JUDGMENT OF THE COURT
28 January 1986 *

In Case 270/83

Commission of the European Communities, represented by Georges Kremlis, a member of its Legal Department, acting as Agent, assisted by Gérard Druesne, professor at the University of Nancy II, Dean of the Faculty of Law and Economic Science of Nancy, with an address for service in Luxembourg at the office of Georges Kremlis, a member of the Commission's Legal Department, Jean Monnet Building, Kirchberg,

applicant,

v

French Republic, represented by François Renouard, acting as Agent, and Alain Sortais, acting as Deputy Agent, with an address for service in Luxembourg at the French Embassy,

defendant,

APPLICATION for a declaration that, by not granting the benefit of shareholders' tax credits to the branches and agencies in France of insurance companies established in another Member State, the French Republic has failed to fulfil its obligations under the EEC Treaty, in particular Article 52 thereof,

THE COURT

composed of: Lord Mackenzie Stuart, President, U. Everling, K. Bahlmann and R. Joliet, (Presidents of Chambers), T. Koopmans, O. Due, Y. Galmot, C. Kakouris and T. F. O'Higgins, Judges,

Advocate General: G. F. Mancini
Registrar: D. Louterman, Administrator

* Language of the Case: French.

after hearing the Opinion of the Advocate General delivered at the sitting on 16 October 1985,

gives the following

JUDGMENT

Facts and Issues

The facts of the case, the course of the procedure and the conclusions, submissions and arguments of the parties may be summarized as follows:

I — Facts

1. *The French legislation concerning shareholders' tax credits*

Article 205 of the French code général des impôts [General Tax Code] provides, in regard to companies and other legal persons designated in Article 206, for tax to be paid on all profits or income earned by taxable companies and legal persons. That tax is known as corporation tax. Its rate is fixed at 50%. For the companies and legal persons liable to it, it corresponds to the income tax to which natural persons are liable under Article 1 of the code général des impôts.

In principle, companies are liable to corporation tax regardless of where their registered office or the centre of their activities is located. Article 209 of the code général des impôts provides in that regard that account may be taken solely of profits made in undertakings operating in France or in those liable to taxation in France by virtue of an international double taxation agreement.

In order to limit cumulative taxation of revenue distributed by companies which is liable first to the corporation tax payable by the companies which distribute the dividends and secondly, in the hands of the recipients to personal income tax or corporation tax, Article 158 bis of the code général des impôts created a tax credit called 'avoir fiscal' in favour of recipients of dividends. That article is in the following terms:

'Persons who receive dividends distributed by French companies dispose in that respect of an income consisting of:

the sums which they receive from the company;

and

a shareholders' tax credit in their favour with the Treasury.

That tax credit is equal to half the sums actually paid by the company.

It may only be utilized in so far as the abovementioned income forms part of the sum on which the recipient is liable to income tax.

It is accepted in payment of that income tax.

...'

Article 158 ter of the Code général des Impôts limits the benefit of the tax credit to 'persons who have their habitual residence or registered office in France'.

Article 242 quater of the code général des impôts provides that:

'the benefit of the tax credit may be granted to persons resident in the territory of States which have concluded an agreement with France for the purpose of avoiding double taxation. The arrangements and conditions for its implementation shall be fixed for each country by a diplomatic agreement.'

The result of those provisions is that in the absence of a contrary provision in a double-taxation agreement, companies and other legal persons whose registered office is in France, including subsidiaries set up in France by foreign companies, benefit from the shareholders' tax credit; however, that benefit is denied to agencies and branches established in France by companies whose registered office is in another country. As is set out in administrative instructions of 30 July 1976, dividends distributed by French companies to foreign companies having a secondary establishment in France are not to have the benefit of the tax credit even if those dividends are included in the income of such establishments which is liable to taxation in France.

Article 15 of the loi des finances [Finance Law] for 1978 (Law No 77-1467 of 30 December 1977) provides that insurance and re-insurance companies and sociétés de capitalisation [a form of endowment insurance company] may set off against the corporation tax to which they are liable the entire tax credit from which they benefit by virtue of Article 158 bis of the code général des impôts in respect of the dividends which they receive.

2. *Pre-litigation procedure*

By letter of 29 July 1981, the Commission informed the French Government, pursuant to Article 169 of the EEC Treaty, that, in its view, the fact of applying to the agencies and branches in France of insurance companies established in another Member State rules concerning the shareholders' tax credit different from those applied to French insurance companies constituted discrimination contrary to Article 52 of the EEC Treaty.

In its reply of 30 December 1981, the French Government explained that that situation was merely a particular aspect of the more general problem of the use of the tax credit by natural or legal persons pursuing an activity in France but residing elsewhere. It justified the rules in question by arguing that the tax position of a French company differed in various respects from that of a secondary establishment (an agency or a branch) which belonged to a foreign company and was not a legal entity. The ensuing fiscal problems could not be unilaterally resolved on the basis of Article 52 of the EEC Treaty but could only be resolved in the context of an approximation of the legislation concerning direct taxation or in the context of bilateral tax conventions. Any other solution would lead to the risk of tax evasion.

On 4 May 1983 the Commission delivered a reasoned opinion under Article 169 of the EEC Treaty in which it stated that by failing to accord to branches and agencies in France of insurance companies established in another Member State the benefit

of shareholders' tax credits on the same terms as applied to French companies, the French Government had failed to fulfil its obligations under the Treaty, in particular Article 52 thereof. The French rules obliged foreign companies to set up subsidiaries in France that is to say, companies incorporated under French law, and placed branches and agencies without separate legal personality at a disadvantage, with the result that Article 52 of the Treaty was deprived of its meaning. According to the Commission, the fact that work on harmonization had been commenced did not release the Member States from their obligation to already apply their own tax legislation in a non-discriminatory way.

By letter of 6 July 1983, the French Government replied that the taxation system applying to branches in France of foreign insurance companies could not be modified unilaterally. In order to ensure absolutely equal tax treatment of subsidiaries and branches of foreign insurance companies, a large number of other provisions would have to be amended and certain of those provisions placed branches at an advantage *vis-à-vis* subsidiaries. Moreover, measures limited to insurance companies would be discriminatory because the problem arose in relation to agencies set up by all foreign companies. It added that a foreign company could always set up a subsidiary in France in order to have the benefit of the shareholders' tax credit.

II — Procedure and conclusions

1. By an application received at the Court Registry on 12 December 1983, the Commission brought an action against the French Republic under Article 169 of the EEC Treaty.

The *Commission* claims that the Court should:

Declare that, by not granting to the branches and agencies, in France, of foreign insurance companies based in another Member State of the Community, the benefit of shareholders' tax credits on the same terms as applied to French companies, the French Republic has failed to fulfil its obligations under the EEC Treaty, in particular Article 52 thereof;

Order the French Republic to pay the costs.

2. The *French Republic* contends that the Court should:

Dismiss the Commission's application;

Order the applicant to pay the costs.

3. The written procedure followed the normal course.

Having heard the views of the Advocate General, the Court decided to open the oral procedure without any preparatory inquiry. The parties were however invited to reply in writing to a number of questions before the hearing.

III — Submissions and arguments of the parties advanced during the written procedure

1. *The discriminatory character of the French system of shareholders' tax credits*

(a) The *Commission* claims that the French rules at issue are contrary to the second paragraph of Article 52 of the EEC Treaty inasmuch as they discriminate against companies incorporated under the law of another Member State.

Those rules provide for different treatment for French insurance companies, including French subsidiaries of foreign companies, on the one hand, and the agencies and branches in France of insurance companies whose registered office is in another Member State, on the other, even though the business of insurance in France, as carried on by a French company, is no different from the same activity carried on by an agency of a foreign company. The rules at issue place branches and agencies, which are not allowed to benefit from the shareholders' tax credit, in a less favourable situation. In that regard, the Commission puts forward the following concrete example: in respect of FF 100 distributed by way of dividend, a company whose registered office is in France would pay FF 25 by way of corporation tax, that is to say ([100 + 50] x 50%) — 50, whereas an agency or branch of a company whose registered office was in another Member State would pay FF 50 by way of corporation tax, namely 100 x 50%.

The essential difference between the French subsidiary of a foreign company and an agency or branch is that the subsidiary is in fact a company incorporated under French law, whereas the agency or branch remains an integral part of the foreign company. The discrimination being criticized is therefore due to the fact that, in respect of the same activity, a company incorporated under French law and a company incorporated under the law of another Member State are subject to different tax rules. However, using the registered office as a criterion amounts in fact to making a distinction according to a criterion equivalent to that of nationality in regard to natural persons because the registered office of a company serves to connect the company to a given legal system. Moreover, taking account of a person's domicile constitutes disguised discrimination.

According to the Commission, that inequality of treatment entails a double disadvantage for foreign companies pursuing their activities in France through a branch or agency. On the one hand, the rules at issue could oblige foreign companies to charge higher prices than their French competitors and thereby distort competition contrary to Article 3 (f) of the Treaty. On the other hand, it limits the freedom of agencies and branches of foreign insurance companies in regard to the composition of their share portfolio and their investments in moveable property because the First Council Directive of 24 July 1973 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct insurance other than life insurance (Directive 73/239/EEC, Official Journal 1973, L 228, p. 3), the First Council Directive of 5 March 1979 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life insurance (Directive 79/267/EEC, Official Journal 1979, L 63, p. 1) and the French legislation adopted to implement those directives, by requiring the establishment of technical reserves composed of 'equivalent and matching assets localized in each country where business is carried on', which presupposes 'the representation of underwriting liabilities expressed in a particular currency by assets expressed or realizable in

the same currency', prevents branches of foreign insurance companies from holding foreign shares and securities with the result that they are in practice obliged to include in their portfolios only French securities, which do not have the benefit of a tax credit.

The discrimination against companies incorporated under the law of another Member State appears even more clearly from the fact that French tax law, in this case, Article 209 of the code général des impôts, uses one criterion to justify imposing tax liability and a different criterion to avoid granting an exemption. From the point of view of taxation, branches of companies incorporated under the law of another Member State are subject to the same rules as apply to French companies and both the method for determining taxable income and the rate of taxation are identical in the two cases; however the exemption is not granted to foreign companies. According to the principle of the territoriality of tax legislation, a French company or a branch of a foreign company operating in France are taxed only in respect of income produced by their activities in France and the activities of the foreign branch of a French company are not taxed in France.

The Commission points out that the choice of the form of a secondary establishment, that is to say, either a subsidiary or an agency or a branch, is not without consequences. For one thing, setting up a subsidiary is more onerous by reason of the costs inherent in the foundation of a new company. Furthermore, the reputation and the business experience of an insurance company whose registered office is in another Member State may to some extent be lost from view if a new company is set up.

It is also completely unacceptable to seek to make extension of the benefit of shareholders' tax credits to agencies and branches of insurance companies established in another Member State subject to the same advantage being granted to French companies in the context of bilateral tax conventions. In its judgment of 25 October 1979 (Case 159/78 *Commission* v *Italy* [1979] ECR 3247), the Court decided that Member States' obligations under Article 52 may not be made subject to a condition of reciprocity. Moreover, even if certain Member States still maintained the same attitude as France as regards the benefit of shareholders' tax credits, a decision of the Court on that subject would be binding on all the Member States, which would therefore also be obliged to abolish that restriction and in that way, the requirement of reciprocity would be satisfied. Furthermore, the Commission states, the requirement of reciprocity has practically no purpose in the Community context because, with the exception of Greece, where dividends may be deducted from taxable income by the undertaking distributing them, and of Luxembourg and the Netherlands, which apply the classic taxation system, all the other Member States either already grant the benefit of the tax credit to branches of foreign companies (Denmark, Germany and Italy) or do not tax the dividends received (Belgium, Ireland and the United Kingdom). On the other hand, double taxation agreements concluded after the entry into force of the EEC Treaty cannot have effects incompatible with the provisions of that treaty and the primacy of Community law over national law precludes reliance in this case, as against a rule of Community law, upon a provision incorporated in the hierarchy of sources of French law, as is the case of international conventions under Article 55 of the French Constitution.

(b) The *French Government* emphasizes that, as the law now stands, direct taxation is

within the jurisdiction of the Member States which may, subject to the provisions of the Treaty, organize their tax system as they see fit and enter into such obligations as they consider necessary by way of international conventions. The fact that the benefit of the tax credit is not granted to agencies and branches of non-resident insurance companies must be viewed in the overall context of the provisions of the code général des impôts and the double-taxation agreements.

The principle of non-discrimination is not involved since the position of a secondary establishment is different from that of a body having separate legal personality and each of those forms has advantages and disadvantages for insurance companies wishing to operate in France. In accordance with the accepted principles of international law and the practice of most of the Member States, those differences led France to apply the rules governing the taxation of non-residents to secondary establishments. The distinction between residents and non-residents exists in most countries. It is regarded as necessary and non-discriminatory in all of those countries.

The French Government emphasizes the importance of the criterion of the residence of natural persons and that of the registered office of legal persons in French law on direct taxation. In regard to companies, the criterion of residence in French law, as in the tax law of most other countries, is based on the location of the registered office or the actual management of the legal entity. In regard to both natural and legal persons, the distinction between residents and non-residents is not based on nationality. The Commission itself accepts that such a distinction may be made in regard to natural persons. Since international law does not recognize secondary establishments as legal persons, they can only be subject to the law governing the company of which they are part that is to say the law of the place in which the registered office is located. Thus, since the French overseas territories have a separate system of taxation, a company whose registered office is in that part of French territory does not benefit from the shareholders' tax credit whereas a subsidiary whose registered office is in France is subject to the tax rules applying to residents even if it is wholly owned by interests which are either foreign or domiciled in the overseas territories.

The registered office has also been adopted as the criterion in international tax law in the model double-taxation agreement adopted by the OECD. The agreements designed to avoid double taxation which France has concluded with many countries, including all the Member States, all make the distinction, not withstanding the special features resulting from the characteristics of the various national systems of taxation in question, between residents and non-residents and they classify branches and agencies of companies whose registered office is abroad as secondary establishments subject to specific legal provisions. Those agreements are also based on the principle of non-discrimination.

Although it is true that the rules applied to secondary establishments in regard to the shareholders' tax credit are different, they are not discriminatory since that difference corresponds to objective differences of situation. The difference is based on a criterion of residence, not of nationality. The fact that a secondary establishment does not have separate legal personality enables it to operate under more favourable conditions than subsidiaries inasmuch as it can make use of the capital and certain operating facilities of the non-resident company and inasmuch as it benefits from

the reputation of that company and the guarantee of solvency which it provides.

Although the rules applicable to secondary establishments do not grant them the benefit of the shareholders' tax credit, in other respects they are more favourable than those applicable to subsidiaries. Secondary establishments are not liable to the fees which companies incorporated under French law, including subsidiary companies, must pay at the time of incorporation, increase in capital, transformation etc. In accordance with the agreements concluded with the other Member States, profits earned in France by secondary establishments are not subject to the tax payable by the non-resident company in the country in which it is based. Finally, in the context of the double-taxation agreements and in accordance with the principles evolved by the OECD, France does not tax at source profits distributed abroad.

The French Government contends that the Commission's solution also raises problems in regard to the so-called 'précompte', which is complementary to the shareholders' tax credit. The shareholders' tax credit is granted only if the corporation tax which gives rise to it has been paid at a rate of 50%; in other cases, such as that of capital gains, taxed at 15%, the company distributing the dividends must pay an additional tax called a 'précompte'.

The disadvantages which the Commission sees in the tax legislation applying to secondary establishments do not in fact arise in reality. The principles requiring representation of underwriting liabilities and matching assets, laid down in Council Directive 73/239/EEC of 24 July 1973 and the French code des assurances [Insurance Code] in no way require that an insurance company hold shares but merely lay down a maximum percentage authorized in addition to securities. Moreover, a branch may hold, in addition to securities, foreign shares quoted on French stock exchanges. In any event, the limit on the number of shares which a company may hold and the lower return on that type of investment limits the financial impact, if there is one, of the failure to grant the benefit of the shareholders' tax credit to secondary establishments. The essential attraction of investment in shares lies in the possibility of making capital gains and that possibility is as much open to branches of foreign companies as it is to companies whose registered office is in France. In fact, some of the insurance companies offering the lowest premium rates on the French market hold nothing but securities. Experience has shown that insurance companies operating through branches or agencies do not have higher premium rates and that should not be surprising because competitiveness and level of premiums depends much more on the level of general overheads, the type of distribution network and the underwriting policy than on the tax credit obtained on a part, which is in any event limited, of the assets in the company's investment portfolio.

The French Government argues that the Commission's solution would cause France to disturb unilaterally the balance established by the double-taxation agreements with the other Member States. The existence of those agreements must be borne in mind in assessing whether or not the French system is discriminatory. Those agreements are based on the principle of

non-discrimination and their purpose is to exclude the principle cause of discrimination, namely double taxation. Unilateral action is an inappropriate means of achieving those objectives whereas the bilateral nature of the double taxation agreements makes it possible to arrive at balanced solutions.

(c) The *Commission* replies, in regard to the advantages which, according to the French Government, flow from the rules applicable to secondary establishments, that it is not possible to draw a parallel, as the French Government attempts to do, between the payment of corporation tax, which is annual, and the payment of fees in respect of the registration of legal acts which, if a company undergoes no transformation, are due only once in the life of that company, namely when it is incorporated.

With regard to premium rates, the Commission accepts that the premiums charged by branches of foreign insurance companies are not higher than those of their French competitors. However, that merely means that only particularly efficient foreign companies pursue their activities in France through a branch or agency, notwithstanding the unfavourable tax situation. Although the matching assets rule does not require branches of foreign companies to hold only French shares, the effect of the rule is that since they are denied the benefit of the shareholders' tax credit, such branches have a more limited choice in making up their portfolio than a company whose registered office is in France.

2. *The existence of an indirect restriction on the setting-up of secondary establishments*

(a) The *Commission* contends secondly that the tax rules at issue constitute an indirect restriction on the setting-up of secondary establishments within the meaning of the first paragraph of Article 52 of the EEC Treaty and on the choice by companies incorporated in other Member States of the form of agency or branch as the means through which to pursue their activities in France.

A company which has a right of establishment on the territory of another Member State under Article 58 of the EEC Treaty is entitled under Article 52, to exercise that right through an agency, a branch or a subsidiary. Moreover, the difference in the tax system obliges agencies and branches of foreign companies to apply different principles of financial management than those of companies whose registered office is in France. In particular, the matching assets rule and the resulting restricted choice in making up the portfolio of a branch could constitute an inducement to do business through a subsidiary rather than through a branch in order to avoid the handicap of being denied the shareholders' tax credit.

The Commission argues that the fundamental right of establishment, which is enshrined in the Treaty itself and may be relied upon by nationals of the Member States before national courts, renders the tax provisions inapplicable to insurance companies whose registered office is in another Member State and which open an agency or branch in France. It is however true that the Council has not yet adopted the Proposal for a Council Directive concerning the harmonization of systems of company taxation and of withholding taxes on dividends, submitted by the Commission on 1 August 1975 (Official Journal No C 253 of 5 November 1975, p. 2). Nonetheless, the failure to complete the task of harmonization in no way releases the Member States from their obligation to

apply their own tax systems in a non-discriminatory manner. In that regard, the Court's reasoning in regard to free movement of goods (see judgment of 9 December 1981 in Case 193/80 *Commission* v *Italy* [1981] ECR 3019) may be readily transposed to the free movement of persons. Article 52 must be fully effective whether or not the different tax systems have been approximated.

(b) *The French Government* considers that only genuine discrimination, placing the pursuit of the insurance business through a secondary establishment at a disadvantage compared to its pursuit through a subsidiary, can give rise to an indirect restriction on the setting-up of branches or agencies. However, no such disadvantage exists. On the other hand, the changes in the tax system proposed by the Commission would place subsidiaries at a disadvantage because they alone are liable to the legal costs involved in setting up a company and the fees payable when changes are made, and also are subject to the difficulties inherent in the operation of subsidiary companies.

The French Government also emphasizes that foreign companies are in no way induced to establish subsidiaries rather than secondary establishments, since the question of the shareholders' tax credit only arises in regard to French shares, insurance companies' investment portfolios may include foreign shares quoted on French stock exchanges and the very low average yield of shares makes it possible to consider that the fact of not having the benefit of the shareholders' tax credit does not constitute a determining factor in the choice of the form of a branch.

3. *Other arguments capable of justifying refusal to grant the benefit of the shareholders' tax credit*

(a) According to the *French Government*, acceptance of the Commission's argument would lead to the introduction of discrimination between different sectors of activity in favour of the insurance sector.

Furthermore, granting the benefit of the tax credit to secondary establishments would lead to the risk of tax evasion. In the double taxation agreements to which France is a party, the shareholders' tax credit is never granted to foreign companies which have a large holding in the capital of the French company which distributed the dividends involved. Granting the benefit of the shareholders' tax credit to secondary establishments could thus induce foreign companies to include their shares in French companies in the assets of their secondary establishments in France solely for the purpose of obtaining a more favourable tax position there. The advantages for a foreign company of placing its French shares in the hands of a secondary establishment in France, and consequently, the danger of tax evasion, is demonstrated by a comparison of the amount actually payable in respect of securities included among the assets of the foreign company with that payable in respect of securities forming part of the assets of a secondary establishment.

(b) With regard to the argument alleging that discrimination is caused between different sectors of activity, the *Commission* observes that the EEC Treaty prohibits only discrimination between the nationals of one Member State and those of another and not discrimination between sectors of activity. More importantly, however, the benefit of the shareholders' tax credit should in future

be extended to all branches and agencies in France of companies established in another Member State, whatever economic sector they operate in, and this action is limited to the insurance sector merely because it was to that area that the Commission's attention was drawn. The Court's decision in this case will however be of general application.

The Commission contests the existence of the risk of tax evasion. A foreign company which holds shares in French companies will be liable to French tax only to a limited degree and will be taxed mainly in its own country. Under the double-taxation agreements, it may be eligible for tax reliefs such as the shareholders' tax credits. On the other hand, dividends paid to a secondary establishment in France are taxed in full in France — and are generally exempt in their own country — and are denied the benefit of the shareholders' tax credit. The case of agencies or branches of a foreign company which hold shares is therefore the only case in which there is a very clear disadvantage.

The inclusion of shares among the assets of a branch in France of a foreign company does not reduce the amount of tax payable in France. If the shares continue to be held by the foreign company at its registered office, the dividends distributed will be subject, under double-taxation agreements, to a tax of 15% deducted at source, which means a deduction of FF 15 on a dividend of FF 100. However, France grants the benefit of the shareholders' tax credit to foreign companies under certain conditions provided for in certain double-taxation agreements. On the other hand, if the shares are part of the assets of the branch, the same dividend will be subject to corporation tax at a rate of 50% as a result of which, taking account of the shareholders' tax credit, tax of FF 25 will be payable in France. The amount of tax payable in France is therefore higher when the shares are held by the branch. Similarly, in the case of a foreign company with a major holding in the capital of a French company, when the benefit of the tax credit is never granted, the danger of tax evasion is non-existent.

(c) The *French Government* replies that the Commission's proposal that the benefit of the shareholders' tax credit should be granted to the branches and agencies in France of all foreign companies, whatever the sector in which they operate would go beyond the purpose of the action. It would also call in question as regards much of its field of application the distinction between residents and non-residents, and would thus call in question a large part of the national tax systems and the double-taxation agreements. Without first carrying out an examination of all the different aspects of the complex tax systems of the Member States applicable to residents and non-residents, it is not possible to claim, as the Commission does by isolating the question of the shareholders' tax credit, that France is the only Member State which applies different treatment to residents and the secondary establishments of non-residents.

With regard to the risk of tax evasion, the French Government considers that if the corporation tax payable by recipients of dividends is to be included in the comparison of taxation in the various cases, as the Commission does in its calculations, that must be done in regard to all the hypotheses and account must be taken of corporation tax paid abroad in order to determine the overall tax burden. The French Government presents a table for that purpose which confirms, in its view, that if a

secondary establishment set up by a foreign company was treated in the same way as a resident company, as advocated by the Commission, it would not be in the interests of foreign companies to hold French shares other than through a secondary establishment in France. Even though such a transfer of shares might be to the advantage of the French treasury in certain cases, there is nonetheless a danger of evasion on the international level and in particular, between the Member States and that is precisely the situation which the double-taxation agreements are designed to avoid. The Commission's analysis is also wrong in regard to large holdings, in respect of which a comparison of the overall tax burden, viewed in an international context also reveals a danger of tax evasion.

IV — Replies to questions put by the Court

1. *The purpose of the action*

The *French Government* confirms that in the French tax system there is no difference between the treatment of insurance companies and that of other companies as regards the shareholders' tax credit since Article 15 of the Finance Law for 1973 abolished, in regard to resident insurance companies, the limitation of the proportion of the tax credit which could be set off against tax liability to one-quarter of the total amount of the credit.

The *Commission* observes that although it restricted its action purely to the insurance sector concerning which complaints had been made to it and in which unlike other areas, the right of secondary establishment is widely exercised through branches, it nonetheless considers, without wishing to suggest that the Court rule on a situation other than that which gave rise to the proceedings, that the Member States must draw the appropriate consequences from a judgment condemning the French system.

2. *The double-taxation agreements between France and the other Member States*

The *French Government* states that France has concluded double-taxation agreements with all the other Member States. According to the information which it provided on this subject, foreign companies, other than those which have a substantial holding in a French company, in which case the tax credit is not transferred to the foreign company, are granted the benefit of the shareholders' tax credit in regard to dividends paid on French shares forming part of the assets of its principal establishment when its registered office is situated in the Federal Republic of Germany, Luxembourg, the Netherlands or the United Kingdom but the agreements with the other Member States do not provide for the transfer of the tax credit to the foreign company. None of the agreements provide for grant of the benefit of the tax credit to the secondary establishment in France of a company whose registered office is in another Member State. Negotiations which might have an effect on the taxation of profits distributed by companies are presently taking place with Denmark and Italy. No other Member State has yet shown any interest in having the benefit of the tax credit granted to its residents in respect of their French shares. There are many reasons why certain

agreements do not provide for the transfer of the tax credit, relating in particular to the characteristics of the tax systems in question, the need to make different kinds of concessions in order to obtain a balanced agreement and a number of considerations not connected with taxation such as the need to avoid encouraging investment abroad.

The *Commission* explains that the grant of the shareholders' tax credit in respect of dividends paid to secondary establishments of companies whose registered office is in another Member State is not regulated by the double-taxation agreements but depends exclusively on national legislation. France is the only Member State operating an imputation system where dividends paid to secondary establishments of non-resident companies are taxed without having the benefit of the corresponding tax credit. Everywhere else in the Community, liability of dividends to national taxation is accompanied by the grant of tax credit.

In cases in which the dividends are paid directly to the company, they are taxed in the Member State in which that company is resident and the amount deducted at source in respect of tax due on the dividends in France is set off against the tax due in the State of residence in order to avoid double-taxation. The agreements concluded by France with the Federal Republic of Germany, Luxembourg, the Netherlands and the United Kingdom expressly provide for the grant of the French shareholders' tax credit in France, even though dividends earned in France are taxed only in the State of residence, where the amount of tax payable is consequently reduced.

3. *Calculation of the tax burden on dividends*

The *French Government* submits explanations concerning the comparative table by which it seeks to establish the existence of a danger of tax evasion by demonstrating the consequences of the Commission's argument that secondary establishments should be treated in the same way as companies resident in France. It compares the position of a foreign company which includes its French shares among the assets of its principal establishment abroad with that of a foreign company which includes the same shares in the assets of a secondary establishment in France which is, for the sake of argument, assimilated to a French company in regard to the shareholders' tax credit. In such a comparison, where a profit of FF 200 has been made and a dividend of FF 100 distributed, to which must be added the tax credit of FF 50, the tax due is FF 125 where the shares are held by the company itself but would be only FF 87.50 if there was a secondary establishment in France which was assimilated to a resident company. That comparison thus demonstrates the existence of a distortion which could give rise to tax evasion.

The *Commission* considers that the table on which that comparison is based is incomprehensible or irrelevant and it contests the figures used. The information on which the comparison is based is completely notional because the French tax system does not give secondary establishments the benefit of the shareholders' tax credit. What should be taken into account is the difference which currently exists between the position of a company whose registered office is in France, on the one hand, and that of a foreign company holding shares, either in its own name or that of its secondary establishment. That comparison shows that although the tax burden is the same whether

the shares are held by a company whose registered office is in France or one whose registered office is in another Member State with which France has an agreement providing for the grant of the shareholders' tax credit, it is heavier when the shares are held by the secondary establishment in France of a non-resident company. The discrimination which exists in the latter case would disappear if the benefit of the shareholders' tax credit was granted.

4. *Legislation of the Member States on this subject*

The *Commission* stated that with regard to the taxation of profits and dividends distributed by companies, there are four different situations within the Community, namely:

(a) The system in force in Luxembourg and the Netherlands, involving double taxation without any reduction, in which profits are taxed in the hands of the company which made them and are taxed again in the hands of the shareholder who has received the dividends distributed;

(b) The system in force in Greece in which double taxation is avoided by reducing company's taxable profits by the amount of the dividends they have distributed;

(c) The system in force in the Federal Republic of Germany and Italy in which double taxation is avoided by setting off the whole amount of the corporation tax paid against the tax liability of the recipient of the dividends;

(d) The systems in force in the other Member States which provide for a partial set off of the corporation tax against the tax payable by the person receiving the dividends by granting an 'avoir fiscal', 'crédit d'impôt' or 'tax credit' at a rate which varies from one State to another.

In order to benefit from the tax credit, the person receiving the dividends must generally be resident in the Member State involved and liable to tax on the dividends received. However, non-resident companies having a secondary establishment on the territory of the State have the benefit of the tax credit on dividends paid to that establishment in all the Member States operating a tax credit scheme, except in France where the dividends paid to secondary establishments are taxed without the shareholders' tax credit being granted.

In general, the criterion used in the legal systems of the Member States to determine the residence of legal persons is the registered office. Residence is used to determine the taxpayer's taxable income. Thus, a company resident in a Member State but pursuing its activity abroad through a secondary establishment may be taxed in the country of residence in respect of profits earned by the latter, though sometimes with the tax paid in the country in which the activity was pursued being set off against liability in the country of residence in order to avoid double taxation. In France however a resident company, by virtue of the principle of territoriality, is taxed only on its profits made in France and not on those of its secondary establishments abroad and consequently its tax position, from the point of view of the determination of its taxable income is no different from that of a secondary establishment of a non-resident company.

V — Oral procedure

The Commission, represented by Mr Druesne and the French Government, represented by Mr Guillaume, presented oral argument and replied to questions put by the Court at the sitting on 19 June 1985.

The Advocate General delivered his Opinion at the sitting on 16 October 1985.

Decision

1 By an application lodged at the Court Registry on 12 December 1983, the Commission of the European Communities has brought an action under Article 169 of the EEC Treaty for a declaration that by not granting the benefit of shareholders' tax credits to the branches and agencies in France of insurance companies established in another Member State on the same terms as those enjoyed by French companies, the French Republic has failed to fulfil its obligations under the EEC Treaty, in particular Article 52 thereof.

The national legislation at issue

2 French tax legislation provides for the charge of corporation tax at a rate of 50% on all profits made by companies and other taxable legal persons; that tax is the equivalent of the income tax to which natural persons are liable. In principle, companies are liable to corporation tax irrespective of where their registered office is situated. However, by virtue of Article 209 of the code général des impôts, account is taken only of profits made in undertakings operating in France or in those liable to taxation in France by virtue of a double-taxation agreement.

3 In order to reduce the effects of the cumulative taxation of profits distributed by companies caused by the fact that such profits are liable first to corporation tax in the hands of the company distributing the dividends and then to income tax or corporation tax in the hands of the recipient of those dividends, Article 158 bis of the code général des impôts provides for a tax credit called 'avoir fiscal' which is granted to the recipients of dividends distributed by French companies and is equal

to half the amount actually paid by those companies. The tax credit may be set off against the tax payable by the recipient of the dividends. It constitutes income of that person and may be used only in so far as it forms part of that person's taxable income.

4 The second paragraph of Article 158 ter of the code général des impôts provides that the benefit of the shareholders' tax credit 'is granted only to persons who have their habitual residence or registered office in France'. Furthermore, according to Article 242 quater of the code général des impôts, that benefit may be granted to persons resident in the territory of States which have concluded double-taxation agreements with France.

5 According to the information which the parties supplied to the Court, the agreements concluded between France and four other Member States, namely the Federal Republic of Germany, Luxembourg, the Netherlands and the United Kingdom, provide that a company whose registered office is in one of those Member States and which holds shares in French companies among the assets of its principal establishment may benefit from the shareholders' tax credit. On the other hand, there is no case in which benefit of the tax credit is granted in respect of shares forming part of the assets of secondary establishments, branches or agencies of companies whose registered office is not in France.

6 It is clear from the aforementioned provisions, and also from Article 15 of the loi des finances [Finance Law] for 1978 (Law No 77-1467 of 30 December 1977, Journal Officiel de la République Française 1977, p. 6316), that insurance companies whose registered office is in France, including subsidiaries set up in France by foreign insurance companies, benefit from the shareholders' tax credit in respect of their shares in French companies. However, that benefit is not granted to secondary establishments set up in France in the form of branches or agencies by insurance companies whose registered office is in another Member State.

The purpose of the proceedings

7 In this action under Article 169 of the EEC Treaty, the Commission is seeking to establish that the rules governing shareholders' tax credits discriminate against branches and agencies of insurance companies whose registered office is situated in

another Member State and constitute an indirect restriction on the freedom to set up secondary establishment. The Commission has added that although it has restricted its action to the insurance sector because it has received complaints only in regard to that sector, all the Member States, and in particular France, must nonetheless draw all the appropriate conclusions from the Court's judgment, even in regard to other sectors.

8 The French Government has expressed its opposition to the Commission's enlarging the scope of the action to all companies whatever their sector of activity.

9 It must be observed in that regard that even though the effects of the national legislation at issue are particularly noticeable in a sector such as insurance, in which branches of foreign insurance companies are required to establish technical reserves consisting of assets localized in the country where business is carried on, the same rules do apply to other sectors as well. It may therefore be regretted that, by reason of the fact that it is restricted to insurance companies, this action raises the problems in terms which cover only part of the scope of the French legislative provisions in question. That does not however affect the admissibility of the action.

10 Since some uncertainty as to the precise subject matter of this action has become visible during the proceedings, it must once again be pointed out that the action is concerned with disparity in the treatment in regard to the shareholders' tax credit of, on the one hand, insurance companies whose registered office is in France, including subsidiaries set up in France by foreign companies, and, on the other, of branches and agencies established in France by insurance companies whose registered office is in another Member State. The action does not therefore deal generally with every difference in treatment between, on the one hand, companies as independent legal entities and, on the other, branches and agencies without separate legal personality. Finally, it must be particularly emphasized that the action does not concern differences which may exist in the rules regarding taxation applicable to branches and agencies, on the one hand, and, on the other hand, subsidiaries of companies whose registered office is in another Member State where those branches and agencies or those subsidiaries transfer to the company which owns them profits made in the undertakings carried on by them in France.

The application of Article 52 of the EEC Treaty

11 The Commission puts forward two submissions intended to show that the said rules governing shareholders' tax credits are contrary to the second paragraph of Article 52 of the EEC Treaty. In the first place, those rules discriminate against branches and agencies in France of insurance companies whose registered office is in another Member State by comparison with companies whose registered office is in France. The tax system prevents such branches and agencies from holding French shares and thus places them at a disadvantage in the pursuit of their activities in France. The discrimination is made all the more clear by the fact that, for the purpose of determining taxable income, French tax law applies the same rules to French companies as it does to secondary establishments of foreign companies. Secondly, the fact that the tax rules in question are unfavourable to the branches and agencies of foreign insurance companies indirectly restricts the freedom which insurance companies based in other Member States must have to establish themselves in France either through a subsidiary or through a branch or agency. It constitutes an inducement to choose to set up a subsidiary so as to avoid the disadvantage resulting from the refusal to grant the benefit of the shareholders' tax credit.

12 In the view of the French Government, such different treatment does not constitute discrimination and is therefore not contrary to the Member States' obligation under the second paragraph of Article 52 to apply to a company whose registered office is in another Member State the conditions laid down for its own nationals in its own law. The French Government puts forward two series of arguments designed to show essentially that different treatment is justified in this case because the situations involved are objectively different and that that difference in treatment is due to the particularities of the tax systems, which vary from one Member State to another, and to the double-taxation agreements.

13 It must be stated firstly that Article 52 of the EEC Treaty embodies one of the fundamental principles of the Community and has been directly applicable in the Member States since the end of the transitional period. By virtue of that provision, freedom of establishment for nationals of one Member State on the territory of another includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings under the conditions laid down for its own nationals by the law of the country where such establishment is effected. The abolition of restrictions on freedom of establishment also applies to restrictions on

the setting up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

14 Article 52 is thus intended to ensure that all nationals of Member States who establish themselves in another Member State, even if that establishment is only secondary, for the purpose of pursuing activities there as a self-employed persons receive the same treatment as nationals of that State and it prohibits, as a restriction on freedom of establishment, any discrimination on grounds of nationality resulting from the legislation of the Member State.

15 It thus appears that the two submissions put forward by the Commission, namely that concerning discrimination in French law against branches and agencies of insurance companies established in other Member States vis-à-vis companies established in France and that concerning the restriction of the freedom of foreign insurance companies to establish branches and agencies, are closely linked. They must therefore be considered together.

16 It is common ground that in French law, in particular, under Article 158 ter of the code général des impôts, insurance companies whose registered office is in France benefit from shareholders' tax credits in respect of dividends on shares which they hold in French companies whereas that benefit is denied to branches and agencies of insurance companies whose registered office is in another Member State. In that respect, insurance companies whose registered office is in another Member State and who pursue their activities in France through branches or agencies are thus not treated in the same way as insurance companies whose registered office is in France.

17 In its first line of argument the French Government seeks to demonstrate that the above-mentioned difference of treatment is justified by objective differences between the position of an insurance company whose registered office is in France and that of a branch or agency of an insurance company whose registered office is situated in another Member State. The difference in question is based on the distinction between 'residents' and 'non-residents', which is to be found in all legal systems and is internationally accepted. It is an essential distinction in tax law. It is

thus also applicable in the context of Article 52 of the Treaty. Furthermore, branches and agencies of companies whose registered office is abroad enjoy various advantages over French companies which balance out any disadvantages in regard to shareholders' tax credits. Finally, those disadvantages are in any event insignificant and may be easily avoided by setting up a subsidiary in France.

18 It must first be emphasized in that regard that freedom of establishment, which Article 52 grants to nationals of another Member State and which entails their right to take up and pursue activities as self-employed persons under the conditions laid down for its own nationals by the law of the country where such establishment is effected, includes, pursuant to Article 58 of the EEC Treaty, the right of companies or firms 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 to pursue their activities in the Member State concerned through a branch or agency. With regard to companies, it should be noted in this context that it is their registered office in the above-mentioned sense that serves as the connecting factor with the legal system of a particular State, like nationality in the case of natural persons. Acceptance of the proposition that the Member State in which a company seeks to establish itself may freely apply to it a different treatment solely by reason of the fact that its registered office is situated in another Member State would thus deprive that provision of all meaning.

19 Even if the possibility cannot altogether be excluded that a distinction based on the location of the registered office of a company or the place of residence of a natural person may, under certain conditions, be justified in an area such as tax law, it must be observed in this case that French tax law does not distinguish, for the purpose of determining the income liable to corporation tax, between companies having their registered office in France and branches and agencies situated in France of companies whose registered office is abroad. By virtue of Article 209 of the code général des impôts, both are liable to taxation on profits made in undertakings carried on in France, to the exclusion of profits which are made abroad or which France is entitled to tax under the terms of a double-taxation agreement.

20 Since the rules at issue place companies whose registered office is in France and branches and agencies situated in France of companies whose registered office is abroad on the same footing for the purposes of taxing their profits, those rules, cannot, without giving rise to discrimination, treat them differently in regard to the grant of an advantage related to taxation, such as shareholders' tax credits. By treating the two forms of establishment in the same way for the purposes of taxing their profits, the French legislature has in fact admitted that there is no objective difference between their positions in regard to the detailed rules and conditions relating to that taxation which could justify different treatment.

21 Notwithstanding the French Government's argument to the contrary, the difference in treatment also cannot be justified by any advantages which branches and agencies may enjoy *vis-à-vis* companies and which, according to the French Government, balance out the disadvantages resulting from the failure to grant the benefit of shareholders' tax credits. Even if such advantages actually exist, they cannot justify a breach of the obligation laid down in Article 52 to accord foreign companies the same treatment in regard to shareholders' tax credits as is accorded to French companies. It is also not necessary in this context to assess the extent of the disadvantages which branches and agencies of foreign insurance companies suffer as a result of the failure to grant them the benefit of shareholders' tax credits and to consider whether those disadvantages could have any effect on their tariffs, since Article 52 prohibits all discrimination, even if only of a limited nature.

22 Furthermore, the fact that insurance companies whose registered office is situated in another Member State are at liberty to establish themselves by setting up a subsidiary in order to have the benefit of the tax credit cannot justify different treatment. The second sentence of the first paragraph of Article 52 expressly leaves traders free to choose the appropriate legal form in which to pursue their activities in another Member State and that freedom of choice must not be limited by discriminatory tax provisions.

23 In a second line of argument, the French Government seeks to demonstrate that the difference in treatment is in fact due to the particular characteristics of and the

differences between the tax systems applying in the various Member States and to the double-taxation agreements. It argues that since the legislation at issue has not been harmonized, different measures are necessary in each case in order to take account of the differences between the taxation systems; those different measures are therefore justified under Article 52 of the Treaty. Thus, the rules which are being contested in this case are necessary, in particular, in order to prevent tax evasion. The application of tax legislation to natural persons and companies pursuing their activities in different Member States is governed by double-taxation agreements whose existence is expressly recognized in Article 220 of the Treaty. The French Government concludes that the difference in treatment provided for by the rules at issue is not contrary to Article 52 of the Treaty.

24 It must first be noted that the fact that the laws of the Member States on corporation tax have not been harmonized cannot justify the difference of treatment in this case. Although it is true that in the absence of such harmonization, a company's tax position depends on the national law applied to it, Article 52 of the EEC Treaty prohibits the Member States from laying down in their laws conditions for the pursuit of activities by persons exercising their right of establishment which differ from those laid down for its own nationals.

25 Furthermore, the risk of tax avoidance cannot be relied upon in this context. Article 52 of the EEC Treaty does not permit any derogation from the fundamental principle of freedom of establishment on such a ground. Moreover, the Court is not convinced by the calculations submitted by the French Government for the purpose of showing that if the benefit of shareholders' tax credits was granted to branches and agencies of companies whose registered offices are in other Member States, those companies would be prompted to include the shares they hold in French companies among the assets of their branches and agencies in France. Those calculations are based on the hypothesis, which finds no support in Article 158 bis of the code général des impôts, that the transfer to the place at which the company has its registered office of profits made by branches or agencies would in its turn benefit from the shareholders' tax credit; nor has the Commission sought in these proceedings to have the benefit of that tax credit extended to such cases.

26 Finally, the French Government is wrong to contend that the difference of treatment in question is due to the double-taxation agreements. Those agreements do not deal with the cases here at issue as defined above. Moreover, the rights conferred by Article 52 of the Treaty are unconditional and a Member State cannot make respect for them subject to the contents of an agreement concluded with another Member State. In particular, that article does not permit those rights to be made subject to a condition of reciprocity imposed for the purpose of obtaining corresponding advantages in other Member States.

27 Consequently, by failing to grant to the branches and agencies in France of insurance companies whose registered office is in another Member State the benefit of shareholders' tax credits in respect of dividends paid by French companies to such branches or agencies, Article 158 ter of the code général des impôts does not apply to those companies the conditions laid down by French law for insurance companies whose registered office is in France. That discrimination constitutes a restriction on the right of establishment of insurance companies whose registered office is in another Member State, which is contrary to the first and second paragraphs of Article 52 of the EEC Treaty.

28 It must therefore be held that by not granting to the branches and agencies in France of insurance companies whose registered office is in another Member State on the same terms as apply to insurance companies whose registered office is in France the benefit of shareholders' tax credits in respect of dividends paid to such branches or agencies by French companies, the French Republic has failed to fulfil its obligations under Article 52 of the EEC Treaty.

Costs

29 Under Article 69 (2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs. Since the French Republic has been unsuccessful in its submissions, it must be ordered to pay the costs.

On those grounds,

The Court

hereby:

(1) **Declares that by not granting to the branches and agencies in France of insurance companies whose registered office is in another Member State on the same terms as apply to insurance companies whose registered office is in France the benefit of shareholders' tax credits in respect of dividends paid to such branches or agencies by French companies, the French Republic has failed to fulfil its obligations under Article 52 of the EEC Treaty;**

(2) **Orders the French Republic to pay the costs.**

Mackenzie Stuart Everling Bahlmann Joliet

Koopmans Due Galmot Kakouris O'Higgins

Delivered in open court in Luxembourg on 28 January 1986.

P. Heim
Registrar

A. J. Mackenzie Stuart
President