IN THE COURT OF JUSTICE OF THE EUROPEAN UNION

CASE C-194/15

VERONIQUE BAUDINET

WRITTEN OBSERVATIONS OF THE UNITED KINGDOM

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INTRODUCTION

1. By Order dated 28 April 2015 the *Commissione Tributaria Provinciale di Torino* has referred the following question to the Court of Justice of the European Union ('the Court'):

   "Do Articles 63 and 65 of the Treaty on the Functioning of the European Union preclude legislation of a Member State under which, when a resident of that State, a shareholder in a company established in another Member State, receives dividends taxed in both States, that double taxation is not remedied by the grant in the State of residence of a tax credit at least equal to the amount of tax paid in the State of the distributing company?"

2. These are the Written Observations of the United Kingdom submitted pursuant to Article 23 of the Protocol on the Statute of the Court of Justice.

FACTUAL BACKGROUND

3. The question arises in the context of proceedings taken by an Italian resident, "the Applicant", and other taxpayers in a similar position. The Applicant received a dividend on shares she held in a company resident in France (Paul Ricard SA). The company levied a withholding tax on the dividend, which was subsequently partially subject to tax in Italy as personal income tax.

4. The taxation of dividends in Italy is governed by the consolidated Italian tax code (the 'TUIR') and the 'Convention for the Avoidance of Double Taxation' (the 'DTC'), concluded between Italy and France on 5th October 1989. The relevant provisions of the TUIR and DTC are set out in the Order for Preliminary Reference.

5. Under the terms of the DTC such dividends are subject to tax in France at the maximum rate of 15%. Equally, the DTC provides that dividends paid in one Member State to persons resident in another can be taxable in that other Member State.

6. Under the TUIR, and in particular Article 47, Italian residents are liable for income tax on 40% of the income derived from dividends on shareholdings in both Italian and foreign-resident companies. This is consistent with the DTC and provides for the same treatment for Italian and foreign-resident companies.

7. Article 24 of the DTC provides that, in order to avoid double taxation, tax paid on the dividends in France can be offset against Italian income tax insofar as that does not exceed the Italian tax **attributable to that income**. This is effected by Article 165 TUIR. The Applicant sought to deduct the entire amount of foreign tax suffered, including that part attributable to the part of dividend, which is not taxed under Italian law. Under Article 11(4) TUIR, where the tax credits provided to a taxpayer under Article 165 exceed their net tax liability, the taxpayer can choose between offsetting the excess against their next tax bill, or being reimbursed the difference by the Italian State.

8. The Applicant claims that since Italian residents in receipt of dividends from Italian companies only pay Italian income tax on those dividends, whereas taxpayers in her position pay both the French withholding tax and Italian income tax, Italian law breaches her right to free movement of capital under Article 63 of the Treaty on the Functioning of European Union ('TFEU').

9. It should however be noted in this case that, to the extent that the income has been subject to juridical double taxation, this double taxation has been completely neutralized by the application of Italian legislation providing for a credit in respect of French tax paid on the 40% of the dividend which has been taxed in Italy. The Applicant therefore complains of the direct consequences of the fact that under the DTC the dividends are taxable in both France and in Italy; and that each Contracting State has designed its tax base and tax rates differently.

10. The proportion of the gross dividend taxed and the rate of tax applied to it under the Italian income rules tax on dividends applies equally to both dividends from domestic and non-resident companies and the alleged difference in treatment arises solely from the application of the French withholding tax.

APPLICABLE PRINCIPLES

11. The Court has established the principles applicable to the relationship between Member States' legislation and bilateral Treaties on direct taxation, and the EU's fundamental freedoms through a settled body of case law.

The Court's jurisdiction

12. As a preliminary matter, it is worth noting that the Court has held that it has no jurisdiction to interpret the bilateral tax treaties entered by the Member States, or the relationship between those treaties with national laws (Case C-298/05 *Columbus Container Services* Case [2007] I-10451, [46]-[47]; C-128/08 *Damseaux* [2009] ECR 2009 I-6823, [20]-[21]).

Member States retain sovereignty over the allocation of taxing rights

13. Under the EU's system of delegated powers, direct taxation remains within the sovereign power of Member States, although this competence must be exercised in a manner compatible with EU law (Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, paragraph 29, C-513/04 *Kerckhaert*-Morres [2006] I-10967 15; *Damseaux*, paragraph 24).

14. In the absence of EU harmonising measures, in situations where a cross-border transaction potentially engages the tax jurisdiction of two Member States, it is for those Member States to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, especially with a view to avoiding double-taxation (*Kerckhaert-Morres*, 23-24; *Damseaux* 30).

15. In doing so, Member States may choose the applicable criteria by which their taxing powers shall be allocated, including by reference to nationality, residence, status as a frontier worker or employment by the private or public sector (Case 336/96 *Gilly v Directeur des Services Fiscaux du Bas-Rhin* paragraphs 29 to 30; Case C-303/12 *Imfeld and Garcet* [2013] paragraph 41). The choice of such connecting factors does not constitute discrimination contrary to the fundamental freedoms of the TFEU (*Gilly* paragraphs 30 and 53).

16. Member States may agree between themselves that a taxpayer is liable to be taxed in both Member States (*Damseaux* paragraphs 34 and 35). A Member State is not obliged to prevent the disadvantages that arise as a result of the parallel exercise of such taxing rights (*Damseaux* paragraph 34). To the extent that a taxpayer finds himself in a less favourable position by reason of the Member State's allocation of taxing rights, this is a consequence of the differing levels of taxation in the Member States and in the absence of any Community legislation in the field the

determination of those scales is a matter for the Member States (*Gilly* at paragraph 47).

17. The Court has held, specifically in the context of dividends paid by companies established in one Member State to persons resident in another, that where the Member State of residence does not assert its taxing rights over payments then there is no obligation on that Member State to offset a fiscal disadvantage arising from a liability for tax imposed entirely by the Member State in which the distributing company is established (see Case C-47/12 *Kronos* at paragraph 84 and Case C-194/06 *Orange European Smallcap Fund* at paragraph 41).

Member States may not discriminate in the exercise of their taxing powers

18. However, once the Member States have agreed the allocation of taxing powers between themselves, those powers must be exercised by the Member State concerned in accordance with the principles of EU law (*Imfeld*, paragraph 42).

19. This is illustrated in the case of *Imfeld*. *Imfeld* concerned a Belgian resident who earned all of his income in Germany, and earned more than his wife who was Belgian-resident. Under a DTC between Member States, he was liable only to income tax in Germany. Belgian law granted a tax-free allowance to the highest earner in a household, but the Belgian tax authorities refused to apply this allowance to the wife's salary, with the effect that the couple could not rely on it. The Court held that Belgium had placed Mr Imfeld at a disadvantage vis-à-vis a couple earning all of its income in Belgium and had therefore restricted his freedom of establishment. It is important to note that, for the purposes of this analysis, the Court used a comparator where all aspects of the relevant transaction took place in the Member State of residence (*Imfeld*, paragraphs 49-50).

THE UNITED KINGDOM'S OBSERVATIONS

20. In light of the applicable principles laid out above, the United Kingdom makes the following observations on the question referred. The question referred first invites consideration of whether the juridical double taxation in this case, which is subject to the relief contained in the DTC and the Italian legislation, amounts to a restriction on the free movement of capital contrary to Article 63 and 65 TFEU. It is necessary

therefore to identify: (i) whether there is any restriction on the facts of this case, (ii) whether and to what extent there is juridical double taxation, and (iii) what obligations arise in EU to remedy fiscal disadvantages which arise from juridical taxation.

No restriction on free movement of capital

21. In relation to the first issue, the United Kingdom cannot identify any restriction of the freedom to move capital in this referral. This is because there is no discrimination or difference in treatment. This can be illustrated by the following example.

22. If an individual resident in Italy receives a domestic sourced dividend in the sum of €10,000, Italy will include 40% of that dividend (i.e. €4,000) within its tax base. The tax rate applicable according to page 5 of the Order for Preliminary Reference is 30%, which results in tax due to the sum of €1,200.

23. If an individual resident in Italy receives instead a foreign (French) sourced dividend of €10,000, the foreign dividend taken into account within the Italian tax base is the same, namely 40% of that dividend (€4,000). The tax rate applicable to the French sourced dividend, according to page 5 of the Order for Preliminary Reference, is 30%. This would result in tax due in Italy of €1,200. However, the French sourced dividend has been subject to a foreign withholding tax at the rate of 15%, which results in French tax of €1,500.

24. There is therefore juridical double taxation in relation to 40% of the French sourced dividend, which is taxed both in France and Italy. However the double taxation relief under Article 24(1) of the DTC between Italy and France, provides that the €1,500 of foreign tax is to be apportioned to reflect the amount of the foreign dividend which is included within the Italian tax base. Under this provision 40% of €1,500 is €600, and 60% of €1,500 is €900.

25. The tax credit granted to provide double taxation relief under the DTC is therefore €600 (based on 40% of the dividend), and this reduces the Italian tax payable from €1,200 to €600. With the tax credit for the French tax offset against the tax payable in Italy, the shareholder will have paid €600 of tax in France and €600 of tax in Italy, which is a total of tax paid on the French sourced dividend of €1,200.

26. The overall tax burden on the 40% of the dividend is the same as that on an Italian sourced dividend at €1,200 and the tax burden on the remaining 60% of the dividend which is not taxed by Italy has suffered French WHT of €900. Consequently the overall tax burden on the proportion of a dividend taken into account within the Italian tax base (40%) is the same whether the dividend is derived from resident or non-resident sources. In each scenario, the tax paid comes to a total of €1,200. Furthermore, in the scenario set out above, the situations are comparable. There is no difference in treatment, since the tax burden is the same, and there is consequently no restriction of the free movement of capital.

27. The balance of the dividend, i.e. the remaining €6,000, remains outside the Italian tax base whether it is derived from resident or non-resident sources. There is therefore no difference in treatment here either. However, the balance of the French sourced dividend will have suffered tax in France of €900, whereas the Order for Preliminary Reference suggests that the balance of a domestic dividend would not. However, that taxation has been levied by another Member State and since this part of the dividend has not been included within the Italian tax base, it is not subject to double taxation. Italy therefore has no obligation to grant a tax credit or refund with regard to this part of the dividend.

28. If, due to various reliefs, the effective rate of Italian tax were reduced, the outcome would still be the same. For example, in a situation where there is a domestic sourced dividend, of which €4,000 is to be included in the tax base, but against which reliefs of €3,000 are due, the net sum chargeable with tax would be €1,000. The tax due on that net sum would be chargeable at a rate of 30%, leaving tax due of €300. If, instead, the dividend is a foreign sourced dividend and the same reliefs were due, the net chargeable sum would be the same, as would the Italian tax due.

29. The Italian TUIR provides for a tax credit for double taxation relief of €400, and under Article 11(4) TUIR the taxpayer can claim that the difference (i.e. €400 of foreign tax suffered, less the €300 of Italian tax due) of €100 is either to be carried forward to the next tax year or be reimbursed by Italy. Consequently the net tax burden on a domestic dividend and its comparable foreign counterpart for that tax year, i.e. the 40% taxed by Italy, is the same (€300). There remains no difference in treatment and consequently no restriction of the free movement of capital.

30. As set out at paragraph 19, *Imfeld* shows that the correct comparator for the purposes of this analysis is a situation entirely domestic to Italy. Firstly, Italian income tax is applied to dividends from Italian and foreign companies in the same manner under the TUIR and does not therefore discriminate against the Applicant (*Orange European Smallcap Fund* paragraphs 35-37). The United Kingdom cannot detect any basis (in the Order for Preliminary Reference) for the conclusion that the Italian legislation treats domestic dividends more favourably than foreign sourced dividends. The effect of the credit allowed by Italy is that the Applicant pays no more income tax to the Italian authorities on the dividends than if the dividends had been issued by an Italian company. There is no difference in treatment and no discrimination of any kind.

31. Secondly, Italy's provision of a partial tax credit in respect of French withholding tax cannot be said to discriminate when compared to the treatment afforded to domestic dividends under Italian law. It is true that where a Member State has a system for preventing or mitigating a series of charges to tax or economic double taxation for dividends paid to residents by resident companies, it must treat dividends paid to residents by non-resident companies in the same way (see Case C-315/02 Lenz [2004] ECR I 7063, paragraphs 27 to 49, and Case C-319/02 *Manninen* [2004] ECR I 7477, paragraphs 29 to 55). However, there is no indication in the Order for Preliminary Reference that there are any provisions of Italian law that have the effect of preventing or mitigating double taxation of dividends paid to Italian residents by Italian companies. Indeed it appears that there is no double taxation in those circumstances in Italy; the Order for Preliminary Reference states (at page 6) that no withholding tax is applied to such dividends at all and only income tax corresponding to 40% of the gross amount is due. Accordingly the situation in the present case is not akin to that in *Manninen*.

No double taxation on 60% of the dividend

32. The United Kingdom observes in relation to the second issue that, insofar as 60% of the dividend is not within the tax base of the Italian State, there is no double taxation on that proportion of the dividend to relieve. This follows the Court's reasoning in *Kronos* at paragraph 84, in which it held that where the Member State of residence does not assert its taxing rights over payments, there is no obligation

on that Member State to offset a fiscal disadvantage arising from a liability for tax imposed entirely by the Member State in which the distributing company is established.

No obligation to remedy the fiscal disadvantage by providing a credit in respect of French tax

33. The United Kingdom's remaining submissions address the obligations of the Italian state in relation to the amount of the dividend included in its tax base and which has been subject to tax in both France and Italy. It is settled law that the disadvantages that may arise from the parallel exercise of tax competences by different Member States (to the extent that such an exercise is not discriminatory) do not constitute restrictions prohibited under EU law. Italy has exercised its taxing rights without discrimination and has fully neutralized the double taxation that had arisen in this case. However, the fact that both the Member State in which the dividends are paid and the Member State in which the shareholder resides are liable to tax those dividends does not mean that the Member State of residence is obliged, under EU law, to prevent the disadvantages which could arise from the exercise of competence thus attributed by the two Member States. (Case C-128/08 *Damseaux* paragraph 34).

No obligation to repay more than the Italian tax due

34. The Court has also previously held that the free movement of capital guaranteed by the TFEU cannot have the effect of requiring Member States to go beyond cancelling national taxes payable by a resident in respect of foreign dividends; nor can it extend to providing reimbursement of a sum whose origin is in the tax system of another state (Case C-446/04 *Test Claimants in the FII Group Litigation* paragraph 52 and *Kronos* at paragraph 83).

35. The Applicant claims that her right to free movement of capital has been infringed because her dividends are subject to both withholding tax in France, and income tax in Italy. However, the United Kingdom submits that her claim is essentially the same as the cases put forward in *Kerhaert-Morres* and *Damseaux*, and must fail to the same reasons. Italy is not under an obligation as a matter of EU law to provide the Applicant with a tax credit, and this is not changed by the fact that under the DTC

and its national law, Italy does allow her to offset a specified proportion of the French withholding tax against her Italian income tax liability.

36. There is no basis under EU law for Italy to be compelled to reimburse the Applicant for the consequences of the assertion of fiscal sovereignty by France and Italy simultaneously over the dividend income. Furthermore, as the Court stated in *Gilly*, quite apart from the lack of any basis under EU law for the Applicant's claim, the purpose of the double taxation convention is simply to prevent the same income from being taxed in each of the two states, "*it is not to ensure that the tax to which the taxpayer is subject in one State is no higher than that to which he or she would be subject in another*" (*Gilly,* paragraph 46) and that any unfavourable consequences which result from the difference do not entail a breach of EU law (*Gilly,* paragraph 47).

37. The question referred asks whether the Italian State is required to provide a tax credit at least equal to the amount of tax paid in France. That would entail an obligation on the Italian State to pay the Applicant more than it received from her in tax. Even if there were a basis for holding that the Italian legislation was in breach of EU law, the repayment of the excess double taxation credit goes further than a Member State is required to do (Case C-446/04 *Test Claimants in FII Group Litigation*, paragraph 52):

"*Where, conversely, those profits are subject in the Member State of the company making the distribution to a higher level of tax than the tax levied by the Member State of the company receiving them, the latter Member State is obliged to grant a tax credit only up to the limit of the amount of corporation tax for which the company receiving dividends is liable. It is not required to pay the difference, that is to say, the amount paid in the Member State of the company making the distribution which is greater than the amount of tax payable in the Member State of the company receiving it.*"

38. Were Italy to be obliged to grant such a tax credit above the limit of tax for which a taxpayer was liable, it would seriously undermine the fundamental principle that the Member States retain sovereignty over direct taxation. Such a conclusion would undermine the allocation of tax powers reached by agreement between the Member States in question. It would also lead to the erosion of Italy's tax base, in

particular in view of the fact that the tax credit claimed by the Applicant is larger than the tax levied on her dividend by Italy (see *Gilly* at paragraph 48).

CONCLUSION

39. The United Kingdom respectfully submits that the principles set out above are clear from the Court's existing case law, and that it would therefore be appropriate for the Court to dispose of the reference by way of a reasoned order. In conclusion, the United Kingdom submits that the following answer should be given to the question referred:

"Articles 63 and 65 TFEU do not preclude legislation of a Member State under which a resident who receives a dividend from a company registered in another Member State is subject to taxation in both States and is afforded no tax credit in respect of the tax levied in the other Member State. Furthermore, legislation whereby a Member State, in the exercise of its sovereign tax power, grants a partial tax credit in respect of the tax levied in another Member State that is not equal in amount to and is less than the foreign tax is compatible with Articles 63 and 65 TFEU."

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