ec TAX REVIEW 2017–1

Editorial XL

Gross Withholding Taxes: Is the Court of Justice of the European Union Back on Track with Regard to Deductible Expenses?

Eric C.C.M. Kemmeren*

1 Introduction

The Court of Justice of the European Union (CJEU) has handed down a massive body of case law on the question whether a withholding tax on gross income is consistent with European Union (EU) law, especially with the fundamental freedoms.[1] The Court does not allow gross withholding taxes levied from non-residents if Members States tax their residents on their net income with the result that residents pay less taxes than non-residents on the same class of income. Key to this comparison of tax burdens of non-residents and residents is what is the tax base of residents to be taken into account, because the tax base multiplied by the tax rate results is the tax burden, leaving aside potential tax credits to be taken into account when calculating the ultimate non-resident's respectively resident's tax burden.

The research questions of this editorial are:

(1) What deductible expenses must be taken into account in order to calculate the net income of a resident from the perspective of the fundamental freedoms when comparing the tax burdens of non-residents and residents receiving the same class of income, such as dividends, interest and royalties?

(2) Is the CJEU consistent in its decisions concerning what deductible expenses must be taken into account in order to calculate the net income of a resident?

The context of an editorial does not allow a very detailed answering of these questions. After setting a benchmark to assess to Court's case law in section 2, the author will address at high level settled case law which was handed down before the *Société Générale* case was decided.[2] This will be done in section 3. Subsequently, this ruling will be separately addressed in section 4, because this ruling dealing with a gross dividend withholding tax seems to be a deviation from the Court's case law. In section 5, the question will be dealt with of whether Court in its *Pensioenfonds Metaal en Techniek* (also known as: *PMT*) decision returned to its settled case law.[3] In section 6, the *Brisal* case will be discussed and the potential impact of this ruling on dividend income and royalties.[4] Section 7 draws the main conclusions.

2 Benchmark to assess to court's case law

In order to assess whether the tax burden of non-residents subject to a withholding tax on gross income, such as wages, dividends, interest, royalties, is not worse than the tax burden of residents taxed on the net income of such classes of income, an extended comparison must be made. The *actual* effective tax rate of non-residents and residents must be compared in order to assess whether the tax treatment of non-residents constitutes a discrimination or a discriminatory restriction.[5] This is only possible if a full comparison is made of the tax positions of both.

Only when the extended comparison is applied, a level playing field is created. A non-resident must be in the same competitive position as a resident. The extended comparison will also satisfy international tax neutrality, because the relation between taxes (burdens)

* Professor of international tax law and international taxation at the Fiscal Institute Tilburg of Tilburg University, The Netherlands. He is also a member of the board of the European Tax College, deputy justice of the Arnhem Court of Appeals (Tax Division), and of counsel to Ernst & Young Belastingadviseurs LLP, Rotterdam, The Netherlands. The author can be contacted by e-mail: kemmeren@tilburguniversity.edu.

1 *See* extensively, e.g. Karin Simander, *Witholding Taxes and the Fundamental Freedoms*, EUCOTAX Series on European Taxation vol. 38 (Kluwer Law International: Alphen aan de Rijn, The Netherlands 2013); Eric C.C.M. Kemmeren, *The Netherlands: What Are the Right Comparators Under Article 63 TFEU When Assessing a Dividend Withholding Tax Refund Claim? – Cases C-10/14 (Miljoen), C-14/14 (X), and C-17/14 (Société Générale)*, in *ECJ-Recent Developments in Direct Taxation 2014*, Series on International Tax Law vol. 91, 121–168 (Michael Lang et al. eds, Linde Verlag Wien: Wien, Österreich 2014); Karin Spindler-Simader, *Dividend Withholding Taxes after Miljoen, X and Société Générale*, 25 EC Tax Rev. 70–76 (2016); and B.M. van der Werf, *The Effective Tax Burden Analysis After Société Générale, PMT and Brisal*, 18(4) Derivatives & Fin. Instruments (2016).

2 CJEU 17 Sept. 2015, Case C-17/14 (*Société Générale*).

3 CJEU 2 June 2016, Case C 252/14 (*PMT*).

4 CJEU 13 July 2016, Case C 18/15 (*Brisal*).

5 *See also*, e.g. Kemmeren, *supra* n. 1, at 138–141.

and public goods (benefits) will not be disturbed to the disadvantage of a transnational situations. If the result is such that the tax burden of a resident is lower than that of a non-resident, a resident pays less for the public goods than a non-resident pays. The extended comparison also respects capital and labour import neutrality (CLIN), because non-residents and residents will carry the same effective tax burden in the source state with regard to the concerned class of income. Furthermore, the non-resident's and resident's ability to pay will be measured in the same manner under the extended comparison. It satisfies the principle of equal treatment. Taxation on a gross basis might easily lead to overtaxation, i.e. taxation on more than the increase of wealth, thus on more than the increase of the ability to pay. The extended comparison is also in line with an origin-state-based taxation, i.e. income should be taxed only in the state where that income has been generated. This is because the public facilities provided by that state have contributed to the operation of the income-producing activities (direct benefit principle). In substance, the direct benefit principle is part of the ability-to-pay principle. The state where the income has been created, contributes to a person's wealth, which gives him the ability to pay taxes. In this context, income must be the net income, i.e. the gross class of income minus the expenses attributable to that class of income. Only then, a state taxes a person's ability which has been created in that state.

In conclusion, the extended comparison contributes to creating a level playing field, establishing international tax neutrality, CLIN and satisfies the ability-to-pay principle and an origin-state-based and therefore contributes to the establishment of the internal market.[6]

3 Settled case law up to *Société Générale*

The extended comparison is also settled case law.[7] This may not come as a surprise, because the CJEU is the most important protector of the development of the internal market, at least in the field of direct taxation.[8]

In this context, the following cases may be mentioned as examples: *Biehl*, *Gerritse*, *Bouanich*, Case 284/09 (*Commission v. Germany*), and Case 342/10 (*Commission v. Finland*).[9] In the *Bouanich* case, the Court argues (italics added):

> 52 With regard to tax treatment under the Franco-Swedish agreement, it should be recalled that a *non-resident shareholder* such as Ms Bouanich is permitted, under that agreement, as interpreted in the light of the commentaries on the OECD Model Tax Convention, *to deduct the nominal value of the shares* from the taxable amount payable on the occasion of a repurchase of those shares. The *remaining amount* is then taxed *at the rate of 15%*.
>
> 53 In view of the fact that *resident shareholders* are taxed at the *rate of 30%* on share repurchase *payments after deduction of the cost of acquisition*, it must be ascertained *whether those shareholders are treated more favourably than non-resident shareholders*. In order to do this, it is necessary to know the cost of acquisition of those shares as well as their nominal value. […]
>
> 55 It is *therefore a matter for the national court* to determine in the proceedings before it whether the fact that *non-resident shareholders* are permitted to deduct the nominal value and are liable to a maximum tax rate of 15% *amounts to treatment that is no less favourable than that afforded to resident shareholders*, who have the right to deduct the cost of acquisition and are taxed at a rate of 30%.
>
> 56 The answer to the second question must therefore be that Articles 56 EC and 58 EC must be interpreted as *precluding national legislation* which derives from a double taxation agreement, such as the Franco-Swedish agreement, which *fixes a lower ceiling on the taxation of dividends for non-resident shareholders than for resident shareholders*, and, by interpreting that agreement in the light of the OECD's commentaries on its applicable model convention, permits the nominal value of such shares to be deducted from the share repurchase payment, except where, under *such national legislation*, *non-resident shareholders are not treated less favourably than resident shareholders. It is for the national court* to determine whether that is the case in the specific circumstances of the main proceedings.

In a number of cases, the Court holds that 'economically connected business expenses' are expenses that are directly linked to the economic activity that generated

6 *See* for further details on these benchmarks, e.g. Eric C.C.M. Kemmeren, *Principle of Origin in Tax Conventions, A Rethinking of Models*, Dissertation PhD thesis, Tilburg University 35 et seq., 177 et seq. and 340–350 (E.C.C.M. Kemmeren/Pijnenburg vormgevers/uitgevers 2001), https://www.tilburguniversity.edu/nl/webwijs/show/kemmeren_nl.htm; Eric C.C.M. Kemmeren & Daniël S. Smit, *Taxation of EU-Non-Resident Companies Under the CCCTB System: Analysis and Suggestions for Improvement*, in *Corporate Income Taxation in Europe, The Common Consolidated Corporate Tax Base (CCCTB) and Third Countries* 51 et seq. (M. Lang et al. eds, Edward Elgar Publishing 2013); and Eric C.C.M. Kemmeren, *Legitimacy of Tax Claims of Developing Countries on Interest and Royalties of MNEs*, in *Practical Problems in European and International Tax Law, Essays in Honour of Manfred Mössner* 163 et seq. (Heike Jochum et al.eds, IBFD: Amsterdam 2016).

7 *See also*, e.g. Kemmeren, *supra* n. 1, at 138–141.

8 *See also*, e.g. Axel Cordewener, *The Prohibitions of Discrimination and Restriction Within the Framework of the Fully Integrated Internal Market*, in *EU Freedoms and Taxation*, 2 EATLP International Tax Series 5 1 et seq. (Frans Vanistendael ed., Amsterdam, The Netherlands: IBFD 2006); and Eric C.C.M. Kemmeren, *The Internal Market Approach Should Prevail over the Single Country Approach*, in *A Vision on Taxes Within and Beyond European Borders, Festschrift in Honor of Prof. Dr. Frans Vanistendael* 560–561 (Luc Hinnekens & Philippe Hinnekens eds, The Hague, The Netherlands: Kluwer Law International 2008).

9 *See* CJEU 8 May 1990, C-175/88 (*Biehl*), paras 14 and 16; CJEU 12 June 2003, C-234/01 (*Gerritse*), paras 47 and 52–54; CJEU19 Jan. 2006, C-265/04 (*Bouanich*), paras 3–7, 44, 52–53, and 55–56; CJEU 20 Oct. 2011, C-284/09 (*Commission/Germany*), paras 49, 51, and 53–58; and CJEU 8 Nov. 2012, C-342/10 (*Commission/Finnland*), paras 24–26, 29, 31–32, 34 and 44.

the taxable income. One of them is the *Scorpio* case (italics added):

> In order to provide the referring court with a useful answer, the concept of '*economically connected business expenses*' must therefore be understood as referring to *expenses that are directly linked*, within the meaning of the line of case-law starting with *Gerritse*, *to the economic activity that generated the taxable income.*[10]

This rule has been affirmed in respect of dividend income in Case C-342/10 (*Commission v. Finland*) (italics added):

> 25 The Commission observes that *resident* pension funds, although as regards the *dividends which they have received*, subject to a rate of taxation of 19.5%, *are in effect authorised to deduct tax*, on the basis of Paragraph 7 and point 10 of the first subparagraph of Paragraph 8 of the LEV, *the amounts reserved in order to meet their obligations as regards pensions*, which, *in fact*, gives rise to a *tax exemption for those dividends.*
>
> 26 However, the dividends received by the *non-resident* pension funds are subject to a rate of tax of at least 15% in accordance with the double taxation conventions or a rate of tax of 19.5% in accordance with national tax legislation, *without the possibility* of their being granted by the Republic of Finland *the right to deduct tax from the amounts in reserve*, *whereas the legislation of that Member State regards those amounts as expenses directly related to the income concerned.*[11]

The author believes that this rule does not mean that only direct expenses related to dividend income should be taken into account and not indirect expenses. In this context, the author points to, e.g. the *Schröder* case, in which the direct expenses were only mentioned as an example of expenses which could be taken into account (italics added):

> 40 However, the Court has held, in relation to *expenses*, *such as business expenses which are directly linked to an activity* which has generated taxable income in a Member State, that residents and non-residents of that State are *in a comparable situation*, with the result that *legislation of that State which denies non-residents*, in matters of taxation, *the right to deduct such expenses*, while, on the other hand, allowing residents to do so, risks operating mainly to the detriment of nationals of other Member States and therefore constitutes indirect discrimination on grounds of nationality.[12]

In fact, the *Scorpio* case itself gives the rule that the CJEU's case law does not limit deduction of (business) expenses to only direct expenses. What it does rule is that at the retention of tax at source, reported direct expenses must be taken into account. However, in a refund procedure, expenses that were not directly linked to the economic activity that generated the taxable income can be taken into account (italics added):

> 50 By this question, which is linked to the preceding one, the Bundesfinanzhof essentially asks whether Articles 59 and 60 of the EEC Treaty must be interpreted as not precluding national legislation under which only the *business expenses directly linked to activities* in the Member State in which the service is provided, which the service provider established in another Member State *has reported* to the payment debtor, *are deducted in the procedure for retention at source*, and *any further business expenses* can be taken into account in a subsequent *refund procedure.*
>
> 51 This question must be answered in the light of the considerations on the previous question and bearing in mind the fact that the Court does not have the material to make a comparison between the situations of resident and non-resident providers of services. While the expenses which the provider of services *has reported to his debtor* must be deducted in the procedure for *the retention of tax at source*, Articles 59 and 60 of the EEC Treaty do not preclude the taking into account if appropriate of *expenses that are not directly linked*, within the meaning of the *Gerritse* line of case-law, *to the economic activity that generated the taxable income*, in a subsequent *refund procedure.*[13]

The author has held earlier that it might be true that the compliance costs for a taxpayer might exceed the benefits of a net income taxation compared to a gross income taxation.[14] Therefore, in the context of a cost-benefit analysis, the CJEU might find it appropriate and proportional to give the taxpayer an option to be taxed on a net basis, but that a net basis taxation would not be mandatory. In this way the taxpayer could opt for a gross base taxation only, for whatever reason. In this respect an analogy might be drawn with the Court's case law regarding exit and final settlement taxes.[15] The Netherlands has included such an option in respect of short-term contracted sportsmen and artists.[16] The author held that he would welcome such a development of the Court's case law for practical reasons.

Actually, the Court has developed its case law in this direction as is evidenced by the *Brisal* decision in which the Portuguese withholding tax on gross interest income

[10] *See* CJEU 3 Oct. 2006, C-290/04 (*Scorpio*), para. 44.
[11] *See* CJEU 8 Nov. 2012, C-342/10 (*Commission/Finland*), paras 25–26.
[12] *See* CJEU 31 Mar. 2011, Case C-450/09 (*Schröder*), para. 40.
[13] *See* CJEU 3 Oct. 2006, C-290/04 (*Scorpio*), paras 50–51.
[14] *See* Kemmeren, *supra* n. 1, at 151–152.
[15] *See*, e.g. CJEU 29 Nov. 2011, C-371/10 (*National Grid Indus BV*); CJEU 12 July 2012, C- 269/09 (*Commission/Spain*); CJEU 6 Sept. 2012, C-380/11 (*DI.VI.*); CJEU 6 Sept. 2012, C-38/10 (*Commission/Portugal*); CJEU 31 Jan. 2013, C-301/1, (*Commission/The Netherlands*); CJEU 25 Apr. 2013,C-64/11 (*Commission/Spain*); CJEU 18 July 2013, Case C-261/11, (*Commission/Denmark*); CJEU 23 Jan. 2014, C-164/12 (*DMC*).
[16] *See* Art. 9.4(3)(b) Wet inkomstenbelasting 2001 (Personal Income Tax Act 2001; PITA 2001).

was under discussion.[17] The Court allows the option to be taxed on a net basis to the taxpayer, but such a taxation is not mandatory. If the taxpayer chooses to be taxed on the gross interest amount with a withholding tax, that is fine as well (italics added):

> 42 Next, the *additional administrative burden* which may fall on the recipient of the service, where the latter must enter into the accounts the business expenses which the service provider seeks to deduct, exists only in a system which provides that that deduction must be made before withholding tax is applied and may therefore *be avoided in the case where the service provider is authorised to claim its right to deduction directly from the authorities once IRC has been levied.* In such a case, the right to deduct will take the form of a *reimbursement* of a fraction of the tax withheld at source.
>
> 43 Finally, *it is for the service provider to decide* whether it is appropriate to invest resources in drawing up and translating documents intended to demonstrate the genuineness and the actual amount of the business expenses which it seeks to deduct.

4 THE EXCEPTION OF *SOCIÉTÉ GÉNÉRALE* WITH REGARD TO DIVIDENDS

Société Générale not only incurred direct expenses in respect of the portfolio shareholdings, such as interest expenses on loans taken up to acquire these shareholdings, but also indirect expenses such as, in the case of hedging, negative exchange and transaction results from other shares and positions than those from which the dividends arose, but which were connected with those dividends. The Dutch Supreme Court raised the question of whether all expenses which, in an economic sense, were connected with the shares from which the dividends arose had to be taken into account when calculating and comparing the effective tax rates.

Under the CITA 1969, residents are taxed on their *net income*, i.e. income after deduction of direct and indirect business expenses causally linked to the income.[18] The author believes that this causal link is essentially to what the CJEU also refers to in its settled case law, since, as follows from the *Scorpio* decision, it allows non-residents to take into account direct and indirect expenses linked to the economic activity that generated the taxable income if residents may do this when calculating their taxable base.[19] Under the DWHTA 1965, no expenses were taken into account at all.[20] The taxable base was the gross dividend. Whereas resident portfolio shareholders can take into account direct and indirect business expenses causally linked to the income, non-resident portfolio shareholders could not. For them, the dividend withholding tax (DWHT) was a final tax. Therefore, in order to establish equal tax treatment of both resident and non-resident portfolio shareholders, non-resident shareholders should also be entitled to take into account direct and indirect business expenses causally linked to the dividends concerned. Such a treatment would contribute to removing the discriminatory treatment or restriction of non-resident portfolio shareholders. Furthermore, it must be noted that the Dutch Supreme Court has decided that 'costs' are current expenses and that in respect of interest income received the interest paid on loans taken up to finance the acquisition of debt claims receivables qualify as current expenses.[21] As consequence, the interest paid is deductible as costs from the interest received. By analogy, under Dutch tax law, interest paid on loans taken up to finance the acquisition of shares are deductible as expenses from dividends received as well. It is rather curious that the Dutch Supreme Court did not take this decision into account when asking the preliminary questions.[22] One could even argue that, based on this decision, the Court itself could have decided the case in respect of deductible interest expenses without asking preliminary questions.[23]

Considering the CJEU's settled case law and the Dutch tax system, the answer of the CJEU in the *Société Générale* case is surprisingly and does not match with its previous case law and the Dutch tax system with regard to deductible expenses linked with dividends. Instead of an extended comparison of the situations of residents and non-residents, in substance, the Court develops its own taxable base, as it decides that, based on European law, only expenses which are directly linked to the actual *payment* of the dividends must be taken into account for the purposes of comparing the tax burdens of resident and non-resident companies. These expenses do not include, for example, interest expenses concerning ownership of the shares *per se*, whereas such expenses are deductible as expenses

[17] CJEU 13 July 2016, Case C 18/15 (*Brisal*), paras 42–43.

[18] *See* Arts 7-15a *Wet op de vennootschapsbelasting 1969* (Corporate Income Tax Act 1969 (CITA 1969)). Based on these provisions, certain expenses are not deductible, but these non-deductible expenses are not relevant for this case. *See* for a more detailed discussion, e.g. E.C.C.M. Kemmeren & O.L.J. Nuijten, *Renpaarden rijden Cessna's niet in de wielen en leiden niet tot een spooktocht* 739–747 (Weekblad Fiscaal Recht 2003).

[19] *See* CJEU 3 Oct. 2006, C-290/04 (*Scorpio*), paras 50–51.

[20] Wet op de dividendbelasting 1965 (Dividend Withholding Tax Act 1965 (DWTA 1965)). As of 1 January 2017, Art. 10a DWTA 1965 provides a refund procedure through which a taxpayer can claim a net base taxation in line with, inter alia, the *Société Générale* decision.

[21] *See Hoge Raad* (HR; Dutch Supreme Court) 17 June 2011, no. 10/00076, *Beslissingen in belastingzaken Nederlandse Belastingrechtspraak* (*BNB*) 2012/23.

[22] *See* HR 20 Dec. 2013, no.12/03235, *BNB* 2014/64.

[23] It should also be noted that the Dutch Supreme Court also neglected HR BNB 2012/23 in its final decision in the *Société Générale* case. *See* HR 4 Mar. 2016, no. 12/03235, *BNB* 2016/88. This may be a good reason to take a similar case as the *Société Générale* case again to Dutch Supreme Court.

from dividends received when calculating the taxable base of residents. The CJEU argues (italics added):

> 57 In that regard, it is settled case-law of the Court, in relation to *expenses such as business expenses which are directly linked to an activity that has generated taxable income* in a Member State, that residents and non-residents of that State are in *a comparable situation*, with the result that legislation of that State which denies non-residents, in matters of taxation, the right to deduct such expenses, while, on the other hand, allowing residents to do so, risks operating mainly to the detriment of nationals of other Member States and therefore constitutes indirect discrimination on grounds of nationality (judgment in *Schröder*, C-450/09, EU:C:2011:198, paragraph 40 and the case-law cited).
>
> 58 In particular, as regards income received in the form of *dividends*, *such a link* exists *only* if *those expenses*, which may in some circumstances be directly linked to a sum paid in connection with a securities transaction, are *directly linked to the actual payment of that income* (see, to that effect, judgment in *Commission* v *Germany*, C-600/10, EU:C:2012:737, paragraph 20).
>
> 59 It follows that *only* expenses which are *directly linked to the actual payment of the dividends* must be taken into account for the purposes of *comparing* the tax burden of companies.
>
> 60 The expenses identified by the referring court in its reference for a preliminary ruling in Case C-17/14 do *not* have such a link. As regards, first, *the deduction of the dividend included in the purchase price of the shares*, it is apparent from the documents before the Court that the purpose of that deduction is to establish the actual purchase price of the shares. That deduction does *not*, therefore, concern expenses which are directly linked to the actual payment of the dividends arising from those shares. Secondly, the *financing costs* also mentioned by the referring court *concern ownership of the shares per se*, and therefore they are also *not* directly linked to *the actual payment* of the dividends arising from those shares.[24]

Thus, the Court did not decide that it is for the national court to determine, based on its national law, whether non-resident shareholders are not treated less favourably than resident shareholders. Such a decision would have been in line with its settled case law as discussed above and with its also settled case law that determining the taxable base is a competence of the Member States as long as no harmonization at European level has taken place. See, for example, the *X Holding* case (italics added):

> It must be borne in mind that, according to settled case-law, although *direct taxation is a matter within the competence of the Member States*, they must none the less exercise that competence in a manner consistent with Community law (see, inter alia, *Marks & Spencer*, paragraph 29, Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, paragraph 36, and Case C-182/08 *Glaxo Wellcome* [2009] ECR I-0000, paragraph 34).[25]

The Court applied a limited comparison based on its self-developed standard instead of the regular extended comparison based on national tax law of the Member State concerned. What expenses are directly linked to an activity that has generated taxable income in the Netherlands, in this case dividends, is determined by Dutch national tax law and not by European law.

Therefore, the author believes that the *Société Générale* decision does not contribute to creating a level playing field, establishing international tax neutrality, CLIN and does not satisfy the ability-to-pay principle and an origin-state-based. In conclusion, the decision does not contribute to the establishment of the internal market.

5 BACK ON TRACK IN *PMT* WITH REGARD TO DIVIDENDS?

However, one may wonder whether the *Société Générale* decision may be considered an incident and that the CJEU is on its way back to its settled case law. Maybe a first indication can be found in the *PMT* decision.[26] This case dealt with Swedish dividend withholding tax on gross dividends received by the Netherlands resident PMT. Point 64 of the decision provides support for the idea that the Court is returning back to its settled case law as handed down before the *Société Générale* decision. The wording of this point is more in line with that case law (italics added):

> That being noted, it is important, moreover, to observe that, if the application of two different taxation methods to resident and non-resident pension funds is in this instance justified by the difference in situation of these two categories of taxpayers, the Court has previously held that, in relation to professional *expenses directly linked to an activity that has generated taxable income* in a Member State, residents and non-residents of that State are in a *comparable* situation (judgment of 17 September 2015, *Miljoen and Others*, C-10/14, C-14/14 and C-17/14, EU:C:2015:608, paragraph 57).

Nevertheless, the ultimate decision seems to be more in line with *Société Générale* decision. However, this could be the result of PMT's relevant actions and procedure. As it seems to be, it has only asked for taking into account expenses directly connected to the *receipt* of dividends and not for taking into account other expenses indirectly but causally linked to the dividends received. Therefore, the Court could limit its decision to expenses directly connected to the *receipt* of dividend (italics added):

[24] *See* CJEU 17 Sept. 2015, Case C-17/14 (*Société Générale*), paras 57–60.

[25] *See* CJEU 25 Feb. 2010, Case C 337/08 (*X Holding*), para. 16. *See also*, e.g. CJEU 26 May 2016, Case C-48/15 (*NN (L)*), para. 43.

[26] *See* CJEU 2 June 2016, Case C 252/14 (*PMT*).

> It is, therefore, *for the referring court to determine* whether the taxation method applied to resident pension funds, by means of the calculation of the tax base of those funds and, in particular, the inclusion of their liabilities in the calculation of the capital base, allows for the taking into account of any professional *expenses directly connected to the receipt of dividends*, *as PMT appears to claim*. If that were the case, it should also be admissible to take into consideration such expenses in respect of non-resident pension funds.[27]

However, it must be emphasized that the Court different from *Société Générale* decision in which it decides itself as to what has to be included and what not as expenses directly linked to the actual payment of the dividends arising from the concerned shares, it decided in the *PMT* case that it is for the national court to determine this.

Furthermore, it should also be emphasized that in the *Société Générale* decision financing costs concerning ownership of the shares *per se* are not considered to be directly linked to the actual payment of the dividends arising from those shares, whereas in the *PMT* decision, in the context of expenses *directly* connected to the *receipt* of dividends, the Court allows to take into account for making a comparison between resident and non-resident pension funds, that resident pension funds include their liabilities in the calculation of their taxable base. It can be argued that, at least to a certain extent, financial costs concerning ownership of the shares *per se* are considered to be directly linked to the actual payment of the dividends arising from the shares held by PMT, indeed. Anyway, according to the author, the Court does not allow to tax resident pension funds on a net taxable base and non-resident pension funds on a gross taxable base, even when the taxation methods differ and that difference is justified because of the different goals of the distinctive taxation methods, if the net taxation of resident pension funds is also meant to take into account any professional expenses directly connected to the receipt of dividends. If the Swedish court establishes that this is the case, then, in the context of comparing the effective tax burdens of resident and non-resident pension funds, that court must also allow non-resident pension funds to take into account such expenses.[28]

Reading the *PMT* decision in this way, this decision is already departing from the *Société Générale* decision. The Court seems to pave the way to return to its settled case law, which move is more than welcome.

6 Back on track in *Brisal*

This idea that the CJEU is getting back on track is further fuelled by the *Brisal* decision.[29] This case was handed down after the *PMT* decision. In this case, the Court decides that the Portuguese withholding tax on gross interest paid by the Portuguese resident company Brisal to the Irish resident bank KBC Finance Ireland is inconsistent with freedom to provide services. Portuguese resident financial institutions have the right to deduct in respect of interest income received business expenses directly related to the activity in question, whereas non-resident financial institutions are not. It is for the Portuguese national court to assess, on the basis of its national law, which business expenses may be regarded as being directly related to the activity that has generated taxable income in Portugal (italics added):

> 44 With regard to the third aspect of the request for a preliminary ruling, that is to say, *how to determine the business expenses directly related to interest income* arising from a financial loan agreement such as that at issue in the main proceedings, it must be recalled that the Court has held that a Member State which grants residents the opportunity *to deduct such expenses* may not, in principle, preclude the deduction of *those same expenses* for non-residents […]
>
> 45 It follows that, as regards the account to be taken of those expenses, non-residents *must*, in principle, *be treated in the same way* as residents and must be able *to deduct the same expenses* as those which residents are allowed to deduct.
>
> 46 Furthermore, it is clear from the case-law of the Court that *business expenses directly related to the income received* in the Member State in which the activity is pursued must be understood as *expenses occasioned by the activity in question*, and therefore *necessary for pursuing that activity* […]
>
> 47 With regard to the service at issue in the main proceedings, that is to say, the granting of a loan, it must be noted that the performance of that service necessarily gives rise to *business expenses* such as, for example, *travel and accommodation expenses, and legal or tax advice*, for which it is relatively easy both to establish the *direct link* with *the loan* in question and to prove the actual amount involved. Since taxpayers with limited liability must be able to enjoy the same treatment as taxpayers with unlimited liability, they must be granted, as regards those expenses, *the same opportunities to make deductions*, whilst being subject to the same requirements as regards, in particular, the burden of proof.
>
> 48 It is important to add that the pursuit of that activity *also occasions financing costs* which must, in principle, be regarded as *necessary* to the pursuit of that activity, but in respect of which it may prove more difficult to establish a direct link with a given loan or the actual amount involved.

[27] *See* CJEU 2 June 2016, Case C 252/14 (*PMT*), para. 65.

[28] *See* for a different opinion, .e.g. Daniël S. Smit, International Income Allocation under EU Tax Law: Tinker, Tailor, Soldier, Sailor, Tilburg University, Tilburg 2016, p. 17, who holds that the CJEU is blending two elements of two different systems and, subsequently, that it uses that blend as a new benchmark. According to Smit, the CJEU creates a new international income allocation rule.

[29] *See* CJEU 13 July 2016, Case C 18/15 (*Brisal*), paras 43–54.

> The same is true, as the Advocate General stated in point 39 of her Opinion, as regards the *fraction of the general expenses* of the financial institution which may be regarded as *necessary* for the granting of a particular loan. […]
>
> 52 *It is for the referring court*, before which the dispute has been brought and which must assume responsibility for the subsequent judicial decision, to determine in the main proceedings, first, *which of the expenses claimed* by KBC may be regarded as business expenses directly related to the financial activity in question *for the purposes of national legislation*, and secondly, *what is the fraction of the general expenses* which may be regarded as *directly related* to that activity […]
>
> 53 In that regard, it is appropriate to add that, *unless national legislation authorises* resident financial institutions to use, in the calculation of the financing costs incurred, interest rates such as those mentioned by the referring court in its third question for a preliminary ruling, that court cannot take those rates into account in a situation such as that at issue in the main proceedings.

With the *Brisal* decision, the Court is back on its track with regard to the deduction of expenses when comparing the situation of non-residents with residents: for comparing their effective tax burdens in respect of a class of income, they are entitled to the same deductions, i.e. the deductions to which residents are entitled, non-residents are entitled as well. The author welcomes this decision, because it contributes to creating a level playing field, establishing international tax neutrality, CLIN and it satisfies the ability-to-pay principle and an origin-state-based. The decision contributes to the establishment of the internal market.

However, it is surprising that the Court does not refer at all to its *Société Générale* decision, although this decision has been heavily criticized.[30] It is even more remarkable, because also Advocate General Kokott was very critical.[31] She even tried to provide the Court with an escape by referring to the distinction made for value added tax (VAT) purposes between holding shares which does not constitute an economic activity for VAT purposes and granting loans which is an economic activity. However, the author does not believe that this distinction can really be an escape, because in respect of the free movement of capital, it is settled case law that no economic activity is required.[32] Indeed, it was exactly that freedom which has been applied in the *Société Générale* decision. The reason why the CJEU did not address the *Société Générale* decision is unclear. Is the *Brisal* decision another step of further departing from this unfortunate decision?

The *Brisal* decision may have a wide impact. The decision may be a good reason to take a similar case as the *Société Générale* case again to CJEU. Furthermore, gross withholding taxes are also frequently levied on royalties. The same approach as in the *Brisal* case should be applied in this context.[33] If a non-resident of a Member State does not have the right to deduct expenses which are directly linked to granting a license which generates taxable income in that Member State, whilst a resident of that Member State has such a right with the result that residents pay less taxes than non-residents on royalties, such a different treatment constitutes a discrimination or a discriminatory restriction which can only be saved from a European law perspective if that different treatment can be justified by a rule of reason.

7 Conclusions

The research questions of this editorial are:

(1) What deductible expenses must be taken into account in order to calculate the net income of a resident from the perspective of the fundamental freedoms when comparing the tax burdens of non-residents and residents receiving the same class of income, such as dividends, interest and royalties?
(2) Is the CJEU consistent in its decisions concerning what deductible expenses must be taken into account in order to calculate the net income of a resident?

To answer the second question first: The CJEU's case law concerning what deductible expenses must be taken into account in order to calculate the net income of a resident is consistent with the exception of the *Société Générale* decision. The *PMT* and *Brisal* decisions indicate that the Court is departing from this unfortunate decision. At least, these decisions may be good reasons to take a similar case as the *Société Générale* case again to CJEU. Then, it can demonstrate that it is back on track with regard to deductible expenses.

I respect of the first question, the answer is that the national tax laws of the Member State concerned determine what expenses must be taken into account in order to calculate the net income of a resident from the perspective of the fundamental freedoms when comparing the tax burdens of non-residents and residents receiving the same class of income, such as dividends, interest and royalties. It is for the national courts of that Member

[30] *See*, e.g. Rens Paternotte in his annotation to CJEU 17 Sept. 2015, Case C-17/14 (*Société Générale*), H&I 2015/343; Spindler-Simader, *supra* n. 1; Dutch Advocate General Wattel in his opinion of 23 Dec. 2015, no. 12/03235, BNB 2016/88, paras 3.6–3.12; P.G.H. Albert in his annotation to BNB 2016/88; H. Vermeulen, Over outbound dividend, kostentoerekening en inningskosten. Het mysterie in de zaak Société Générale, NTFR 2016/1515; and van der Werf, *supra* n. 1.

[31] *See* Advocate General in her opinion of 17 Mar. 2016, Case C-18/15 (*Brisal*), paras 31–36.

[32] *See*, e.g. CJEU 11 Dec. 2003, Case C-364/01 (*Erven Barbier*), paras 56–63, CJEU (*Stauffer*), paras 18–24, and CJEU (*Welte*), paras 31–39.

[33] Compare also, e.g. van der Werf, *supra* n. 1.

State to make this assessment. If national tax legislation gives the right to residents to deduct direct and indirect expenses causally linked with the class of income concerned, it must give non-residents the option to claim the same deductions if as a result of these deductions residents pay less taxes than non-residents on the same class of income.

With the exception of the *Société Générale* decision and possibly the *PMT* decision, the CJEU's case law with regard to deductible expenses contributes to creating a level playing field, establishing international tax neutrality and CLIN. It also satisfies the ability-to-pay principle and an origin-state-based. Thus, this case law contributes to the establishment of the internal market.