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The French 3 Percent Distribution Tax: Claiming a Refund

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Since December 2012, French companies have been liable for a 3 percent tax on distributions to their shareholders (***3 Percent Tax)***, but practitioners have widely questioned whether this tax is compliant with the provisions of the EU treaties and the double tax treaties signed by France. French subsidiaries whose parent companies are established in an EU Member State or in a treaty-protected State should consider submitting a claim to obtain a refund of the 3 Percent Tax. To date, a number of companies have already sent a claim to the French tax authorities, and some are in the process of bringing their claim before the competent administrative lower court.

Scope of the 3 Percent Tax

The 3 Percent Tax is assessed on dividend distributions and/or deemed dividend distributions by French companies, French permanent establishments and other French entities that are liable for corporate income tax in France. For French tax purposes, the 3 Percent Tax is defined as a corporate tax due by the French distributing entity, not as a withholding tax.

However, the 3 Percent Tax does not apply to distributions made by small and medium-sized companies (as defined by EU Regulation n° 800/2008), or between companies that are included in the same French tax consolidated group. Pursuant to the French tax code, French companies, as well as non-French companies with a French permanent establishment, can form a tax consolidated group with the subsidiaries in which they hold, directly or indirectly, at least 95 percent of the shares).

Compliance with the Parent-Subsidiary Directive

Pursuant to Article 5 of the EU Parent-Subsidiary Directive, distributions to EU parent companies that directly hold at least 10 percent of the shares of the relevant EU distributing subsidiaries for at least two years are exempt from any withholding tax.

Under European Court of Justice (ECJ) case law, the withholding tax is defined as “any tax on income received in the State in which dividends are distributed, where (i) the chargeable event for the tax is the payment of dividends or of any other income from shares, (ii) the taxable amount is the income from those shares and (iii) the taxable person is the holder of the shares.” (*See in particular* ECJ, n° C-286/06, June 26, 2008, *Burda GmbH*.)

Since the 3 Percent Tax is assessed on the French distributing entity rather than the holder of the shares, the success of a claim based on the withholding tax exemption of the EU Parent-Subsidiary Directive is uncertain. In a previous case and in similar circumstances, the ECJ recognized that a tax levied at the level of a distributing entity had the same economic effect as a withholding tax and should therefore be regarded as such. (*See* ECJ, n° C-294/99, October 4, 2001, *Athinaïki Zythopoiia AE*.)

Compliance with the Freedom of Establishment

Pursuant to Article 49 of the Treaty on the Functioning of the European Union (TFEU), restrictions on the freedom of establishment of EU companies are prohibited to the extent that they cannot be justified by an overriding reason of public interest.

The 3 Percent Tax Constitutes a Restriction on the Freedom of Establishment

Under ECJ case law, differing tax treatment of French companies in comparable positions, based on their shareholders' place of establishment, constitutes a restriction on the freedom of establishment. (*See in particular* ECJ n° C-324/00, December 12, 2002, *Lankhorst-Hohorst GmbH*.)

The 3 Percent Tax is assessed on a French distributing company held by a non-French parent company with no permanent establishment in France, but not on a French distributing company held by a French parent company if both companies are included in the same French tax consolidated group. Under French case law, the position of both French distributing companies should be considered as comparable, to the extent that the non-French parent company in question would have been in a position to form a tax consolidated group with its French subsidiary had it been established in France. Therefore, this difference in tax treatment should constitute a restriction on the freedom of establishment. (*See* French Tax Supreme Court, n° 249047, December 30, 2003, *SARL Coréal Gestion*.)

The Restriction Is Not Justified by Any Overriding Reason of Public Interest

A restriction on the freedom of establishment may be justified by an overriding reason of public interest to the extent that the restriction is proportional to the achievement of the objective pursued. In particular, the French tax authorities could argue that the restriction brought about by the 3 Percent Tax is justified because it preserves the cohesion of the tax system.

The preservation of the cohesion of the tax system would be regarded as a valid justification if there was a direct link between the grant of a tax advantage and the compensation for that advantage through a tax levied within the framework of the same tax regime. In the scenario at hand, the French tax authorities would claim that the exemption from the 3 Percent Tax granted to distributions within French tax consolidated groups is compensated by the taxation of distributions made to shareholders of the French parent companies, and that this objective would not be achieved if exemption from the 3 Percent Tax were also granted for distributions to non-French parent companies.

It is unlikely, however, that this justification would be upheld in the courts, since the exemption from the 3 Percent Tax granted to distributions within French tax consolidated groups is not subject to the condition that the distributions received by the French parent company be distributed onward to its shareholders and thus be subject to the 3 Percent Tax. (*See* ECJ n° C-300/07, June 18, 2009, *Aberdeen Property Fininvest Alpha Oy*.)

Furthermore, non-French parent companies that have a permanent establishment in France are entitled to form a French tax consolidated group, such that distributions by their French subsidiaries are definitely exempt from the 3 Percent Tax. Therefore, French subsidiaries that are at least 95 percent held by EU parent companies should be entitled to claim a refund of the 3 Percent Tax based on article 49 of the TFEU.

This position is also shared by the European Commission, which launched an infringement procedure against France on February 26, 2015, on the ground that the 3 Percent Tax constitutes an infringement to the freedom of establishment. The European Commission also argued in its notification letter that the 3 Percent Tax constitutes an infringement to the Parent-Subsidiary Directive, as discussed above.

Compliance with the Double Tax Treaties Signed by France

Most of the double tax treaties signed by France include a non-discrimination provision, pursuant to which French companies that are wholly or partly held by residents of the other contracting State shall not be subjected to taxation that is more burdensome than the taxation to which other similar French companies are or may be subject.

Under French case law, the French subsidiary of a non-French parent company should be considered as similar to a French subsidiary that is included in a French tax consolidated group to the extent that the non-French parent company would have been in a position to form a tax consolidated group with its French subsidiary had it been established in France. (*See* French Tax Supreme Court, n° 233894, December 30, 2003, *Andritz*.)

Therefore, French subsidiaries that are at least 95 percent held by parent companies established in a treaty-protected state should also be entitled to claim a refund of the 3 Percent Tax based on the non-discrimination provisions of the relevant double tax treaty.

Introducing a Claim to Obtain a Refund of the 3 Percent Tax

Claims to obtain a refund of the 3 Percent Tax (based on the grounds discussed herein) must be sent to the French tax authorities no later than December 31 of the second year following the year in which the 3 Percent Tax was paid.

If the French tax authorities reject the claim (or do not reply within a six-month period), the taxpayer will be entitled to bring the claim before the competent administrative lower court during a two-month period following the notification of the refusal (or, in case of a deemed refusal, following the end of the six-month period). The lower courts typically render decisions within two years following commencement of the action.

If the court decision is not satisfactory to the taxpayer, an appeal can be brought before the competent administrative court of appeal, and ultimately before the Supreme Tax Court, in case of a breach by the court of appeal of a rule of law.

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