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The ECJ's Decision in AMID and its Implications
for Belgian Companies

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I. INTRODUCTION

The European Court of Justice rendered its decision the AMID case, *Algemene Maatschappij voor Investeren en Dienstverlening NV (AMID) v. Kingdom of Belgium* (Case C-141/99) on 14 December 1999 on the interpretation of Art. 52 (now, after amendment, Art. 43) of the EC Treaty. This decision has implications for Belgian companies that have branches or subsidiaries in other EU Member States and warrants attention in two respects.

First, following the AMID decision, Belgian companies that have established themselves in other Member States by opening a local branch (permanent establishment) may no longer be required to set off Belgian losses against the profits of their foreign branches which are exempt from tax under a tax treaty.

The second respect concerns Belgian companies that have established themselves in other Member States by incorporating a local subsidiary. At present, the dividends received from that subsidiary are not excluded from the Belgian taxable profits of the parent company (as required by the Parent-Subsidiary Directive, as implemented into Belgian domestic law) if the

subsidiary benefits from a corporate tax regime which is significantly more favourable than the regime applicable in Belgium to its parent. The AMID decision puts a question mark, in our view, over the compatibility of such a blanket anti-avoidance provision with Community law. This article reviews these two issues.

II. BELGIAN COMPANIES WITH BRANCHES IN OTHER MEMBER STATES

A. National legal background

Pursuant to the provisions of the Belgian Income Tax Code, the business losses incurred by a Belgian company in previous years can be set off against the profits made during a following taxable period. Art. 66 of the Royal Decree implementing the 1964 Belgian Income Tax Code (hereafter "Royal Decree") provides that "the total amount of profits determined in accordance with Art. 65 shall, where appropriate, be broken down, according to their origin into:

- (1) profits made in Belgium (hereafter "Belgian profits");
- (2) profits made abroad for which tax is reduced (hereafter "profits taxable at a lower rate"); and
- (3) profits made abroad and exempt from tax by virtue of a tax treaty (hereafter "profits exempt by treaty").

Before this breakdown is made, any losses incurred during the taxable period, in one or more of the company's establishments in Belgium and abroad, are to be successively set off against the total profits of the other establishments in the following order:

- (a) losses incurred in a country in which the profits are exempt by treaty: first, against profits exempt by treaty and, if these are insufficient, against profits taxable at a lower

- rate and then against Belgian profits;
- (b) losses incurred in a country in which the profits are taxable at a lower rate: first, against profits taxable at a lower rate and, if these are insufficient, against profits exempt by treaty and then against Belgian profits; and
 - (c) losses incurred in Belgium: first, against Belgian profits and, if these are insufficient, against profits taxable at a lower rate and then against profits exempt by treaty.

Under Art. 69 of the Royal Decree, the previous business losses are to be offset insofar as they have not hitherto been capable of being offset or have not previously been covered by profits exempt by treaty.

B. Belgium-Luxembourg treaty provisions

Belgium has concluded bilateral double taxation treaties with all the EU Member States. All of the treaties are based on the OECD Model Tax Convention on Income and on Capital.

Belgium and Luxembourg concluded an income and capital tax treaty on 17 September 1970. Under Art. 7 of the treaty, the profits of an enterprise of a contracting state are taxable only in that state unless the enterprise carries on its business in the other contracting state through a permanent establishment situated there. If the enterprise carries on its business in such a manner, the profits of the enterprise are taxable in the other state, but only insofar as they are attributable to that permanent establishment.

Under Art. 23(2)(i) of the treaty, income derived in Luxembourg which, under the treaty, is taxable in Luxembourg is exempt from

tax in Belgium.

III. THE AMID DECISION

A. The facts

AMID was a company incorporated in Belgium and had its head office there. It had also established itself in Luxembourg by opening a branch in that country. In 1981, AMID incurred a tax loss in Belgium of approximately BEF 2 million. In the same year, its Luxembourg branch had a profit of approximately BEF 3 million. Pursuant to the treaty between Belgium and Luxembourg, the profits of the Luxembourg branch were taxed in Luxembourg and exempt from corporation tax in Belgium.

In 1982, AMID made a profit in Belgium. In its Belgian corporation tax return for the 1982 accounting year, AMID deducted the Belgian loss incurred in 1981 from the Belgian profits realized in 1982. The Belgian tax authorities denied the deduction. According to them, in accordance with Art. 66 of the Royal Decree, the Belgian loss incurred in 1981 should have been set off (for Belgian tax purposes) against the (treaty-exempt) profits made in the same year in Luxembourg, with the result that the loss could not be deducted (again) from the Belgian profits made in 1982.

B. Legal proceedings

AMID lodged a complaint against the decision of the tax authorities, which was rejected by the regional director for direct taxes. AMID appealed the rejection to the Court of Appeals of Ghent. Before that Court, AMID put forward two arguments.

First, AMID argued that Art. 66 of the Royal Decree was contrary to the provisions of the Belgium-Luxembourg treaty insofar as Art. 66 led indirectly to the taxation in Belgium of the treaty-exempt profits made in Luxembourg.

This line of argument, however, was almost bound to fail.¹ The Belgian Supreme Court, in its "much criticized" *Velasquez* decision, held, in a similar tax dispute involving a Belgian company with a branch in the Netherlands, that the treaty exemption of the profits of the foreign branch does not restrict the right of Belgium, regarding the taxation of the Belgian profits, to deny a carry-forward of the Belgian losses to the extent they can be compensated by treaty-exempt foreign branch profits.² The Court of Appeals of Ghent followed the *Velasquez* decision and, accordingly, rejected the first argument.

AMID's second argument met with more success. AMID argued that Art. 66 of the Royal Decree was contrary to Community law insofar as Art. 66 penalizes, from a tax perspective, a Belgian company wishing to establish a branch in another Member State, as compared to a Belgian company that operates only in Belgium.

The Court of Appeals saw some merit to this argument and, accordingly, decided to request a preliminary ruling from the ECJ on the following question: Does Art. 52 (now, after amendment, Art. 43) of the EC Treaty preclude the application of the national legislation of a Member State under which, for corporate tax purposes, a company incorporated under national law, having its

¹ Belgium does not apply the *stare decisis* principle. Accordingly, a court of appeals is not bound to follow, except in special circumstances, a ruling on a point of law made by the Belgian Supreme Court.

² Cass. 29 June 1984, F.J.F., 1984, No. 84/164. See further Dassel, M. and P. Minne, *Droit Fiscal* (Brussels: Bruylant, 4th ed., 1996), at 854 and the references cited there.

seat in that Member State, may deduct a loss incurred in the previous year from the current year's taxable profits only on the condition that the loss was not capable of being set off against the profits made during that same previous year by one of its permanent establishments situated in another Member State, when the loss, although set off, cannot be deducted from taxable income in either of the Member States concerned, whereas the loss would be deductible if the establishments of that company were situated exclusively in the Member State in which it has its seat? (AMID decision, Para. 17.)

C. The Belgian government's arguments before the ECJ

The Belgian government's arguments were twofold. First, the Belgian government argued that the legislation at issue does not constitute a hindrance to the freedom of establishment because the legislation must be considered in its overall context. The Belgian government admitted that the specific situation under examination constituted a disadvantage for AMID; according to the Belgian government, however, it was equally true that, if that same enterprise had profits in Belgium and the establishment situated in Luxembourg had a loss, the basic amount which the enterprise in Belgium stood to have charged to tax would be reduced; in addition, the loss might be set off in Luxembourg against profits subsequently made there. In this case, the position of that enterprise would be better than the position of an enterprise without a foreign establishment. Thus, a Belgian company with one or more of its establishments in other Member States could find itself at a disadvantage in some cases and at an advantage in others, compared to a Belgian company having operations in Belgium only. In reality, this system does not influence the choice by enterprises whether or not to create a foreign establishment. When

an enterprise decides to establish a permanent establishment in another Member State, the enterprise does not know whether the permanent establishment will consistently make losses or profits, and the enterprise certainly does not know whether the losses will occur in the new permanent establishment or at the main seat of the business in Belgium. Accordingly, this system does not create a hindrance contrary to the Treaty. (AMID decision, Para. 24.)

Second, the Belgian government argued that Belgian enterprises that have a permanent establishment abroad are not in the same position as enterprises that have concentrated all their operations in Belgium. In terms of their tax treatment, the two categories of enterprises will always be in a different situation; thus, the application of a system leading to different results does not necessarily constitute discrimination. (AMID decision, Para. 25).

It should be noted that the Belgian government's first argument failed to take into account the recapture provision in the Belgium-Luxembourg treaty. If the Luxembourg branch had a loss in year one and made a profit in year two, the Belgian profits in year two will be increased by adding to them the Luxembourg profits made in year two to the extent that the Luxembourg loss in year one was set off against the Belgian profits made in year one. See Art. 23(2)(v) of the treaty. This point was not lost on either the Commission in its observations before the ECJ or on the Advocate General, who specifically referred to it in his opinion. See Para. 24 of the opinion of Advocate General Siegber Alber dated 8 June 2000.

D. The reasoning of the ECJ

Before addressing these arguments, the ECJ recalled that, according to established case-law, with regard to companies formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community, it is their corporate seat in the above sense that serves as the connecting factor with the legal system of a particular State, like nationality in the case of natural persons (AMID decision, Para. 20).³ The ECJ pointed out that, even though, according to their wording, the provisions of the EC Treaty concerning the freedom of establishment are mainly aimed at ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, the provisions also prohibit the State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation which comes within the definition in Art. 58 of the EC Treaty (AMID decision, Paras. 21).⁴

The ECJ observed that, by setting off domestic losses against profits exempt by treaty, the legislation of that home Member State establishes a different tax treatment as between companies incorporated under national law having establishments only on national territory and companies having establishments in another Member State. According to the ECJ, as the Belgian government itself recognized, where such companies have a permanent establishment in a Member State other than that of origin and a double taxation treaty binds the two States, those companies are

³ The ECJ cited Case 270/83, *Commission v. France*, [1986] ECR 273, Para. 18; Case C-330/91, *Commerzbank*, [1993] ECR I-4017, Para. 1; and *ICI v. Colmer*, [1998] ECR I-4695, Para. 20.

⁴ The ECJ referred to Case 81/87, *Daily Mail and General Trust*, [1988] ECR 5483, Para. 16, and Case C-200/98, *X and Y v. Riksskatteverket*, [1999] ECR I-8261, Para. 26.

likely to suffer a tax disadvantage which they would not have to suffer if all their establishments were situated in the Member State of origin. (AMID decision, Para. 23.)

The ECJ then examined the two arguments put forward by the Belgian government. The ECJ quickly dismissed the argument based on the overall context⁵ of the Belgian tax system. Even if the Belgian tax system were favourable to companies with establishments abroad more often than not, that does not prevent the system from resulting, where the system proves disadvantageous for those companies, in an inequality of treatment in relation to companies without establishments outside Belgium and thus creating a hindrance to the freedom of establishment guaranteed by Art. 52 of the EC Treaty. (AMID decision, Para. 27.)

The ECJ also gave short shrift to the argument based on the lack of comparability of the two categories of Belgian companies considered. Regarding the argument based on the differences between Belgian companies having a permanent establishment abroad and those without, the differences referred to by the Belgian government cannot in any way explain why the former cannot be treated in the same way as the latter for purposes of deducting losses. A Belgian company that has no establishments outside Belgium and incurs a loss during a given tax year finds itself, for tax purposes, in a comparable situation with that of a Belgian company which, having an establishment in Luxembourg, incurs a loss in Belgium and makes a profit in Luxembourg during that same tax year. Since an objective difference in the respective positions of the companies has not been established, a difference

⁵ As noted by the Advocate General in his opinion (see Para. 39: "... in the instant case, the Belgian government has not expressly invoked the need to preserve the coherence of the tax system as a justification" (author's translation).

in treatment regarding the deduction of losses in calculating the companies' taxable income cannot be accepted. In the absence of justification, that difference in treatment is contrary to the provisions of the EC Treaty on the freedom of establishment. (AMID decision, Paras. 28 to 31.)

It would be premature, however, to conclude that the last word has been said regarding the soundness of the argument based on the lack of comparability of the two categories of companies. Indeed, the ECJ pointedly remarked: "In that respect, it should be noted that the Belgian Government has not attempted to justify that difference in treatment in relation to the Treaty provisions on freedom of establishment on any grounds other than those indicated in paragraph 25 of this judgment" (AMID decision, Para. 32). Para. 25 contains the Belgian government's second argument, the last part of which states: "from the point of view of their tax treatment, the two categories of undertaking will always been in a different situation, so that the application of a system leading to different results does not necessarily constitute discrimination".

Thus, the door remains ajar, and the (ugly) head of the *Bachmann* "coherence" line of argument could be raised in future cases, albeit on which grounds remains to be seen. As indicated in III.C., the recapture provision of the Belgian-Luxembourg treaty, to which attention was drawn by the Advocate General in his opinion and by the Commission in its observations before the ECJ, preempts any risk of a double deduction of losses (namely, from the Belgian profits in year one, and from the Luxembourg profits in year two, in the reverse situation from that with which the AMID case was concerned).

IV. IMPLICATIONS OF THE AMID DECISION FOR BELGIAN COMPANIES HAVING SUBSIDIARIES IN OTHER EU MEMBER STATES

As stated by the ECJ in *Commission v. France*, the *Avoir Fiscal* case, to which the AMID decision made reference, albeit in another context,⁶ the freedom of establishment can be exercised by a company in two ways: either by setting up a local branch or by incorporating a local subsidiary. The choice between these two options is for the company to make, and its freedom of choice may not be hindered by tax restrictions. Thus, in neither case may the freedom of establishment be restricted by Belgian legislation which makes establishment abroad, at least in some cases, more onerous tax-wise than operating in Belgium only.

This, in turn, raises the question of the compatibility with Community law of some of the provisions of Belgian law implementing the Parent-Subsidiary Directive.⁷ In the Belgian legislation, the general rule is that, if certain thresholds and conditions are met, all dividends received by a Belgian parent company from a Belgian subsidiary company benefit from a tax exemption regime at the level of the Belgian parent. The tax exemption regime does not apply, however, if the Belgian parent receives dividends from a subsidiary which is subject to a local corporation tax regime that is substantially more advantageous than the Belgian corporation tax regime applicable to its parent.

It is likely that, following the AMID judgement, the compatibility of such a blanket and irrebuttable anti-avoidance provision with the freedom of establishment of Belgian companies in other Member

⁶ See note 3, *supra*, and accompanying text.

⁷ Council Directive 90/435/EEC of 23 July 1990.

States (including the Dublin dock area of Ireland) by way of a local subsidiary will be raised before the Belgian courts, and eventually before the ECJ.