JUDGMENT OF THE COURT (Fourth Chamber)

17 January 2008 (*)

(Freedom of establishment – Free movement of capital – Tax legislation – Corporation tax – Interest paid by a subsidiary on funds lent by the parent company established in another Member State – Reclassification of the interest as taxable dividends – No such reclassification where interest payments are made to a resident company)

In Case C‑105/07,

REFERENCE for a preliminary ruling under Article 234 EC from the rechtbank van eerste aanleg te Antwerpen (Belgium), made by decision of 17 January 2007, received at the Court on 22 February 2007, in the proceedings

NV Lammers & Van Cleeff

v

Belgische Staat,

THE COURT (Fourth Chamber),

composed of K. Lenaerts, President of the Chamber, G. Arestis (Rapporteur), R. Silva de Lapuerta, J. Malenovský and T. von Danwitz, Judges,

Advocate General: J. Kokott,

Registrar: R. Grass,

having regard to the written procedure,

after considering the observations submitted on behalf of:

– NV Lammers & Van Cleeff, by D. Merckx, advocaat,

– the Commission of the European Communities, by R. Lyal and A. Weimar, acting as Agents,

having decided, after hearing the Advocate General, to proceed to judgment without an Opinion,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Articles 12 EC, 43 EC, 46 EC, 48 EC, 56 EC and 58 EC.

2 The reference has been made in the context of proceedings between NV Lammers & Van Cleeff, the company seat of which is in Belgium ('the Belgian subsidiary'), and the Belgische Staat (Belgian State) concerning payment of corporation tax for the assessment years 1996 and 1997.

Legal context

3 Article 18(1), point 3, of the Income Tax Code 1992, consolidated by the Royal Decree of 10 April 1992 (*Belgisch Staatsblad* of 30 July 1992, p. 17120), in the version in force at the time of the facts in the main proceedings ('the ITC 1992'), provided:

'Dividends shall include:

…

3. interest on loans where one of the following limits is exceeded and to the extent of that excess:

– either the limit set out in Article 55,

– or the total of the interest-bearing loans is higher than the paid-up capital plus taxed reserves at the beginning of the taxable period.'

4 Article 18(2) of the ITC 1992 provided:

'Loan includes any claim, whether or not represented by securities, of a director of a capital company against that company, or of a partner of a partnership against that partnership, and any claim, against those firms, of his spouse or of his children if the director, partner or his spouse are legally entitled to the income of the children, except for:

1. bonds issued by a public call for savings;

2. claims against cooperative companies recognised by the National Council of cooperatives;

3. claims of directors and partners which are companies referred to in Article 179.'

5 Article 179 of the ITC 1992 was worded as follows:

'Resident companies and, from 1 January 1995, the communal savings banks referred to in Article 124 of the New Communal Law shall be subject to corporation tax.'

6 Article 55 of the ITC 1992 provides inter alia that interest on bonds, loans, claims, deposits and other financial instruments equivalent to loans is to be treated as professional expenses only to the extent to which it does not exceed an amount corresponding to the market rate having regard to the particular factors specific to the assessment of the risk connected with the transaction and, in particular, the financial situation of the debtor and the duration of the loan.

The main proceedings and the question referred

7 The Belgian subsidiary was established on 25 July 1991. On that date, and in accordance with the applicable statutory provisions, three directors were appointed, namely the two shareholders of the

Belgian subsidiary and the parent company BV Lammers & Van Cleeff, established in the Netherlands.

8 Pursuant to a claim of the parent company BV Lammers & Van Cleeff against the Belgian subsidiary, the subsidiary paid interest to it. In accordance with the second indent of Article 18(1), point 3, of the ITC 1992, that interest was considered by the Belgian tax authorities in part to be dividends and was assessed as such.

9 The Belgian subsidiary then lodged objections against the assessments at issue before the Director of Direct Taxation, Antwerp II. By decision of 17 June 2002 the latter upheld the disputed assessments. On 16 September 2002 the Belgian subsidiary brought an action before the rechtbank van eerste aanleg te Antwerpen (Court of First Instance, Antwerp) for the annulment of that decision.

10 In its order for reference, the rechtbank states that it follows from Article 18(2), point 3, of the ITC 1992 that interest payments are not reclassified as dividends and thus are not taxable if made to a director which is a Belgian company, whereas those interest payments are reclassified as dividends, and thus taxable, if made to a director which is a foreign company.

11 In those circumstances, the rechtbank van eerste aanleg te Antwerpen decided to stay the proceedings and to refer the following question to the Court for a preliminary ruling:

'Do Articles 12 EC, 43 EC, 46 EC, 48 EC, 56 EC and 58 EC preclude Belgian national statutory rules, as set out in the then applicable Articles 18(1), point 3, and 18(2), point 3, of the Income Tax Code 1992, whereby interest payments were not reclassified as dividends, and were therefore not taxable, if those interest payments were made to a director which was a Belgian company, whereas in the same circumstances those interest payments were reclassified as dividends, and therefore taxable, if they were made to a director which was a foreign company?'

The question referred for a preliminary ruling

12 As a preliminary point, it must be remembered that, according to settled case-law, although direct taxation falls within their competence, Member States must none the less exercise that competence consistently with Community law and avoid any discrimination on grounds of nationality (see, inter alia, Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, paragraph 37; Case C-324/00 *Lankhorst-Hohorst* [2002] ECR I-11779, paragraph 26; and Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paragraph 25).

13 The national court refers in its question to Articles 12 EC, 43 EC, 46 EC, 48 EC, 56 EC and 58 EC.

14 In this respect, it must be stated that it follows from the case-law that the general prohibition of all discrimination on grounds of nationality laid down by Article 12 EC applies independently only to situations governed by Community law for which the EC Treaty lays down no specific rules of non-discrimination. The Treaty lays down in Articles 43 EC and 56 EC, in particular, such specific rules in relation to freedom of establishment and the free movement of capital (see, inter alia, *Metallgesellschaft and Others*, paragraphs 38 and 39, and Case C-443/06 *Hollmann* [2007] ECR I-0000, paragraphs 28 and 29).

15 In so far as the rechtbank is putting a question to the Court as to the interpretation of both Article 43 EC on freedom of establishment and Article 56 EC on the free movement of capital, the Court must

determine whether legislation of a Member State such as that at issue in the main proceedings, which provides for taxation of interest payments, as dividends, of a resident company only if they are made to a director or to a partner which is a non-resident company, is liable to fall within the scope of those freedoms.

16 In this instance, it is apparent from the case-file that the interest payments made by the Belgian subsidiary were reclassified as dividends because they relate to a loan granted by a non-resident parent company which is a director of that subsidiary.

17 It is therefore necessary to examine the rules at issue, first, from the perspective of the Treaty provisions on freedom of establishment.

18 Freedom of establishment, which Article 43 EC grants to Community nationals and which includes the right for them 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 Member State where such establishment is effected, entails, in accordance with Article 48 EC, for 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 European Community, the right to exercise their activity in the Member State concerned through a subsidiary, branch or agency (see, inter alia, CaseC-307/97 *Saint-Gobain ZN* [1999] ECR I-6161, paragraph 35; Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, paragraph 41; and *Test Claimants in the Thin Cap Group Litigation*, paragraph 36).

19 In the case of companies, their registered office for the purposes of Article 48 EC serves, in the same way as nationality in the case of individuals, as the connecting factor with the legal system of a State. Acceptance of the proposition that the Member State in which a subsidiary seeks to establish itself may freely apply different treatment merely by reason of the fact that the registered office of its parent company is situated in another Member State would deprive Article 43 EC of all meaning (see, to that effect, Case C-330/91*Commerzbank* [1993] ECR I-4017, paragraph 13; *Metallgesellschaft and Others*, paragraph 42; and *Test Claimants in the Thin Cap Group Litigation*, paragraph 37). Freedom of establishment thus aims to guarantee the benefit of national treatment in the host Member State, by prohibiting any discrimination based on the place in which companies have their seat (see, to that effect, *Saint-Gobain ZN*, paragraph 35, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 37).

20 In the present case, the national legislation at issue in the main proceedings introduces, as regards the taxation of interest paid by a resident company in respect of a claim to a director which is a company, a difference in treatment according to whether or not the latter company has its seat in Belgium.

21 It follows from that legislation that interest payments made by a company to a director which is a resident company are not reclassified as dividends and are, on that basis, not taxable, even if they exceed one of the two limits laid down in Article 18(1), point 3, of the ITC 1992. By contrast, where they exceed one of those limits, the interest payments made by a company to a director which is a non-resident company are reclassified as dividends and are, on that basis, taxable. Companies managed by a director which is a non-resident company are therefore subject to tax treatment which is less advantageous than that accorded to companies managed by a director which is a resident company.

22 Similarly, in relation to groups of companies within which a parent company takes on management

tasks in one of its subsidiaries, such legislation introduces a difference in treatment between resident subsidiaries according to whether or not their parent company has its seat in Belgium, thereby making subsidiaries of a non-resident parent company subject to treatment which is less favourable than that accorded to the subsidiaries of a resident parent company.

23 A difference in treatment between resident companies according to the place of establishment of the company which, as director, has granted them a loan constitutes an obstacle to the freedom of establishment if it makes it less attractive for companies established in other Member States to exercise that freedom and they may, in consequence, refrain from managing a company in the Member State which enacts that measure, or even refrain from acquiring, creating or maintaining a subsidiary in that Member State (see, to that effect, *Lankhorst-Hohorst*, paragraph 32; *Test Claimants in the Thin Cap Group Litigation*, paragraph 61; and Case C-231/05 *Oy AA* [2007] ECR I-0000, paragraph 39).

24 It follows that the difference in treatment to which, under national legislation such as that at issue in the main proceedings, resident companies are subject depending on the place in which their director is established, amounts to a restriction on freedom of establishment which is prohibited, in principle, by Articles 43 EC and 48 EC.

25 Such a restriction is permissible only if it pursues a legitimate objective which is compatible with the Treaty and is justified by overriding reasons of public interest. It is further necessary, in such a case, that its application be appropriate to ensuring the attainment of the objective thus pursued and not go beyond what is necessary to attain it (see, inter alia, Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, paragraph 35, and *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 47).

26 In this respect, it must be pointed out that, according to established case-law, a national measure restricting freedom of establishment may be justified where it specifically targets wholly artificial arrangements designed to circumvent the legislation of the Member State concerned (*Test Claimants in the Thin Cap Group Litigation*, paragraph 72 and the case-law cited).

27 The mere fact that a resident company is granted a loan by a related company which is established in another Member State cannot be the basis of a general presumption of abusive practices and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty (*Test Claimants in the Thin Cap Group Litigation*, paragraph 73 and the case-law cited).

28 In order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory (*Test Claimants in the Thin Cap Group Litigation*, paragraph 74 and the case-law cited).

29 At paragraph 80 of its judgment in *Test Claimants in the Thin Cap Group Litigation*, the Court held that legislation of a Member State may be justified by the need to combat abusive practices where it provides that interest paid by a resident subsidiary to a non-resident parent company is to be treated as a distribution only if, and in so far as, it exceeds what those companies would have agreed upon on an arm's-length basis, that is to say, the commercial terms which those parties would have accepted if they had not formed part of the same group of companies.

30 The fact that a resident company has been granted a loan by a non-resident company on terms which

do not correspond to those which would have been agreed upon at arm's length constitutes, for the Member State in which the borrowing company is resident, an objective element which can be independently verified in order to determine whether the transaction in question represents, in whole or in part, a purely artificial arrangement, the essential purpose of which is to circumvent the tax legislation of that Member State. In that regard, the question is whether, had there been an arm's-length relationship between the companies concerned, the loan would not have been granted or would have been granted for a different amount or at a different rate of interest (*Test Claimants in the Thin Cap Group Litigation*, paragraph 81).

31 In the present case, it is apparent from the order for reference that the interest payments made by the Belgian subsidiary on a loan granted by a non-resident company which is a director were reclassified as dividends because the limit laid down in the second indent of Article 18(1), point 3, of the ITC 1992 had been exceeded, that is to say, at the beginning of the taxable period the total of the interest-bearing loans was higher than the paid-up capital plus taxed reserves.

32 It is clear that, even if the application of such a limit seeks to combat abusive practices, it goes in any event beyond what is necessary to attain that objective.

33 As the Commission of the European Communities stated in its submissions, the limit laid down in the second indent of Article 18(1), point 3, of the ITC 1992 also affects situations in which the transaction concerned cannot be regarded as a purely artificial arrangement. If interest payments made to non-resident companies are reclassified as dividends as soon as they exceed such a limit, it cannot be ruled out that that reclassification will also apply to interest paid on loans granted on an arm's length basis.

34 Consequently, the answer to the question submitted must be that Articles 43 EC and 48 EC must be interpreted as precluding national legislation, such as that at issue in the main proceedings, under which interest payments made by a company resident in a Member State to a director which is a company established in another Member State are reclassified as dividends and are, on that basis, taxable, where, at the beginning of the taxable period, the total of the interest-bearing loans is higher than the paid-up capital plus taxed reserves, whereas, in the same circumstances, where those interest payments are made to a director which is a company established in the same Member State, those payments are not reclassified as dividends and are, on that basis, not taxable.

35 Since the Treaty provisions on freedom of establishment thus preclude national legislation such as that at issue in the main proceedings, it is not necessary to examine whether the Treaty provisions on the free movement of capital also preclude that legislation.

Costs

36 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the referring court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Fourth Chamber) hereby rules:

Articles 43 EC and 48 EC preclude national legislation, such as that at issue in the main

proceedings, under which interest payments made by a company resident in a Member State to a director which is a company established in another Member State are reclassified as dividends and are, on that basis, taxable, where, at the beginning of the taxable period, the total of the interest-bearing loans is higher than the paid-up capital plus taxed reserves, whereas, in the same circumstances, where those interest payments are made to a director which is a company established in the same Member State, those payments are not reclassified as dividends and are, on that basis, not taxable.

[Signatures]

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* Language of the case: Dutch.