more and more information, the need for a withholding tax is less obvious. The source State provides the State of residence with all the information needed for appropriate taxation of the foreign income of its residents.

The Savings Directive provides for a system of information exchange whereby the source State submits to the State of residence the appropriate data regarding the identity of the beneficiary/individual and the payment of interest. This is intended to enable the State of residence to tax the foreign interest income of its residents effectively. The source State levies no withholding tax whatsoever.

The FEB believes that the time has come to abolish withholding taxes on cross-border dividends within the EU. Consequently, we are in favor of option 1 as a solution for individual portfolio investors and with option 6 as a solution for corporate investors. However, to ensure effective taxation, this abolition of withholding tax could, in the case of individuals, go hand in hand with an exchange of information between the source State and the State of residence. ■



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Annex

Double taxation of dividends in the EU

1 Introduction

1.1 Double taxation of dividends

In principle, company profits are subject to economic double taxation.¹ They are taxed both as profit in the hands of the company distributing the profit and as dividends in the hands of the shareholder.

Additionally, a withholding tax is deducted in most cases when issuing dividends. In a purely national context, this withholding tax is mostly (e.g. in Belgium) also the final tax bill for the shareholder or can be offset against the income tax owed by the shareholder. However, in an international context this is generally not the case, meaning that the shareholder faces international juridical double taxation.²

Only juridical double taxation is examined below.

1.2 Does this also occur in the EU?

Economic and/or juridical double taxation is not prohibited per se in the EU. However, Article 293 of the Treaty establishing the European Community did stipulate that Member States shall so far as is necessary “enter into negotiations with each other with a view to securing for the benefit of their nationals ... the abolition of double taxation within the Community”³

Nobody disputes the fact that double taxation is an obstacle to the smooth operation of the Internal Market. In 1992, the Ruding Report stated that “the manner in which Member States currently provide relief for the double taxation of corporate profits distributed to individual shareholders in the form of dividends constitutes a source of discrimination against cross- border investment flows”.⁴

¹ Economic double taxation arises when a single taxable item is taxed in the hands of two different taxpayers.

² Juridical double taxation arises when a taxpayer is taxed twice for a single taxable item.

³ The Treaty of Lisbon no longer contains an equivalent provision to the one regarding double taxation in Article 293 of the Treaty establishing the European Community. Some authors view this as an argument for claiming that double taxation constitutes an obstacle to the Internal Market that is prohibited by the rules on freedom of movement. According to other authors, this simply means that the Member States deemed the relevant article useless because it did not provide for any obligation for the Member States and legal grounds exist for the abolition of double taxation (old Article 94 of the Treaty establishing the European Community).

⁴ Report of the Committee of Independent Experts on Company Taxation (Ruding Report), March 1992, pp. 207-208.



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This leads to a misallocation of resources, in particular because “capital inputs are directed from their most productive uses - that is, those with the highest rates of return before taxes - to locations where such inputs are less productive, but yield greater after-tax returns as a consequence of their relatively favourable tax treatment”. This economic inefficiency “manifests itself in reduced capital productivity, which impairs the Community's international competitiveness, and lower levels of total output and living standards in the Community as a whole”.⁵

In 2003, the European Commission reiterated that a better functioning single market for equity would also help to achieve the Lisbon goal of making the EU the most competitive and dynamic knowledge-based economy in the world by 2010.⁶

The need for coordination of legislation on the basis of the case law of the European Court of Justice was reaffirmed in a Communication in 2006 in which the Commission strongly advocated removing discrimination and double taxation (especially with regard to dividends).⁷

This desire to tackle the fiscal obstacles to the smooth operation of the Internal Market has now also become one of the main goals of the ‘Europe 2020’ strategy and was recently emphasised again in the Monti Report. Against this background the European Commission organised a public consultation on the issue of double taxation within the European Union. This consultation was completed on 30 June and the results will be published soon.

We must not forget either that the establishment of the eurozone also created new obligations for the Member States. As stressed by Prof. Dassesse, the persistence of cases of juridical double taxation is incompatible with a single currency, and at the least any measure taken by one of the Member States that could represent a step backwards in the liberalisation of the movement of capital and payments as they stood when the Member State joined the eurozone must be condemned.

1.3 What has been achieved?

As early as 1969, the European Commission tabled an initial proposal to eliminate juridical and economic double taxation of dividends within groups of enterprises (qualifying affiliated companies), and it should be remembered that the 1975

⁵ Ruding Report, p. 34.

⁶ Communication of 19 December 2003 “Dividend taxation of individuals in the internal market”, COM (2003) 810 final.

⁷ Communication of 19 December 2006, “Co-ordinating Member States' direct tax systems in the Internal Market”, COM (2006) 823.



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proposal regarding harmonisation of corporation tax was explicitly aimed at withholding taxes.⁸

In the end, it was not until 23 July 1990 that a much less far-reaching proposal, the so-called Parent-Subsidiary Directive, was adopted.⁹

Nor has the European Commission neglected to declare Member States in breach in the event of discrimination and to refer recalcitrant Member States to the European Court of Justice. It has also repeatedly indicated its intention to coordinate implementation of the Court's rulings by the Member States by means of Communications and the development of Directives¹⁰. The case law of the Court of Justice could then serve as a 'crowbar' to break the unwillingness of the Member States.

Driven in part by complaints filed by taxpayers, over the past 25 years the Court of Justice of the European Communities has been a pioneer in the fair treatment of domestic and cross-border dividends.¹¹ The Court has repeatedly called Member States to order for breaches of the Treaty establishing the European Community.

However, the limitations of the case law of the Court of Justice are becoming increasingly palpable, meaning that the lack of secondary EU legislation (Directives) risks becoming more and more of a problem.

Moreover, there are a number of other less positive aspects associated with EU harmonisation by means of the Court of Justice:

- many disputes take a long time to settle;
- it is not always possible to find a consistent line in the Court's verdicts or to derive general rules from them, since every case is different and is based on the specific practical and legal context of each Member State, which cannot simply be transposed to another Member State;
- in some cases, a verdict throws up more questions than it answers;
- the Member States are not quick in adapting their legislation and they do not always do so in the same way – in some Member States there is even manifest 'hostility' to the Court's case law.

On top of this, the Member States continue to cling onto their fiscal sovereignty and have not considered it necessary to proactively conduct negotiations with each other with a view to abolishing juridical double taxation. In other words, at present

⁸ Proposal for a Directive of the Council concerning the harmonisation of systems of company taxation and of withholding taxes on dividends, COM (75) 392 final.

⁹ Directive 90/435/EEC of 23 July 1990, as amended by Directive 2003/123/EC of 22 December 2003.

¹⁰ COM (2001) 582 final.

¹¹ The first ruling was the "Avoir fiscal" case, European Court of Justice, 28 January 1986, Commission/France, C-270/83.



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European legislators (i.e. the Member States) do not have any solution for the juridical double taxation to which non-affiliated companies and individuals fall victim.

2 Individuals and European¹² companies

2.1 Treaty establishing the European Community

The fact that the Member States are responsible for determining whether and to what extent double taxation of distributed profit should be avoided (unilaterally or via double-taxation conventions) does not mean that they have free rein to take measures that conflict with the freedoms enshrined in the Treaty establishing the European Community.

In principle, therefore, Member States must not treat dividends that are issued to a foreign shareholder less favourably than dividends that are paid out to a domestic shareholder. Conversely, dividends obtained from a foreign company must not, in principle, be treated less favourably than dividends received from a domestic company.¹³

The European Commission also keeps a close eye on Member States in this regard and has brought many cases before the European Court of Justice, some of them resulting in convictions.

However, in the absence of an EU Directive, the Court can only take action if a single Member State is treating cross-border dividends less favourably than domestic dividends. The Court is powerless if the double taxation is simply the result of two Member States exercising, without discrimination, their respective power to levy taxes, since if the Court were to rule in such a case it would have to decide which Member State – the source state or the state of residence – should avoid double taxation. However, the Court has no legal foundation to allocate the power to levy taxes.

2.2 Double-taxation conventions

Belgium as the source state

Double-taxation conventions provide mechanisms to avoid or limit international juridical double taxation, via withholding taxes.

¹² Including companies from EEA countries.

¹³ Unless their circumstances are objectively different or there is justification.



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Most double-taxation conventions are based on the OECD Model Tax Convention which stipulates, for example, that the shareholder's state of residence is entitled to tax dividend income but that the source state is permitted to deduct withholding tax up to a maximum of 15% in most cases.

Nearly all the double-taxation conventions concluded by Belgium provide for a reduced 15% rate for withholding tax on financial income.

For affiliated companies, most conventions even provide for a greater reduction (5% or 10%) or even the complete elimination of withholding tax. Generally the shareholding required for this is 10% (Belgian Model Convention) or 25% (older conventions).

Belgium as the state of residence

Double-taxation conventions can provide mechanisms to avoid or limit juridical double taxation in the shareholder's state of residence (e.g. by means of a tax credit or a fixed quota of foreign tax).

2.3 Dividend payouts to individuals

Few appropriate mechanisms exist to eliminate juridical double taxation in the case of dividend payouts to individuals. In principle they can only enjoy the reduced withholding tax rate of 15% provided for in most double-taxation conventions.

European Court of Justice case law states that EU law does not unconditionally commit the Member States to avoid double taxation. In other words, the Member States can continue to conclude double-taxation conventions in which the power to levy taxes is shared between the two Member States. However, in principle the Member States must not treat inbound (and outbound) dividends less favourably than domestic dividends. However, Member States must comply with the Treaty establishing the European Community (no discrimination).

In 2004, the Ghent Court of First Instance referred a question to the Court of Justice for a preliminary ruling with a view to establishing whether Belgian legislation conflicted with the free movement of capital because it subjected both domestic dividends and foreign dividends to a single withholding tax and allowed no offsetting of the withholding tax applied in the other Member State.¹⁴ The Court of Justice came to the conclusion that this did not breach the principle of free movement of capital. Double taxation is merely the result of two Member States sharing the power to levy taxes. Since Belgium treats both domestic and foreign dividends in the same

¹⁴ Kerckhaert-Morres, European Court of Justice, 14 November 2006, C-513/04.



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way, the Court ruled that Belgium had not breached the Treaty establishing the European Community.

It goes without saying that this is not conducive to the creation of an actual single capital market in the EU, since it deters investments in other Member States and because companies are forced to introduce complicated structures (cf. Fortis) to avoid double taxation of dividends.

That the existing rules can have unpleasant consequences became very clear a few years ago when the Belgian shareholders of Petrofina and Electrabel saw their Belgian shares suddenly converted into French shares after Petrofina was acquired by Total and Electrabel was bought by Suez, leading immediately to their dividends being taxed at a considerably higher rate.

Only very recently, the Court of Justice ruled against a Belgian shareholder with a shareholding in a French group.¹⁵ The Court found that Community law did not currently provide general criteria for the sharing of powers between Member States as regards the abolition of double taxation.

Consequently, Belgian shareholders will continue to be taxed at a higher rate on their foreign dividends than on dividends paid out in Belgium.

2.4 European affiliated companies (Parent-Subsidiary Directive)

The EU Parent-Subsidiary Directive requires Belgium both to completely exempt from withholding tax the outbound dividends paid by a Belgian subsidiary to its foreign parent company and to exempt from tax (to the tune of at least 95%) the inbound dividends that a Belgian parent company receives from a foreign subsidiary.

To be recognised as an 'affiliated company', the parent company must hold at least a 10% stake in the subsidiary and retain it for a specified minimum period.¹⁶

Therefore, within the EU, economic and juridical double taxation has been largely eliminated between affiliated companies, although the European Court of Justice has repeatedly had to call Member States to order for incorrect or incomplete transposition of the Directive.

This issue is not examined further in the present document.

¹⁵ Damseaux case, European Court of Justice, 16 July 2009, C-128/08.

¹⁶ Member States can lower, but not raise, the thresholds for shareholding exemption stipulated in the Directive. Belgium requires a shareholding of 10% or €2,500,000 (€1,250,000 until last year) and a holding period of one year.



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2.5 European non-affiliated companies

Non-affiliated companies cannot invoke the Parent-Subsidiary Directive and therefore in many cases face double economic and juridical taxation.

The European Court of Justice has repeatedly indicated that in the case of shareholdings that do not fall under the Parent-Subsidiary Directive, Member States are responsible for determining whether and to what extent double taxation of the distributed profit should be avoided, and for introducing mechanisms to avoid or reduce this double taxation through conventions signed with other Member States.¹⁷ However, the Member States must comply with the Treaty establishing the European Community (no discrimination).

2.6 Dividends received from or paid out to non-European companies

This issue, which also relates to the free movement of capital, goes beyond the scope of the present document and therefore is not discussed here.

3 European Court of Justice case law: provisional conclusions

The foregoing shows that, in spite of the many European Court of Justice rulings, juridical double taxation of dividends is still a reality in the EU, at least for individuals and for companies that cannot invoke the Parent-Subsidiary Directive.

Unfortunately, the Kerkhaert-Morres ruling in 2006 confirmed that the existence of double taxation is completely legal under European primary law. The Member States continue to have sovereign power to decide on the distribution of taxing rights, including double taxation, regardless of whether it is in their national law (Kerkhaert-Morres, Block, Truck Center) or in their double-taxation conventions (Damseaux).

In the absence of an EU Directive, double taxation can only be penalised in the event of discrimination (unjustified difference of treatment, e.g. when a Member State takes measures to mitigate such taxation in domestic situations while allowing it to persist in cross-border situations that are considered objectively comparable - see Manninen and ACT Group Litigation with regard to economic double taxation),

¹⁷ Amurta case, 8 November 2007, C-379/05, Test Claimants in Class IV of the ACT Group Litigation case, 12 December 2006, C-374/04.



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or in the event of a breach of secondary law (e.g. juridical double taxation maintained in breach of the provisions of the Parent-Subsidiary Directive).

In view of the above, Professor Wathelet believes that there is only one realistic way forward at this stage: “The only way to make double taxation illegal in the European Union is to draw up rules at EU level in the form of Directives that are comparable to the Parent-Subsidiary Directive or to the Interest and Royalty Directive, which are not so much harmonisation directives as multilateral double-taxation conventions”.

We can therefore conclude that a genuine solution can only be achieved by means of a legislative initiative of the Commission itself, initiated and supported by the Member States (such harmonisation is not required by the convention itself and therefore can only be adopted by the Member States on a voluntary basis).

The best solution would be to abolish withholding taxes.

An announced European Commission Communication on this issue of withholding taxes could already be a first step towards helping the Member States to better coordinate their legislation.¹⁸

4 Proposal: abolition of withholding tax on cross-border dividends for individuals¹⁹

What would this solution look like for individuals?

Member States can probably draw inspiration from what has happened over the past 20 years with double taxation of cross-border interest. Until the 1980s, this interest was also subject to double taxation: specifically withholding tax in the source state plus tax in the beneficiary’s state of residence. Historically the deduction of withholding tax was regarded as an answer to the fear that certain forms of income would elude taxation in both the source state and the state of residence.

To attract savings from abroad, more and more countries – including EU countries – have abolished withholding tax on outbound interest over the past 20 years (while in most cases withholding tax on domestic interest has been retained).

¹⁸ However, it would be useful to continue to bring appeals before the European Court of Justice, specifically invoking Article 63 of the Treaty, which prohibits any restriction on the movement of capital between the Member States themselves and between the Member States and other countries. Also, as stressed by Prof. Dassesse, the Court should be consulted whenever a Member State of the eurozone introduces a new measure that would represent a step backwards in the liberalisation of the movement of capital and payments as it stood when it joined the eurozone.

¹⁹ Pension funds should also be exempt from any withholding tax, as is already the case in the conventions that have been concluded recently by Belgium.



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Also, since the Member States are exchanging more information, the need for a withholding tax is waning. The source state provides the state of residence with all the information needed for appropriate taxation of the foreign income of its residents.

The Savings Directive provides for a system of information exchange whereby the source state submits to the state of residence the appropriate data regarding the identity of the beneficiary/individual and the payment of interest. This is intended to enable the state of residence to tax the foreign interest income of its residents effectively. The source state levies no withholding tax whatsoever.

More and more people are now also pressing for the abolition of the withholding tax on dividends that are paid out across borders within the EU.²⁰

However, to ensure effective taxation, this abolition of withholding tax would, in the case of individuals, have to go hand in hand with an exchange of information between the source state and the state of residence.

The system that would be introduced could incorporate a distribution key covering the distribution of the proceeds of taxation between the state of residence and the source state.

5 Proposal: expansion of the Parent-Subsidiary Directive for companies

The concern that has been expressed for individuals is clearly less relevant for companies since, through their accounts, they are completely transparent in their provision of information about their dividend income.

For companies, the abolition of withholding tax is a development that is clearly in line with historical precedent. Therefore, the minimum shareholding percentage required by the directive should be abolished (gradually if necessary).

²⁰ In fact "Death of withholding taxes?" was the title of one of the seminars of the 2009 International Fiscal Association Congress in Vancouver.