



Reports of Cases

OPINION OF ADVOCATE GENERAL
CRUZ VILLALÓN
delivered on 7 November 2013¹

Case C-47/12

Kronos International Inc.

v

Finanzamt Leverkusen (Request for a preliminary ruling

from the Finanzgericht Köln (Germany))

(Freedom of establishment — Free movement of capital — Tax legislation — Corporation tax — Taxation of dividends — Scope of Articles 49 TFEU and 63 TFEU respectively — National legislation applicable without distinction to controlling holdings and investment holdings — Arrangements to prevent double taxation of dividends — Exemption regime for foreign-sourced dividends — Set-off regime for nationally-sourced dividends — Different treatment of the parent company's losses — Restriction — Justifications — Allocation of the power of taxation between Member States — Overall coherence of the system)

1. In the present case the Court once again has before it a request for a preliminary ruling concerning the compatibility of national corporation tax legislation with EU law — in this instance the Treaty provisions on freedom of establishment and the free movement of capital — where that legislation makes dividends paid to resident parent companies subject to tax regimes that differ according to whether the dividends are nationally-sourced or foreign-sourced.

2. The Court will first of all be required to determine which freedom is to be applied to the dispute in the main proceedings, on the basis that the resident company in question is incorporated in the United States of America, its shareholdings in its various subsidiaries are greater than 90% and the national legislation applies to any holding in excess of 10%. The Court will therefore be called upon to elaborate on its very abundant case-law regarding determination of the freedom applicable to the tax treatment of dividends.

3. The Court will then have to examine whether the national legislation at issue in the main proceedings,² which seeks to prevent the imposition of a series of charges to tax on, or economic double taxation of, dividends paid to resident companies by exempting foreign-sourced dividends, which are subject to taxation at source, whilst subjecting nationally-sourced dividends to a set-off regime, is compatible with the provisions of the Treaty.

¹ — Original language: French.

² — Legislation of which the Court has already had occasion to consider certain aspects; see Case C-292/04 *Meilicke and Others* [2007] ECR I-1835 and Case C-262/09 *Meilicke and Others* [2011] ECR I-5669.

4. The Court, it is true, has already had occasion to rule on questions of this nature, but in circumstances where, conversely to the situation in the main proceedings, the nationally-sourced dividends were exempt from tax and the foreign-sourced dividends benefitted from a set-off regime,³ or should have done.⁴

5. However, the present case involves a complicating factor which distinguishes it from the cases hitherto examined by the Court. What is challenged in the main proceedings is not so much that there are two regimes applicable to dividends as the consequences of their application where the resident company receiving the dividends records losses. The Court is therefore faced with a problem at the intersection of its already very abundant case-law on the tax treatment of dividends and of its case-law on the treatment of losses,⁵ but in an entirely novel configuration.

I – Legal background

A – Double taxation agreements

6. The various relevant bilateral agreements in force during the tax years at issue in the main proceedings, which the Federal Republic of Germany entered into with, respectively, the Kingdom of Belgium, the Kingdom of Denmark, the French Republic, the United Kingdom of Great Britain and Northern Ireland and Canada, all provided in general terms that dividends paid by subsidiaries to a parent company established in Germany in respect of a shareholding reaching or exceeding a threshold of between 10 and 25% were not taxable in Germany but in the State of establishment of those subsidiaries.

B – German legislation

7. Paragraph 49(1) of the German Law on corporation tax (Körperschaftsteuergesetz)⁶ refers to the provisions of the Law on income tax (Einkommensteuergesetz)⁷ for the purposes of the implementation of corporation tax, including the set-off regime.

8. Paragraph 36(2)(3) of the EStG, which governs the ‘full set-off’ regime, provides as follows:

‘... The following shall be set off against income tax:

3. corporation tax on a company or association fully subject to corporation tax in the amount of 3/7 of income within the meaning of Paragraph 20(1)(1) or (1)(2), in so far as the income does not arise from dividend distributions for which own capital within the meaning of Paragraph 30(2)(1) of the Law on corporation tax is regarded as used. The same applies to income within the meaning of Paragraph 20(2)(2)(a) which has been obtained from the first

3 — See Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, ‘*Test Claimants in the FII Group Litigation I*’; order in Case C-201/05 *Test Claimants in the CFC and Dividend Group Litigation* [2008] ECR I-2875; judgment of 23 April 2009 in Case C-406/07 *Commission v Greece*; and Case C-35/11 *Test Claimants in the FII Group Litigation* [2012] ECR, ‘*Test Claimants in the FII Group Litigation II*’.

4 — See Joined Cases C-436/08 and C-437/08 *Haribo Lakritzen Hans Riegel and Österreichische Salinen* [2011] ECR I-305.

5 — See, inter alia, Case C-264/96 *ICI* [1998] ECR I-4695; Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727; Case C-446/03 *Marks & Spencer* [2005] ECR I-10837; Case C-414/06 *Lidl Belgium* [2008] ECR I-3601; *Haribo Lakritzen Hans Riegel and Österreichische Salinen*; Case C-18/11 *Philips Electronics UK* [2012] ECR; and Case C-123/11 *A* [2013] ECR.

6 — ‘The KStG’.

7 — ‘The EStG’.

assignment by the shareholder of dividend coupons or other rights; in that case the corporation tax that may be set off shall be limited to 3/7 of the amount distributed in respect of the rights assigned. Corporation tax shall not be set off:

...

(f) where the income has not been recorded in determining the basis of assessment;

...'

9. The national court states furthermore that foreign-sourced dividends were also exempt from corporation tax in Germany under Paragraph 26(7) of the KStG, in the version in force until 1993, and under Paragraph 8b(5) of the KStG, in the version in force from 1994 to 2000.

II – Factual background to the main proceedings

10. Kronos International Inc.,⁸ the applicant in the main proceedings, is a holding company set up in 1988 under the laws of the State of Delaware (United States of America) which has its registered office in that state and the seat of its management in Germany, where it is entered in the commercial register with a branch.

11. It was set up in order to ensure the integrated management of various European and Canadian companies which it was to buy from NL Industries Inc. (USA). Since 1989 it has held 99.95% of the shares in the German company Kronos Titan GmbH, and from 1991 to 2001, the years at issue in the main proceedings, it had direct or indirect holdings of between 90 and 100% in a number of companies.

12. Between 1991 and 2001, KII thus held 100% of the capital of Kronos Canada Inc. and of the capital of Kronos UK Ltd, and had a holding of between 92.941 and 93.771% in the capital of Société Industrielle Titane (France).

13. Between 1999 and 2001, it also held 100% of the capital of Kronos Denmark APS, through which it controlled 99.99% of the capital of Kronos Europa SA/NV (Belgium) and 100% of the capital in Kronos Norge (Norway) in 2000 and 2001.

14. The dispute in the main proceedings concerns the corporation tax for which KII is liable in Germany in respect of the years 1991 to 2001 and, more specifically, the fact that KII is unable to set off against corporation tax payable in Germany the corporation tax paid by its subsidiaries and second-tier subsidiaries established in other Member States or third countries and to obtain, where appropriate, refunds of tax in Germany in the event of losses.

15. Between 2004 and 2010, notices of assessment were issued to KII in respect of corporation tax payable for the years 1991 to 2001. KII paid EUR 4 190 788.57 in respect of corporation tax for 1991 and EUR 2 050 183.81 for 1992. Conversely, it paid no corporation tax between 1993 and 2001, owing to losses which it had recorded.

16. In that context, KII applied for the setting off, against the corporation tax for which it was liable in Germany, and the refund of the tax paid by its subsidiaries and second-tier subsidiaries established in other Member States (Belgium, France and the United Kingdom) or third countries (Canada and Norway) between 1991 and 2001.

⁸ — 'KII'.

17. By decision of 15 December 2005, Finanzamt Leverkusen (Tax Office, Leverkusen) refused that application. That refusal was based on Paragraph 36(2)(3)(f) of the EStG in conjunction with Paragraph 49(1) of the KStG, under which the corporation tax borne by dividends can be set off only where the dividends are recorded as taxable income. However, foreign-sourced dividends are exempt and so cannot be taken into account as taxable income.

18. By decision of 10 January 2007, Finanzamt Leverkusen dismissed as unfounded the objection lodged by KII as regards the notice relating to the statement of account and to offsetting of the tax credit in respect of corporation tax for the year 1994.

19. On 7 February 2007, KII applied to the Finanzgericht Köln (Finance Court, Cologne) for the annulment of that decision and also brought an action for failure to act concerning the statement of account for corporation tax in respect of the years 1991 to 1993 and 1995 to 2001.

III – The questions referred for a preliminary ruling and the procedure before the Court

20. Against that background the Finanzgericht Köln decided to stay the proceedings and refer the following questions to the Court for a preliminary ruling:

- ‘(1) Is the exclusion of the set-off of corporation tax as a consequence of the tax exemption of dividend distributions by capital companies in third countries to German capital companies, for which the German legislation requires only that the capital company receiving the dividends has a holding of not less than 10% in the distributing company, subject only to the freedom of establishment within the meaning of Article 49 TFEU in conjunction with Article 54 TFEU or also to the free movement of capital within the meaning of Articles 63 TFEU to 65 TFEU, if the actual holding of the capital company receiving the dividends is 100%?
- (2) Are the provisions concerning freedom of establishment (now Article 49 TFEU) and, as the case may be, also concerning the free movement of capital (Article 67 EEC/EC until 1993, now Articles 63 TFEU to 65 TFEU) to be interpreted as meaning that they preclude a provision which, where the dividends of foreign subsidiaries are exempt from tax, excludes the set-off and refund of corporation tax on those dividend distributions even where the parent company makes a loss, if, for distributions by German subsidiaries, there is provision for relief by setting off corporation tax?
- (3) Are the provisions concerning freedom of establishment (now Article 49 TFEU) and, as the case may be, also concerning the free movement of capital (Article 67 EEC/EC until 1993, now Articles 63 TFEU to 65 TFEU) to be interpreted as meaning that they preclude a provision which excludes the set-off and refund of corporation tax on dividends of second and third-tier subsidiaries which are exempted from tax in the country of the subsidiary and which are (re)distributed to the German parent company and likewise exempted from tax in Germany, but in the case of purely domestic situations, as the case may be by means of the set-off of corporation tax on the second-tier subsidiary’s dividends in the hands of the subsidiary and the set-off of corporation tax on the subsidiary’s dividends in the hands of the parent company, enables a refund in the event of a loss by the parent company?

- (4) If the provisions on the free movement of capital are also applicable, a further question, depending on the reply to question 2, arises with regard to the Canadian dividends:

Is the present Article 64(1) TFEU to be understood as meaning that it permits the application by the Federal Republic of Germany of German legislation, and provisions of double taxation conventions, which have remained unchanged in substance since 31 December 1993 and, therefore, that it permits the continuing exclusion of the offsetting of Canadian corporation tax on dividends exempted from tax in Germany?’

21. The applicant and defendant in the main proceedings, the German and United Kingdom Governments and the European Commission submitted written observations.

22. The applicant and defendant in the main proceedings, the German Government the Commission also presented oral argument at the hearing held on 16 May 2013.

IV – Preliminary observation

23. The four questions referred for a preliminary ruling by the national court raise, in general terms, two clearly distinct problems which will be examined in turn: the first, concerning the freedom applicable to the dispute, corresponds to the first question and the second, concerning the compatibility of the German legislation with that freedom, corresponds to the second, third and fourth questions.

V – The freedoms which may be relied on and are applicable in the dispute in the main proceedings (first question)

24. By its first question, the national court is essentially asking the Court whether the legislation of a Member State (the Federal Republic of Germany) applicable to the taxation of dividends paid to companies of that Member State (‘German capital companies’) by subsidiaries established in a non-Member State (‘capital companies of a third country’) comes solely within Articles 49 TFEU and 54 TFEU on freedom of establishment or whether it also comes within Articles 63 TFEU to 65 TFEU on the free movement of capital, where it applies to any shareholding greater than 10% and the shareholding at issue is in fact 100%.

25. Anticipating the reasoning to be set out below, I can at the outset state that the answer to the first question raised by the national court, as thus formulated, is to be found in the Court’s case-law, and, specifically, in *Test Claimants in the FII Group Litigation II*.⁹

26. Expressed in very simple terms, and as we shall subsequently see, the Court in fact held in that judgment that, since freedom of establishment does not apply *ratione loci* to national legislation concerning the tax treatment of dividends paid to a company resident in a Member State by a subsidiary established in a third country,¹⁰ the free movement of capital must apply, except in cases of abuse, provided that the legislation applies without distinction to shareholdings enabling the holder to

9 — Paragraphs 88 to 104.

10 — It may be recalled that the Court pointed out in Opinion 1/94 [1994] ECR I-5267, paragraph 81, that the objective of the chapter in the Treaty on freedom of establishment is to secure freedom of establishment solely for nationals, whether natural or legal persons, of the Member States. It contains no provision which extends its scope to situations external to the European Union. Freedom of establishment cannot therefore be relied on either in a context where a legal person in a third country has a holding which confers on it a determinative influence on the decisions and activities of company in a Member State (see, in particular, the order in Case C-492/04 *Lasertec* [2007] ECR I-3775, paragraphs 15 to 28) or in situations relating to the establishment of a company of a Member State in a third country (see, in particular, the order in Case C-102/05 *A and B* [2007] ECR I-3871, paragraphs 19 to 30).

exert a definite influence on a company's decisions and to determine its activities ('controlling holdings') and to shareholdings acquired with the sole intention of making a financial investment without any intention of influencing the management and control of the undertaking ('investment holdings').

27. Whilst the question of the freedom applicable in the dispute in the main proceedings arises in regard to dividends paid to KII by its subsidiary established in a third country, which for convenience I shall call the 'extra-Community dimension' of the dispute in the main proceedings, it none the less also arises in regard to dividends paid to KII by its subsidiaries established in other Member States or in States party to the Agreement on the European Economic Area of 2 May 1992,¹¹ that is to say, to the 'intra-Community dimension' of the main proceedings, notwithstanding the fact that the national court did not believe it was obliged to question the Court in that connection. The reason for that twofold dimension is as follows.

28. Under the Court's established case-law, freedom of establishment alone is in principle applicable to the intra-Community dimension of the dispute in the main proceedings. Yet, contrary to what the questions referred by the national court seem to postulate, KII may not, owing to its 'nationality', rely on freedom of establishment either in regard to its subsidiaries established in third countries or in regard to its subsidiaries established in other Member States or in EEA States.

29. The Court is therefore faced with the question whether, in line with its judgment in *Test Claimants in the FII Group Litigation II*, and having regard to the legal reasoning underlying its decision in that case, the free movement of capital must apply not only to the extra-Community dimension of the dispute in the main proceedings but also to its intra-Community dimension.

30. As I shall endeavour to demonstrate, this question calls for an affirmative reply. In so far as freedom of establishment is not applicable *ratione personae* to national legislation concerning the tax treatment of dividends paid to a company resident in a Member State by a subsidiary established in another Member State, the free movement of capital must apply, except in cases of abuse, provided that the legislation applies without distinction to controlling holdings and investment holdings.

31. Let us examine these questions in detail.

A – The freedom applicable to the extra-Community dimension of the dispute in the main proceedings

32. In its judgment in *Test Claimants in the FII Group Litigation II*,¹² which, it should be pointed out, was delivered subsequent to the date on which the Court received the present reference for a preliminary ruling, the Court provided an affirmative reply to a question which was very similar to the first question referred by the national court in the present case and which was asked in a comparable situation,¹³ whilst making a reservation in respect of a situation in which rights are being abused.¹⁴

33. It held that a company resident in a Member State owning a controlling holding in a company resident in a third country is entitled to rely on Article 63 TFEU in order to call into question the consistency with that provision of legislation of that Member State on the tax treatment of dividends originating in the third country which applies to both controlling holdings and investment holdings.¹⁵

11 — OJ 1994 L 1, p. 3, 'the EEA Agreement'.

12 — Paragraphs 88 to 104.

13 — In that case, the fourth question referred for a preliminary ruling. See paragraphs 30 and 31 and 88 to 104.

14 — See paragraph 100.

15 — See paragraph 104 and paragraph 4 of the operative part.

34. It is important to note in this connection that the judgment in *Test Claimants in the FII Group Litigation II* expressly amends, specifically in regard to extra-Community situations, the approach laid down by the Court in settled case-law for determining the freedom applicable to national legislation on the tax treatment of dividends.

1. The alteration to the case-law made by the judgment in *Test Claimants in the FII Group Litigation II* in regard to extra-Community situations

35. Until the judgment in *Test Claimants in the FII Group Litigation II*, as the Court moreover explains in paragraphs 89 to 92, the freedom applicable to the tax treatment of dividends fell to be determined having regard both to the purpose of the national legislation at issue (legal criterion) and to the factual situation at issue (factual criterion).

36. Thus, if the national legislation at issue was intended to apply solely to controlling holdings, it then had to be examined in the light of freedom of establishment,¹⁶ in principle exclusively.

37. If the national legislation applied to investment holdings, it then had to be examined in the light of the free movement of capital, likewise in principle exclusively.

38. On the other hand, if the national legislation applied irrespective of the size of the holding, that is to say, without distinction to controlling holdings and investment holdings, it was then not possible to determine whether it came preponderantly within one or the other freedom solely by reference to its purpose, and it was then necessary to have recourse to the factual criterion.

39. Thus, in the case of a controlling holding freedom of establishment applied, and in the case of an investment holding the free movement of capital applied, in both cases in principle exclusively. If it was not possible to determine the nature of the holdings at issue, the national legislation then had to be examined in the light of both freedoms.¹⁷

40. This twofold test was to be fully applied both in situations involving dividends paid to resident companies by subsidiaries established in other Member States (intra-Community situations) and in situations involving dividends paid by subsidiaries established in third countries (extra-Community situations).

41. Now, pursuant to the judgment in *Test Claimants in the FII Group Litigation II*, in a context relating to the tax treatment of dividends originating in a third country, in other words, an extra-Community situation, it is sufficient to examine merely the purpose of the national legislation in order to determine the applicable freedom.¹⁸

16 — Sometimes the Court is content to state that the national legislation at issue concerns only ‘relations within a group of companies’ but the idea remains the same, namely that the legislation comes within freedom of establishment since, by its aim, it predominantly affects the latter. On that line of case-law, derived from Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, paragraph 32, and *Test Claimants in the FII Group Litigation I*, paragraph 118, see Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107 paragraph 33; Case C-231/05 *Oy AA* [2007] ECR I-6373 paragraph 23; and Case C-284/06 *Burda* [2008] ECR I-4571, paragraph 68.

17 — That is particularly the case in the context of actions for failure to fulfil obligations, for reasons specific to that form of action: see, in that connection, the judgment of 17 July 2008 in Case C-207/07 *Commission v Spain*, paragraph 37; *Commission v Greece*, paragraph 22; Case C-212/09 *Commission v Portugal* [2011] ECR I-10889, paragraphs 41 to 45; and Case C-387/11 *Commission v Belgium* [2012] ECR, paragraph 35. It may also be the case in the context of references for a preliminary ruling where the information available to the Court does not allow it to determine the size of the shareholding in question in the main proceedings; see, in that connection, *Test Claimants in the FII Group Litigation I*, paragraph 38; Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, paragraph 40; and Case C-310/09 *Accor* [2011] ECR I-8115, paragraphs 30 to 38.

18 — Paragraph 96.

42. Thus, if the national legislation at issue is intended to apply both to controlling holdings and to investment holdings (the legal criterion) the free movement of capital may be relied on regardless of the holdings at issue (the factual criterion).

43. By thus redefining the method and criteria for determining the freedom applicable to the tax treatment of dividends in extra-Community situations, the judgment in *Test Claimants in the FII Group Litigation II* applies a corrective to the sometimes radical consequences of a line of case-law capable of leading the Court to declare EU law quite simply inapplicable in certain situations.¹⁹

44. What therefore essentially justifies the innovative solution in the judgment in *Test Claimants in the FII Group Litigation II* is that, when that legislation is applied to dividends originating in third countries, it cannot come within freedom of establishment with the consequence that it falls outside the ambit of EU law.

2. Application of *Test Claimants in the FII Group Litigation II* to the extra-Community dimension of the dispute in the main proceedings

45. In this case, KII, which is a company regarded as ‘resident’ in Germany, though registered in the United States of America, owns a 100% holding in the capital of a subsidiary established in a third country, which undeniably confers it definite influence over the decisions of that company. Moreover, it is subject to the regime for exempting dividends paid by that subsidiary, which applies to any holding above 10% and therefore does not apply solely to situations in which the parent company exerts definite influence on the company distributing the dividends.

46. The national court’s first question, taken literally, thus refers to a situation which may be considered to correspond precisely to the situation covered by the judgment in *Test Claimants in the FII Group Litigation II*, so that the reply to it may be affirmative, in the same terms and on the same grounds as those contained in that judgment.

B – The freedom applicable to the intra-Community dimension of the dispute in the main proceedings

47. However, as I have already pointed out, the first question submitted by the national court refers, in the circumstances of the dispute in the main proceedings, only to the subsidiary of KII established in a non-Member State (third country) and does not therefore seem to concern the subsidiaries established in Member States other than Germany or in EEA States. The national court seems also to be postulating, as is apparent from its second and third questions, that the intra-Community dimension of the dispute in the main proceedings comes under freedom of establishment and, ‘as the case may be’, under the free movement of capital.

48. Yet, freedom of establishment is not, in the circumstances of the dispute in the main proceedings, applicable *ratione loci* or *ratione personae*. KII cannot in fact rely on freedom of establishment in regard to dividends paid by its subsidiaries established in third countries, as stated above. Nor can KII rely on it in regard to dividends paid by its subsidiaries established in other Member States, owing to its ‘nationality’.

19 — *Test Claimants in the Thin Cap Group Litigation*, paragraphs 26 to 35 and 103 to 105; *Lasertec*, paragraph 27; *A and B*, paragraph 29; order of 6 November 2007 in Case C-415/06 *Stahlwerk Ergste Westig*, paragraphs 18 and 19; and Case C-31/11 *Scheunemann* [2012] ECR, paragraphs 33 and 34.

1. KII is not in a position to rely on freedom of establishment

49. The dispute in the main proceedings displays a peculiar configuration, in the sense that KII cannot rely on freedom of establishment either in regard to its subsidiaries established in third countries, given the purely intra-Community nature of that freedom, or in regard to its subsidiaries established in other Member States or EEA States, owing to its ‘nationality’.

50. Furthermore, the Court pointed out in Opinion 1/94²⁰ that the objective of the chapter of the Treaty on freedom of establishment is to secure freedom of establishment solely for nationals, whether natural or legal persons, of the Member States. It contains no provision extending its scope to situations external to the European Union. Freedom of establishment cannot therefore be relied on either in a context where a legal person in a third country has a holding which confers on it a determinative influence on the decisions and activities of a company in a Member State²¹ or in situations concerning the establishment of a company of a Member State in a third country.²²

51. KII is a company incorporated in accordance with United States law whose registered office is situated in the United States. Its management, however, is located in Germany, with the result that, as is apparent from the written observations submitted by the Federal Republic of Germany, it is fully subject to corporation tax in Germany, in accordance with Paragraph 1(1) of the KStG. It is in that capacity as a ‘resident’ company subject to corporation tax in Germany that KII relies on freedom of establishment and the free movement of capital in order to resist the application to it of the German tax legislation or, more accurately, in order to obtain the tax treatment of dividends to which it claims entitlement.

52. In the light of Article 54 TFEU, KII cannot therefore rely on freedom of establishment since it is not formed in accordance with the law of a Member State.²³ The immediate question arising is whether it may, if appropriate, rely on the free movement of capital.

53. The main proceedings therefore also raise the question whether the free movement of capital is applicable to the intra-Community dimension of the case or, in other words, whether the solution adopted by the Court in regard to extra-Community situations in *Test Claimants in the FII Group Litigation II* may be transposed to intra-Community situations, thus rendering it applicable to the whole of the dispute in the main proceedings.

2. The reply given in *Test Claimants in the FII Group Litigation II* must be applicable in the circumstances of the dispute in the main proceedings

54. In my view, since freedom of establishment cannot be relied on in regard to national legislation applicable generally to the tax treatment of dividends covering both controlling holdings and investment holdings, the free movement of capital must be applicable, subject to safeguards in cases of abuse, even if controlling holdings are at issue in the main proceedings.

55. As is apparent from the foregoing analysis, this solution is perfectly in line with that adopted by the Court in *Test Claimants in the FII Group Litigation II* and there is nothing in the grounds of that judgment to preclude it from being transposed to the present case.

20 — Paragraph 81.

21 — See, inter alia, *Lasertec*, paragraphs 15 to 28.

22 — See, inter alia, *A and B*, paragraphs 19 to 30.

23 — See inter alia, *a contrario*, Case 81/87 *Daily Mail and General Trust* [1988] ECR 5483, paragraph 16; Case C-212/97 *Centros* [1999] ECR I-1459, paragraph 17; Case C-208/00 *Überseering* [2002] ECR I-9919, paragraphs 56 and 57; Case C-210/06 *Cartesio* [2008] ECR I-9641, paragraph 110; and Case C-186/12 *Impacto Azul* [2013] ECR, paragraph 32.

56. It is immediately apparent from the judgment in *Test Claimants in the FII Group Litigation II* that the fundamental reason why the Court took the view that the free movement of capital has to apply to national legislation of general application in extra-Community situations is none other than the impossibility of applying freedom of establishment to them.

57. As has been seen, like subsidiaries established in third countries, KII cannot, as a parent company, rely on freedom of establishment and therefore satisfies the condition laid down by the Court for the applicability of the free movement of capital. Moreover, the national legislation at issue in the main proceedings applies without distinction to investment holdings and controlling holdings, and thus satisfies the condition laid down by the Court for the free movement of capital to apply.

58. The situation at issue in the main proceedings therefore substantively meets the requirements laid down by the Court in *Test Claimants in the FII Group Litigation II*, and does not fall within the case which the Court clearly sought to exclude from the scope of the new case-law. The Court was at pains to emphasise that the free movement of capital, and therefore EU law, remain inapplicable to extra-Community situations where the national legislation on the tax treatment of dividends applies solely to controlling holdings. In that case, freedom of establishment remains the only freedom applicable and the extra-Community situation falls outside the ambit of EU law.²⁴

59. Finally, applying the judgment in *Test Claimants in the FII Group Litigation* would above all prevent EU law from applying to the extra-Community dimension of the dispute in the main proceedings whilst being inapplicable to its intra-Community dimension, a situation which could not but be considered an anomaly.

60. Applicability of the free movement of capital in circumstances such as those at issue in the main proceedings seems to me to be necessary, in particular because it is neither automatic nor systematic, such as to contribute to the creation of situations involving an abuse of rights, as noted by the Court in paragraph 100 of the judgment in *Test Claimants in the FII Group Litigation II*.

61. The Court stated that it is important to ensure that the interpretation of Article 63(1) TFEU does not enable economic operators who benefit from the free movement of capital but who do not fall within the limits of the territorial scope of freedom of establishment to profit from the latter freedom. However, it held that that was not so in that case because the legislation of the Member State in question did not relate to the conditions for access of a company from that Member State to the market in a third country or of a company from a third country to the market in that Member State.

62. This criterion of market access conditions is the same as was used by the Court in *Fidium Finanz*,²⁵ so that, whilst the underlying justifications for the reservation thus laid down by the Court do not expressly emerge from the grounds of its judgment in *Test Claimants in the FII Group Litigation II*, they may none the less be perfectly well understood in the light of the judgment in *Fidium Finanz*.

63. In *Fidium Finanz*, the German legislation made the pursuit by financial institutions established in third countries of their activities, that is to say, the provision of financial services in Germany, subject to the obtaining of an authorisation which could in fact be equated to an obligation of establishment. It had the effect of ‘imped[ing] access to the German financial market for companies established in non-member countries’.²⁶ It was difficult to acknowledge in such circumstances that a company

24 — *Test Claimants in the FII Group Litigation*, paragraph 98. See also Case C-168/11 *Beker and Beker* [2013] ECR, paragraph 30.

25 — Case C-452/04 [2006] ECR I-9521.

26 — Paragraphs 46 and 48.

established in a third country might rely on the free movement of capital in order in some way to circumvent or neutralise the legislation of a Member State governing very specifically the conditions under which financial services may be provided and the market may be accessed in that Member State.

64. In the present case, and like the United Kingdom legislation at issue in *Test Claimants in the FII Group Litigation II*, the German legislation at issue in the dispute in the main proceedings in no way has the objective or the effect of affecting market-access conditions as defined in *Fidium Finanz*.

C – Conclusion

65. It follows from the foregoing that, in the circumstances of the main proceedings, a company resident in a Member State owning controlling holdings in companies resident in other Member States, EEA States or third countries may rely on the Treaty provisions on the free movement of capital in order to challenge the compatibility with those provisions of the legislation of a Member State on the tax treatment of dividends where that legislation is intended to apply both to shareholdings enabling the holder to exert a definite influence on a company's decisions and to determine its activities (controlling holdings) and to shareholdings acquired with the sole intention of making a financial investment without any intention of influencing the management and control of the undertaking (investment holdings), in so far as that legislation does not seek to govern the conditions for access of companies from that Member State to the market in the other Member States or third countries or of companies from the other Member States and third countries to the market in the first mentioned Member State.

66. Consequently I propose that the Court should rule, in reply to the first question referred by the national court, as reformulated, that EU law must be interpreted as meaning that the compatibility of the legislation of a Member State on taxation of dividends which is applicable to any shareholding above 10% may be examined in the light of the free movement of capital where the shareholdings at issue enable the holder to exert a definite influence on the companies' decisions and to determine their activities, in so far as that legislation does not seek to govern the conditions for access of companies from that Member State to the market in the other Member States or third countries or of companies from the other Member States and third countries to the market in the first mentioned Member State.

VI – Compatibility of the German legislation with the free movement of capital

67. By its second, third and fourth questions, which it is convenient to examine together, the national court is essentially asking the Court whether the Treaty provisions on the free movement of capital must be interpreted as precluding legislation of a Member State, such as that at issue in the main proceedings, which does not permit the setting off and refund of corporation tax paid by the subsidiaries and second-tier subsidiaries of a resident company which are established in other Member States or third countries when that company makes losses, whereas such set-off and refund are provided for in respect of resident subsidiaries.

A – *The German legislation on the taxation of dividends (the mechanisms for setting off national dividends and exempting foreign dividends)*

68. We should begin by reminding ourselves of the essential features of the German tax legislation on dividends, which distinguishes those paid to a resident company by a resident subsidiary (nationally-sourced dividends), which are subject to the set-off regime, from those paid to a resident company by a subsidiary established in another Member State or a third country (foreign-sourced dividends), which benefit from an exemption regime.

1. The set-off regime for nationally-sourced dividends

69. Under Paragraph 36(2)(3) of the EStG, nationally-sourced dividends are subject to a set-off regime under which the corporation tax paid at source by the dividend-distributing subsidiary is set off against the tax to be paid by the recipient parent company; the set-off is partial where the company does not redistribute those dividends to the final shareholders and full when it redistributes them fully.

2. The exemption regime for foreign-sourced dividends

70. Foreign-sourced dividends, on the other hand, benefit from an exemption regime known as the ‘preferential intra-group dividend regime’. Such dividends deriving from holdings reaching or exceeding a threshold of between 10 and 25% are exempt from tax in Germany under various bilateral agreements. As those foreign-sourced dividends do not constitute taxable income, they are not taken into account for the purposes of determining tax and cannot therefore be set off against tax for which the parent company is liable. Paragraph 36(2)(3)(f) of the EStG in fact provided that corporation tax was not set off against income tax where the income was not recorded in determining the basis of assessment.

3. The treatment of losses under the set-off regime for nationally-sourced dividends

71. It is clear from the order for reference and from the written observations submitted to the Court that the set-off regime provided for by the German legislation enables a parent company in receipt of dividends distributed by a resident subsidiary to acquire the right, where it makes or carries forward losses and the dividends paid by the distributing subsidiary do not fully offset those losses, not to pay any corporation tax and to receive a payment corresponding to the corporation tax paid at source by the subsidiary making the distribution.

72. Conversely, such a payment is in any event precluded in the case of foreign-sourced dividends, inasmuch as they are exempt and, under paragraph 36(2)(3)(f) of the EStG, cannot therefore be taken into account in the parent company’s basis of assessment.

B – *Existence of a restriction on the free movement of capital*

1. Summary of the observations submitted to the Court

73. The national court considers that the rule in Paragraph 36(2)(3)(f) of the EStG making set-off subject to the condition that the corresponding income be taken into account in the tax determination does not constitute a restriction, since it does not draw a distinction according to the origin of the income. If there were found to be a restriction, that could only be as a result of the combined effect of the rules on determination of tax and the rules on set-off of the tax.

74. The national court considers that the exemption regime enjoyed by foreign-sourced dividends, which, moreover, is in conformity with the requirements of Article 4(1) of Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States,²⁷ is always more advantageous than the set-off regime governing nationally-sourced dividends.

²⁷ — OJ 1990 L 225 p. 6.

75. There could be unequal treatment as between nationally-sourced dividends and foreign-sourced dividends only where the foreign subsidiaries distribute dividends and the resident parent company records or carries forward losses. It doubts, however, that such a situation is incompatible with EU law.

76. The exemption regime for foreign-sourced dividends and the set-off regime applicable to nationally-sourced dividends, examined at the two stages of determination of tax and setting off of tax, are in fact equivalent, the former even presenting an advantage in relation to the second, inasmuch as it imposes no evidential obligation and therefore no procedural burden.

77. It is true that the national court acknowledges by reference to the Court's case-law²⁸ that a tax rule to the detriment of foreign-sourced dividends constitutes a restriction even if its application may have advantageous effects in certain situations. However, it does not share KII's view that a restriction is constituted by the mere fact that the exemption regime secures an advantage in terms of the procedure for determination of the amount of tax and results in a cash-flow disadvantage in terms of the procedure for setting off tax.

78. Since foreign-sourced dividends are exempt, they always escape the determination of the amount of tax and are thus always privileged. They cannot therefore be set off. Conversely, nationally-sourced dividends are always taken into account for the purposes of determining the amount of tax, but that is counterbalanced by the set-off of the corporation tax in respect of the dividends that has been paid by the distributing subsidiary against the tax paid by the recipient parent company; such set-off is total where the parent company immediately redistributes the dividends or partial where it does not do so.

79. Where the resident parent company makes losses, the payment of dividends by resident subsidiaries also generates a disadvantageous effect both at the stage of the procedure for determining the amount of tax and at the stage of the procedure for set-off of tax. At the stage of the procedure for determining the amount of tax, such payment offsets the losses, in whole or in part, and contributes to reducing or preventing losses from being carried back to previous years and forward to subsequent years. At the stage of the procedure for the set-off of tax, the reduction in losses carried back in respect of previous years reduces the refund of tax paid in the preceding years.

80. The cash-flow advantage under the set-off regime in the case of losses occurs only at the stage of the set-off procedure. At the stage of the procedure for determination of the tax, the tax payable by the parent company is reduced or nil, notwithstanding the dividends paid by the resident subsidiary. At the stage of the set-off procedure, the tax on dividends that has been paid by the subsidiary is set off against the parent company's tax and can, consequently, result in a partial or total refund.

81. Those advantageous and disadvantageous effects from one tax year to the next are, however, only the logical consequence of the application of two different regimes.

82. KII essentially maintains in its written observations that the German tax legislation applicable to the dividends paid to a resident parent company constitutes a restriction on the free movement of capital, inasmuch as the regime for the exemption of foreign-sourced dividends is less advantageous than the set-off regime for nationally-sourced dividends where the resident parent company makes losses.

28 — Case C-141/99 *AMID* [2000] ECR I-11619, paragraph 27, and Case C-182/06 *Lakebrink and Peters-Lakebrink* [2007] ECR I-6705.

83. On the basis that a German parent company may, when it makes losses, obtain a refund, under the set-off mechanism, of the tax paid by its German subsidiary, KII seeks the same advantage, by receipt of a refund in Germany of corporation tax paid by its subsidiaries in their State of establishment. Where the parent company makes losses, it is contrary to the free movement of capital to exclude from set-off and refund corporation tax paid previously by foreign subsidiaries on dividends paid to the parent company.

84. KII states that the exemption regime and the set-off regime are equivalent only in so far as one does not take into account the taxation of its shareholders. If one takes into account the taxation of final shareholders, it is only in respect of nationally-sourced dividends that double taxation is avoided both in the hands of the parent company and in the hands of its shareholders. Referring to the judgment in *Accor*,²⁹ KII maintains in particular that in determining whether foreign-sourced dividends are treated in a manner equivalent to that of nationally-sourced dividends, the tax burden must be evaluated by taking into consideration the redistribution of the dividends received.

85. The Federal Republic of Germany and Finanzamt Leverkusen essentially consider that the set-off mechanism and the exemption mechanism, which are both intended to avoid economic double taxation, are globally equivalent, and that foreign-sourced dividends and nationally-sourced dividends are accorded equivalent treatment, there being a difference only in the detailed rules for implementation. They also maintain that, even on the supposition that the German legislation is considered to be restrictive, it is none the less justified by the need to ensure the coherence of the tax system, to maintain a balanced allocation of the power of taxation between the Member States and to prevent losses from being used twice.

86. Finally, the Commission considers that the situations of national subsidiaries and foreign subsidiaries are not comparable since foreign-sourced dividends are exempt from corporation tax in Germany under bilateral agreements, whereas nationally-sourced dividends are subject to corporation tax in Germany. The refund to the resident parent company of the corporation tax paid by the dividend-distributing resident subsidiary forms part of the mechanism for seeking to avoid or mitigate economic double taxation in regard to the parent company. Thus the different tax treatment of foreign-sourced dividends and nationally-sourced dividends is objectively justified by that difference in their situations. In any event it is justified by the overriding public-interest requirement to ensure coherence of the national tax system.

2. Analysis

87. It is settled case-law that, whilst direct taxation falls within the competence of the Member States, they must none the less exercise that competence consistently with EU law and, in particular, with the Treaty provisions on the free movement of capital.³⁰

88. Thus, it is for each Member State to organise, in compliance with EU law, its system of taxation of dividends by defining the tax base and the tax rate which apply.³¹

29 — Paragraph 45 et seq.

30 — See, inter alia, Case C-80/94 *Wielockx* [1995] ECR I-2493, paragraph 16; Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraph 32; and Case C-315/02 *Lenz* [2004] ECR I-7063, paragraph 19.

31 — See *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 50; *Test Claimants in the FII Group Litigation I*, paragraph 47; Case C-194/06 *Orange European Smallcap Fund* [2008] ECR I-3747, paragraph 30; and C-128/08 *Damseaux* [2009] ECR I-6823, paragraph 25.

89. The Court has also stated that, in the absence of unifying or harmonising measures of EU law, the Member States retain the power to define, unilaterally or by treaty, the criteria for allocating their powers of taxation, in particular with a view to eliminating double taxation.³² They thus remain at liberty, in the framework of bilateral agreements concluded in order to prevent double taxation, to determine the connecting factors for the purposes of allocating their powers of taxation.³³

90. None the less, although the Member States are at liberty to arrange their tax systems and, in particular, to select the mechanism by which they propose to prevent or mitigate the imposition of a series of charges to tax on, or the economic double taxation³⁴ of, dividends paid to a resident company, they must, however, when they make use of that power, comply with the requirements of EU law.³⁵

91. Where a Member State establishes a system for preventing or mitigating the imposition of a series of charges to tax on, or economic double taxation of, dividends paid to resident companies by other resident companies, it must therefore, in conformity with Article 63 TFEU, grant equivalent treatment to dividends paid to resident companies by non-resident companies.³⁶ In particular, it cannot treat foreign-sourced dividends less advantageously than nationally-sourced dividends, unless that difference in treatment is justified by overriding reasons in the public interest or concerns situations which are not objectively comparable.³⁷

92. The German tax legislation applicable to the dispute in the main proceedings must be examined in the light of those principles to see whether it restricts the free movement of capital and, if so, whether that restriction can be justified.

a) Existence of a restriction

93. It is apparent from the order for reference that, pursuant to the various relevant bilateral agreements entered into by the Federal Republic of Germany with the Member States or third countries in which the various subsidiaries of KII at issue in the main proceedings are established, the dividends paid to KII by those subsidiaries are taxable in those States and exempt in Germany.

94. In that connection, it should be noted that this regime for exempting foreign-sourced dividends, which is a result both of double taxation agreements and of German domestic law, is in itself in compliance with the requirements of Article 4(1) of Council Directive 90/435.

32 — Case C-336/96 *Gilly* [1998] ECR I-2793, paragraphs 24 and 30; Case C-307/97 *Saint-Gobain ZN* [1999] ECR I-6161, paragraph 57; and *Damseaux*, paragraph 30.

33 — See, inter alia, *Gilly*, paragraphs 24 and 30; *Saint-Gobain ZN*, paragraph 57; and Case C-170/05 *Denkavit Internationaal and Denkavit France* [2006] ECR I-11949, paragraphs 43 and 44.

34 — Legal double taxation, it should be recalled, relates to the situation in which the same taxpayer is subject to double taxation on the same income, while economic double taxation refers to the situation in which different taxpayers are respectively subject to taxation on the same income. See, on this, the tax glossary of the International Bureau of Fiscal Documentation (IBFD); see also the Communication from the Commission of 19 December 2003, Dividend taxation of individuals in the Internal Market (COM(2003) 810 final); the Opinion of Advocate General Geelhoed in *Test Claimants in the FII Group Litigation I*, point 2 et seq.; and the Communication from the Commission of 11 November 2011, Double Taxation in the Single Market (COM(2011) 712 final).

35 — See *Test Claimants in the FII Group Litigation I*, paragraph 45, and *Accor*, paragraph 43.

36 — See *Test Claimants in the FII Group Litigation I*, paragraph 72, and *Haribo Lakritzen Hans Riegel and Österreichische Salinen*, paragraph 156.

37 — See, inter alia, *Test Claimants in the FII Group Litigation I*, paragraphs 45 and 46 and the case law cited. See also *Accor*, paragraph 44.

95. Since the foreign-sourced dividends are exempt in Germany and do not form part of the recipient parent company's basis of assessment, they are therefore not liable to be subject to the imposition of a series of charges to tax in the hands of the recipient parent company. As the Court has had occasion to point out, a system exempting distributed dividends by definition eliminates the risk of their being subject to a series of charges to tax.³⁸

96. It follows that, from the point of view of the objective pursued by the German legislation, which is to avoid the imposition of a series of charges to tax on, or economic double taxation of, dividends paid to resident companies, the regime exempting foreign-sourced dividends is in itself perfectly legitimate inasmuch as it achieves an outcome equivalent to the set-off regime applicable to nationally-sourced dividends. Consequently, and in so far as foreign-sourced dividends are not in fact taxed, which it is for the national court to ascertain, Germany cannot be reproached for subjecting dividends paid to resident companies to different regimes depending on their origin.

97. From that perspective, KII's argument derived from the judgment in *Accor* that the equivalence of the exemption regime and the set-off regime should be evaluated by taking into consideration the taxation of final shareholders must be rejected.

98. The taxation of KII in Germany is at issue in the dispute in the main proceedings, not that of its shareholders; thus, it is with the company itself, not its shareholders, that the dispute in the main proceedings began.³⁹ KII, moreover, states in its written observations that its direct shareholders reside in the United States without providing the slightest indication as to whether they may be liable to tax in Germany.

99. None the less, the disadvantage criticised by KII is not, as the Commission has rightly pointed out, the economic double taxation of foreign-sourced dividends but the difference of outcome, depending on whether the exemption regime or the set-off regime applies, that occurs in a situation where the parent company in receipt of dividends makes losses.

100. KII is, more specifically, complaining about the fact that, owing to the application of the exemption regime to foreign-sourced dividends, it is not in a position to benefit from the advantage procured by the set-off mechanism in the case of losses; that advantage is the refund of an amount corresponding to the corporation tax paid by the resident subsidiary on the distributed dividends. Consequently, it claims that the set-off regime should be applied to foreign-sourced dividends in order to enable it to obtain that refund.

101. It must be observed in that regard that the Court has only few details as to the basis on which and the conditions under which a resident company making losses or carrying forward losses may obtain, under the set-off regime applicable to nationally-sourced dividends, a refund of the corporation tax on the profits distributed by its resident subsidiary.

102. That stated, it is not contested that no such refund is payable under the exemption regime applicable to foreign-sourced dividends since, by virtue of being exempt, such dividends are by definition not included in the basis of assessment of the resident parent company.

38 — See *Test Claimants in the FII Group Litigation I*, paragraph 63, and *Haribo Lakritzen Hans Riegel and Österreichische Salinen*, paragraph 158.

39 — It indeed follows, logically, that neither the national court nor the various parties having presented written and/or oral argument to the Court, with the exception of KII, refer to the legal double taxation affecting foreign-sourced dividends mentioned by KII.

103. Finanzamt Leverkusen and the Federal Republic of Germany, confirming the details provided in this connection by the national court, concede that where the resident parent company makes or carries forward losses, the exemption regime may entail a cash-flow disadvantage compared to the set-off regime, since in respect of the year in which the dividends are distributed application of the exemption regime may result in a greater tax burden.

104. None the less, they consider that a temporary cash-flow disadvantage only is involved, occurring only in the specific circumstance in which the parent company makes or carries forward losses greater than the dividends received, and this cannot call into question the equivalence of the two regimes. They add that that disadvantage is essentially limited by the fact that, unlike a set-off regime, an exemption regime entails no obligation to provide proof of the tax burden on the distributed dividends and thus involves the recipient parent company in no expenditure in connection with obtaining the exemption.

105. However, it is clear from the explanations provided to the Court that a resident parent company does seem to be in a more advantageous position when it receives nationally-sourced dividends than when it receives foreign-sourced dividends inasmuch as, when it makes or carries forward losses, it may obtain a refund of the tax on the dividends distributed by its resident subsidiary, at least when the dividends paid are not enough to offset the losses made.

106. The possibility cannot therefore be excluded that the differentiation thus established by the German legislation may be such as to deter resident companies from investing capital in companies established in other Member States or third countries,⁴⁰ and that it must therefore be classified as a restriction on the free movement of capital.

107. However, as the Court has consistently held, a restriction on the free movement of capital is prohibited only to the extent to which it cannot be justified under Article 64(1) TFEU or Article 65(1) TFEU or by overriding reasons in the public interest.

b) Justifications

108. As is clear from the summary of the observations submitted to the Court, the national court, supported by Finanzamt Leverkusen, the Federal Republic of Germany and the Commission, considers that, if the German legislation is regarded as restrictive, it can none the less be justified by the need to ensure the coherence of the German tax system, to maintain the balanced allocation of the power of taxation between the Member States and to prevent losses from being used twice.

109. I for my part consider that, as EU law currently stands, and in the very specific circumstances of the case in the main proceedings which, when all is said and done, are entirely unprecedented, the claim put forward by KII cannot be upheld, even if on grounds which depart somewhat from the justifications traditionally accepted by the Court.

110. If the system of taxation of dividends in Germany, as resulting from double taxation agreements and provisions of German domestic law, were found to be incompatible with the Treaty provisions on the free movement of capital, and if that Member State were, as a consequence, obliged to refund to a resident company the tax on dividends that has been paid by its subsidiaries in the Member States and third countries in which they are established, not only the overall coherence of that system but also the allocation of the power of taxation between the Member States and between Member States and third countries would be seriously compromised.

40 — See, inter alia, Case C-370/05 *Festersen* [2007] ECR I-1129, paragraph 24, and *Haribo Lakritzen Hans Riegel and Österreichische Salinen*, paragraphs 50 and 80.

111. In that regard, it should be borne in mind first of all that Germany, where KII is considered to be resident, and the various Member States and third countries in which its subsidiaries are established have perfectly legitimately agreed on the allocation of their respective powers of taxation, by entering into agreements designed in particular to eliminate the economic double taxation of dividends in accordance with the provisions of Directive 90/435, as noted by the national court, and with the guiding principles of international tax law.⁴¹

112. Those agreements provide for dividends to be taxed by the Member State or third country where they have their source, that is to say, the State of establishment of the subsidiaries distributing them, and, as a corollary, that they are to be exempt from tax in the Member State where they are distributed, that is to say, the State of residence of the recipient parent company. The agreements thus guarantee the right of Member States and of third countries to exercise their tax jurisdiction in relation to the activities carried out on their territory.⁴²

113. Nor, moreover, is it alleged, as has been noted above, that the exemption regime fails to ensure that foreign-sourced dividends are not subject to a series of charges to tax.⁴³

114. The fact remains, as I have stated, that the exemption regime for foreign-sourced dividends entails a disadvantage in relation to the set-off regime applicable to nationally-sourced dividends. This disadvantage, which may be described as inevitable, must none the less be placed in the very specific context in which it arises and which distinguishes the case in the main proceedings from all the cases which have hitherto come before the Court, whether those cases concern the tax treatment of dividends or the setting off of losses within groups of companies.⁴⁴

115. First of all, the twofold regime for taxing the dividends at issue in the case in the main proceedings is the reverse of the regimes which have hitherto been before the Court. It is the foreign-sourced dividends which benefit from an exemption regime and the nationally-sourced dividends which are subject to a set-off regime. The fact that in this case foreign-sourced dividends escape all taxation in Germany radically alters the terms of the comparison to be made in order to determine whether the two regimes are equivalent.

116. Moreover, it must be borne in mind that the set-off regime at issue in the main proceedings includes a classic mechanism for offsetting losses of a parent company against the profits distributed by its subsidiary; this forms part of the further classic mechanism of setting off the corporation tax paid by the subsidiary against the corporation tax to be paid by the parent company with a view to avoiding the economic double taxation of dividends. The interplay of these two mechanisms constitutes, however, the specific nature of the present case and lends it its great complexity.

117. In this connection, it must be emphasised that it is not the losses of a non-resident subsidiary which are set off against the basis of assessment of a resident parent company, thus reducing the latter's taxable profit.⁴⁵ Here, it is the losses of the resident parent company which, by being taken into account for tax purposes under a set-off mechanism, enable a refund to be obtained of the tax paid previously by its resident subsidiary on the dividends.

41 — See, in this connection, inter alia, OECD, *Addressing Base Erosion and Profit Shifting*, 2013 p. 37.

42 — See, to that effect, *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 56; *Test Claimants in the Thin Cap Group Litigation*, paragraph 75; Case C-182/08 *Glaxo Wellcome* [2009] ECR I-8591, paragraph 82; Case C-284/09 *Commission v Germany* [2011] ECR I-9879 paragraph 77; and Case C-371/10 *National Grid Indus* [2011] ECR I-12273, paragraph 46.

43 — That is an essential difference from the situation which the Court had to deal with in the case which gave rise to the judgment in *Haribo Lakritzen Hans Riegel and Österreichische Salinen*, paragraphs 158 and 163.

44 — See, in that regard, the Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee of 19 December 2006, *Tax Treatment of Losses in Cross-Border Situations* (COM(2006) 824 final).

45 — See, inter alia, Case C-446/03 *Marks & Spencer* [2005] ECR I-10837; A; *Lidl Belgium*; and *Haribo Lakritzen Hans Riegel and Österreichische Salinen*.

118. That is the context in which it is necessary to appraise the disadvantage affecting foreign-sourced dividends complained of by KII, which is the counterpart of the advantage enjoyed by nationally-sourced dividends.

119. The resident parent company is refunded the amount of tax on dividends which has been paid by its resident subsidiary when the dividends distributed by the subsidiary do not cover the parent company's losses. The refund to the parent company is thus, as the Commission points out, directly linked to the taxation of the subsidiary, and occurs only as a result of such taxation. Where the aggregate constituted by the parent company and its subsidiary have made no profit on its territory, the Federal Republic of Germany thus foregoes its right, in its dual capacity as the Member State of residence of the parent company and subsidiary and the Member State in which the profits arise,⁴⁶ to levy any tax on the dividends.

120. The situation is quite different under the exemption regime. The dividends distributed to a resident parent company by the non-resident subsidiaries are not taxed in Germany, but in the States in which those subsidiaries are established, pursuant to double taxation agreements and in conformity with the guiding principles of international tax law. Accordingly, there can be no link between the prior taxation of the subsidiary and the later refund to the parent company.

121. Consequently, if Germany were required, in its capacity as the State of residence of the parent company, to refund to the latter the tax on dividends levied by the Member States or third countries in which its subsidiaries are established, acting in their capacity as the States in which the profits arise, that would break the symmetry that must exist between the right to tax profits and the possibility of deducting losses,⁴⁷ and would irremediably affect both the overall coherence of the system of taxation of dividends and the allocation of the power of taxation resulting from double taxation agreements entered into by the various Member States and third countries concerned.

3. Conclusion

122. It follows from the foregoing that the difference in treatment under German tax legislation between foreign-sourced dividends, which are exempt, and nationally-sourced dividends, which are subject to a set-off regime, is justified. That being so, there is no need to distinguish between dividends from subsidiaries and those from second-tier subsidiaries, which forms the subject-matter of the third question. Nor, *a fortiori*,⁴⁸ is there any reason to distinguish dividends originating in other Member States from those originating in third countries, which forms the subject-matter of the fourth question.

123. Accordingly, it is not necessary specifically to answer the third and fourth questions in terms differing from the answer to the second question.

124. Consequently, I propose that the Court should reply to the second, third and fourth questions by ruling that the Treaty provisions on the free of movement of capital must be interpreted as not precluding legislation of a Member State, such as that at issue in the main proceedings, which does not permit the setting off and refund of corporation tax paid by the subsidiaries and second-tier subsidiaries of a resident company which are established in other Member States, EEA States or third countries when that company makes losses, although such set-off is provided for in the case of resident subsidiaries and a refund may be made in the event of losses.

46 — On that distinction, see *Test Claimants in Class IV of the ACT Group Litigation*, paragraphs 56 to 66.

47 — See *Lidl Belgium*, paragraph 33; *National Grid Indus*, paragraph 58; and *Philips Electronics UK*, paragraph 24.

48 — On the difference between the intra-Community and extra-Community aspects of the free movement of capital, see *Test Claimants in the FII Group Litigation I*, paragraph 170; *A*, paragraph 60 et seq.; *Orange European Smallcap Fund*, paragraphs 89 and 90; *Test Claimants in the CFC and Dividend Group Litigation*, paragraph 92; and Joined Cases C-439/07 and C-499/07 *KBC Bank and Beleggen, Risicokapitaal, Beheer* [2009] ECR I-4409, paragraphs 71 and 72.

VII – Conclusions

125. I therefore propose that the Court reply to the questions referred for a preliminary ruling by the Finanzgericht Köln as follows:

- (1) EU law must be interpreted as meaning that the compatibility of the legislation of a Member State on taxation of dividends which is applicable to any shareholding above 10% may be examined in the light of the free movement of capital where the shareholdings at issue enable the holder to exert a definite influence on the companies' decisions and to determine their activities, in so far as that legislation does not seek to govern the conditions for access of companies from that Member State to the market in the other Member States or third countries or of companies from the other Member States and third countries to the market in the first mentioned Member State.
- (2) The Treaty provisions on the free movement of capital must be interpreted as not precluding legislation of a Member State, such as that at issue in the main proceedings, which does not permit the setting off and refund of corporation tax paid by the subsidiaries and second-tier subsidiaries of a resident company which are established in other Member States, States which are party to the Agreement on the European Economic Area or third countries when that company makes losses, although such set-off is provided for in the case of resident subsidiaries and a refund may be made in the event of losses.