Case C- 685/16, EV

CJEU confirms that German rules introducing an unfavourable treatment for dividends from third-States are in breach of the free movement of capital

On 20 September 2018, the Court of Justice of the European Union ("CJEU" or "Court") issued its judgment in the case *EV v. Finanzamt Lippstadt* (Case C-685/16; for a comment of the Opinion of AG Wathelet in this case, please see our EU TAX ALERT 2018/3). The case concerns the tax treatment of dividends received by German companies from non-EU companies for the purpose of German business tax. Under the relevant German rules, dividends from domestic shareholdings are exempt from German business tax, subject to a 15% minimum holding requirement. By contrast, with regard to foreign shareholdings, the exemption is subject to stricter rules since, in addition to the minimum holding requirement, the distribution must satisfy certain additional conditions (such as an active business test at the level of the distributing company). The Court held that such difference of treatment is in breach of the free movement of capital envisaged in Article 63 and ff. of the Treaty on the Functioning of the European Union ("TFEU").

The Court recalled its previous case law (see, in particular, C-504/16 and C-613/16, *Deister Holding and Juhler Holding*) to point out that a shareholding of 15% does not necessarily imply that the shareholder exercises a definite influence over the participated company (§ 40). Therefore, in the case at stake the Court concluded that the free movement of capital is applicable since the relevant German rules do not apply exclusively to situations in which the parent company exercises a decisive influence over the company paying the dividends (§ 41).

The Court went further to deny the applicability of the standstill clause envisaged in Article 64 of TFEU, under which restrictions on the free movement of capital to or from third countries are not in breach of the TFEU if such restrictions (i) involve direct investments and (i) existed on 31 December 1993.

In particular, the Court pointed out that the German shareholder indirectly owned the entire capital of the non-EU subsidiary and concluded that such shareholding was to be regarded as a direct investment (§ 71). However, the Court found that German legislation cannot be regarded as existing on 31 December 1993. In reaching this conclusion, the Court pointed out a number of significant changes introduced to the German system after 1993, including the abandoning of the imputation credit system in favour of the exemption system (§ 79).

Lastly the Court analysed the possible existence of a justification. Pursuant to its established case law, the Court found that, in light of the aim of the German legislation – i.e. the elimination of economic double taxation – German companies receiving dividends from domestic shareholdings and German

companies receiving dividends from foreign shareholdings are comparable (§§ 91-92). That said, the Court denied that the restriction could be justified by the objective of combating tax avoidance and evasion. In this respect, the Court highlighted that German rules introduce a non-rebuttable presumption of fraud and abuse and are not targeted exclusively to wholly artificial arrangements which do not reflect economic reality (§ 98).

The judgment could impact on the Italian rules regarding the taxation of dividends from companies resident of low tax jurisdictions. Indeed, such dividends are, as a general rule, subject to full taxation (under certain conditions, a 50% exemption applies as from 2018) and do not benefit of the 95% exemption granted to domestic dividends.

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