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CJEU decision in *Argenta Spaarbank* case

Freedom of establishment – notional interest deduction – permanent establishment

On July 4, 2013, the Court of Justice of the European Union (CJEU) rendered its decision in the *Argenta Spaarbank* case (C-350/11). The Court concluded that the Belgian notional interest deduction regime is contrary to the EU freedom of establishment.

Background

Belgium applies a notional interest deduction regime, which consists of deducting a percentage of the adjusted equity capital of the company from the basis of its assessment for corporate income tax. The equity capital has to be reduced by the net value of the assets of permanent establishments, the income of which is exempt from Belgian tax by virtue of a double tax treaty.

The case at hand concerns Argenta Spaarbank NV ("Argenta"). In calculating its notional interest deduction, Argenta was unable to take into account that part of its equity capital equal to the assets of its Dutch permanent establishment. Had the permanent establishment been established in Belgium, no reduction in respect of the permanent establishment's assets would have to be made.

In defending this regime, the Belgian Government put forward two arguments. First, they argued that the exclusion of the permanent establishment (PE) only affects the PE's profits, exempt from Belgian tax, and not those of the Belgian company as such. In the case of a foreign PE not exempt under a double tax treaty, the notional interest deduction is indeed applied first to the profits of that PE. By analogy, the Belgian Government argued that the notional interest deduction should therefore be applied to the profits attributed to an establishment based in a country with which Belgium has concluded a double tax treaty. However, those profits are not taxed in Belgium. Secondly, the Belgian Government argued that the difference in treatment is a consequence of the parallel exercise of tax jurisdiction by Belgium and the Netherlands, and the fact that a similar notional interest deduction scheme is currently not available in the Netherlands. Moreover, the exclusion was justified on the grounds of the cohesion of the Belgian tax system and in order to preserve the balanced allocation of taxing rights between Belgium and the Netherlands.

CJEU decision

The Court followed the opinion of Advocate General (AG) Mengozzi and rejected the arguments put forward by the Belgian Government. In addressing the first argument, the Court pointed out that Belgian resident companies were subject to tax on their worldwide income. Therefore, even if the deduction would

first be allocated to the profits made by the PE, any surplus would be deducted from the profit earned by the principal company (Belgian head office). The Court also noted that the notional interest deduction applied even where only the foreign PE was profitable, as such profits would ultimately be attributed to the principal company (Belgian head office). The Court rejected the second argument on the ground that the difference in treatment is solely a result of the Belgian tax system, and not the tax system of more than one Member State.

The Court concluded that the disputed Belgian rules do indeed discourage a Belgian company from carrying out its activity through a PE situated in another Member State and, consequently, are in breach of the EU freedom of establishment. In examining the justifications put forward by Belgium, the Court dismissed the idea that the rules were justified by the need to preserve the cohesion of the Belgian tax system. According to the Court, there is no direct link between the tax advantage, in the form of a reduced corporate income tax charge, and the taxation of the return generated by the assets of the PE. The Court also rejected the justification based on the need to preserve the balanced allocation of taxing rights. In treating a Belgian company with a PE in a treaty country the same as a Belgian company with a domestic PE for the purposes of calculating the deduction, Belgium's power to tax the profits of such a PE would not be limited.

EU Tax Centre Comment

As a result of the CJEU judgment, Belgian companies with tax exempt PE's that have been precluded from utilizing the notional interest deduction calculated on the net assets of these PE's, can now reclaim the excess tax that has been paid *in the past 5 years* by means of an ex officio waiver request.

A spokesperson for the Minister of Finance meanwhile announced that corrective legislation for *future years* will be analyzed after the summer break.

Should you require further assistance in this matter, please contact the EU Tax Centre or, as appropriate, your local KPMG tax advisor.

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