ARGENTA SPAARBANK 2: DEDUCTION RULES FOR RISK CAPITAL CHALLENGED AGAIN

Dr Tom O'Shea[1]

In *Argenta Spaarbank NV v Belgische Staat* ("*Argenta Spaarbank 2*"),[2] the Court determined that new Belgian rules concerning deductions for risk capital were not in breach of the freedom of establishment. The Court sent the matter back to the national referring court to verify whether the cross-border situation was not treated less favourably than a purely domestic situation.

Part 1

Background

Article 205a of the Belgian Income Tax Code 1992 (Wetboeck van de inkomstenbelastingen 1992), as amended, provides the basis of assessment for determining the amount of taxable income to be reduced by a deduction for risk capital. The deduction is equal to the risk capital multiplied by a rate contained in Article 205c. The risk capital to be taken into account is the amount of the company's equity capital at the end of the previous tax period.

In 2013, the CJEU determined that Article 49 TFEU precluded national legislation which failed to take into account the net value of the assets of a permanent establishment situated in another Member State when the profits of that permanent establishment were not taxable in Belgium, whereas the assets of a permanent establishment situated in Belgium were taken into account for that purpose.

1 Dr Tom O'Shea is the Director of the Academy of European and International Taxation, London. He may be contacted at tom@drtomoshea.com. Comments on this article are welcome.

2 *Argenta Spaarbank NV v Belgische Staat* ("*Argenta Spaarbank 2*") C-459/18, ECLI:EU:C:2019:871.

Consequently, the Belgian rules at issue in that case were amended by Article 205d which provides that (paragraph 12 of *Argenta Spaarbank 2*) –

> "When, in another Member State of the European Economic Area, the company has one or more permanent establishments, immovable property or rights in respect of such immovable property not belonging to a permanent establishment the income from which is exempt under a double taxation convention, the deduction determined in accordance with Article 205a shall be reduced by the lesser of the following two amounts:
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> 1° the amount determined in accordance with subparagraph 3;
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> 2° the positive result of those permanent establishments, that immovable property and those rights in respect of such immovable property …"

Argenta Spaarbank NV ("Argenta") is a company established in Belgium with a permanent establishment in the Netherlands. The income of this permanent establishment was exempt in Belgium under the Belgium-Netherlands Double Tax Convention.

The corporation tax in Belgium was calculated as follows. First, the amount of the deduction for risk capital relating to Argenta's permanent establishment was calculated. This result (EUR 1.97m) was compared with the positive result of that permanent establishment (EUR 149.185m). Lastly, the deduction for risk capital relating to the permanent establishment (EUR 1.97m) was deducted in full from the total deduction for risk capital because the positive result of the permanent establishment was higher than the deduction for risk capital relating to that establishment.

Argenta objected to its tax assessment and the matter came before the Court of First Instance, Antwerp, Belgium ("Rechtbank van eerste aanleg te Antwerpen") which referred a preliminary ruling to the CJEU.

Restriction on the Freedom of Establishment

The CJEU indicated that the net value of the assets of the cross-border permanent establishment was taken into account, initially, in the calculation of the deduction for risk capital granted to the Belgian resident company, but subsequently, the amount of the deduction was reduced by the lesser of (i) the deduction for risk capital which relates to the foreign permanent establishment or (ii) the positive result generated by the permanent establishment. The Court noted that this reduction did not apply in the case of a resident company with a permanent establishment in Belgium.

Recalling its earlier judgment in *Argenta Spaarbank 1,* [3] the Court explained that, in paragraphs 38-40, that –

> "The Court has already held … that the taking into account of the assets of a permanent establishment in order to calculate the deduction for risk capital of a company subject to corporation tax in Belgium also constitutes a tax advantage, since taking them into account helps to reduce the effective rate of the corporation tax that such a company must pay in that Member State …
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> The national legislation at issue … now provides that the net value of the assets of a permanent establishment situated in another Member State, the income from which is exempt in the Member State of the resident company under a double taxation convention, is to be taken into account, initially, in the calculation of the deduction for risk capital granted to the resident company…
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> A difference in treatment cannot therefore be found in that respect between a company with a permanent establishment in Belgium and a company with a permanent establishment situated in another Member State, the income from which is exempt in Belgium under a double taxation convention, in so far as both the assets attributed to the permanent establishment situated in Belgium and those attributed to the permanent establishment situated in another Member State are taken into account in the calculation of the overall deduction for risk capital granted to the resident company".

Consequently, in relation to this aspect of the case, the CJEU determined that there was no restriction on Article 49 TFEU.

The Court then went on to examine the reduction in the deduction for risk capital involving a cross-border permanent establishment whereas there was no such reduction in relation to a Belgian permanent establishment. The Court accepted that the Belgian legislation established a difference in tax treatment between the cross-border and purely domestic situations. Accordingly, it had to investigate whether this difference in tax treatment constituted a restriction on the freedom of establishment.

Three Scenarios

The Court noted that three scenarios were possible under the Belgian rules. In each situation, the income from the permanent establishment situated in another Member State was exempt from taxation in Belgium under a double tax convention.

3 *Argenta Spaarbank 1*, C-350/11, EU:C:2013:447, para. 24. For analysis by this author, see Tom O'Shea, "Belgian Notional Interest Deduction Rules Challenged Before the ECJ", Tax Notes International, Mar. 10, 2014, 915-919.

First, where the permanent establishment situated in another Member State did not generate a positive result and the overall deduction for risk capital was not reduced. In this situation, the resident company with the cross-border permanent establishment was not treated less favourably than a resident company with a permanent establishment in Belgium. This was a matter for the national court to verify.

The second scenario occurred when the permanent establishment that was established in another Member State generated a positive result that was lower than the part of the deduction for risk capital which related to that permanent establishment. This resulted in the overall deduction for risk capital being reduced, but the part of the deduction for risk capital which exceeded the positive result of the permanent establishment was taken into account. The Court noted, in paragraph 49 of *Argenta Spaarbank 2,* that –

> "The resident company's basis of assessment is therefore reduced by the amount of the deduction for risk capital which relates to that permanent establishment only to the extent that that amount exceeds the positive result of that permanent establishment".

In the third situation, the permanent establishment generated a positive result which exceeded the part of the deduction for risk capital that related to the permanent establishment. In such circumstances, the amount of deduction for risk capital relating to the permanent establishment does not result in any reduction of the Belgian company's basis of assessment.

Consequently, the Court concluded, in paragraph 51, that –

> "in the second and third situations … the overall deduction for risk capital is reduced when the resident company has a permanent establishment situated in another Member State, the income from which is exempt in Belgium under a double taxation convention, unlike situations where a permanent establishment is situated in Belgium".

Disadvantageous Tax Treatment

Next, the Court had to investigate whether the tax treatment in relation to the second and third scenarios treated the cross-border situation less favourably than a purely domestic situation (where the permanent establishment was establishment in Belgium).

The Court indicated, in paragraph 52, that –

> "the application of such a mechanism [must] be disadvantageous for a resident company with a permanent establishment situated in another Member State in such a way as to render, following the reduction of the overall deduction for risk capital, that company's basis of assessment higher than that

> of a resident company whose permanent establishment is situated in Belgium".

This brought into play the fact that the income from the cross-border establishment was exempt from taxation in Belgium, whereas the income from a Belgian permanent establishment was always taken into consideration in a Belgian tax assessment.

The Court highlighted that in the second scenario there was no disadvantage for the cross-border situation compared to the purely domestic. A Belgian company with a Belgian permanent establishment had its basis of assessment reduced only to the extent that the amount of deduction for risk capital relating to the permanent establishment exceeded the positive result of that permanent establishment. Therefore, such a resident company's basis of assessment was not less that a resident company with a permanent establishment established in another Member State, the income from which was exempt from tax in Belgium.

In relation to the third situation, the Court also concluded that that the cross-border situation was not disadvantaged. The Court explained, in relation to a Belgian company with a permanent establishment in Belgium, the positive result of the permanent establishment exceeded the amount of the deduction for risk capital which related to that establishment. Therefore, even if that company could make a deduction for risk capital in relation to its Belgian establishment, that did not make the cross-border situation basis of assessment higher than that of a Belgian company with a Belgian establishment.

The Court pointed out, in paragraph 57, that –

> "it must be found, subject to verifications to be carried out by the national court, that, because of the reduction of the overall deduction for risk capital, a resident company whose basis of assessment does not include the profits made by a permanent establishment situated in another Member State is not treated less advantageously, as regards taxable income in Belgium, than a resident company whose basis of assessment includes the profits of a resident permanent establishment and whose deduction for risk capital is not reduced".

The Court's Conclusion

Consequently, the Court determined that there was no restriction on the freedom of establishment in this case. This conclusion is subject to verification by the national court that the scenarios outlined above operated as analysed by the CJEU.

Part 2

Analysis

Following the *Argenta Spaarbank 1* case,[4] Belgium changed its rules concerning deductions for risk capital to comply with the Court's judgment. The *Argenta Spaarbank 2* case involves a challenge to these new rules which Argenta argued were also in breach of the freedom of establishment.

The case brings into play the interaction between the new Belgian rules concerning deductions for risk capital and Belgian double tax conventions, which exempted the income of permanent establishments of Belgian resident companies, when such establishments were established in other EU/EEA Member States. The main issue in the case is whether a Belgian company with a cross-border permanent establishment was treated less favourably under the new Belgian rules than a Belgian company with a similar establishment in Belgium.

The case is significant because the Court determined that there was no restriction on the freedom of establishment, even though the Belgian rules concerning deduction for risk capital operated in a different way in relation to cross-border situations where the foreign permanent establishment produced profits that were exempt in Belgium under a Belgian double tax convention. In such instances, the Court concluded that the basis of assessment of a Belgian company with a Belgian permanent establishment was higher than that of a Belgian resident company with a permanent establishment situated in another EU/EEA Member State since that company benefited from a Belgian double tax convention that exempted the income of the non-Belgian permanent establishment. In the former, purely domestic situation, the income of the permanent establishment located in Belgium was taken into account in determining the basis of assessment of the Belgian resident company.

The Court referred the matter back to the national court to verify whether its assessment of the three possible scenarios in this case was correct.

The Lack of a Restriction

Argenta Spaarbank 2 concerns an interaction between the new Belgian rules concerning the granting of a deduction for risk capital and Belgian double tax conventions that exempted the income of foreign permanent establishments. Thus, the Belgian rules at issue reduced or eliminated the deduction for risk capital in situations related to a permanent establishment situated in another EU/EEA Member State but

4 *Argenta Spaarbank NV v Belgische Staat ("Argenta Spaarbank 1"),* C-350/11, ECLI:EU:C:2013:447. For analysis, see Tom O'Shea, "Belgian Notional Interest Deduction Rules Challenged Before the ECJ", Tax Notes International, Mar. 10, 2014, 915-919.

not in relation to situations where a permanent establishment was established by a Belgian resident company in Belgium.

At first glance, the operation of this "deduction for risk capital" mechanism looks discriminatory because its operation may lead to the cross-border situation being treated less favourably since the deduction may be reduced or eliminated in relation to cross-border establishments only. However, the Court pointed out that it must still be determined whether that difference in tax treatment constitutes "disadvantageous treatment liable to deter a Belgian company from carrying on its business through a permanent establishment situated in a Member State other than the Kingdom of Belgium" (paragraph 43 of *Argenta Spaarbank 2*).

Having identified three possible scenarios – first, the deduction cross-border was not reduced under the Belgian rules; second, the deduction cross-border was partially reduced and third, the reduction cross-border was fully reduced – the Court stressed, in paragraph 52, that –

> " It is also necessary that the application of such a mechanism be disadvantageous for a resident company with a permanent establishment situated in another Member State in such a way as to render, following the reduction of the overall deduction for risk capital, that company's basis of assessment higher than that of a resident company whose permanent establishment is situated in Belgium".

In these circumstances, the impact of the Belgian double tax conventions had to be taken into account because they formed part of the legal background to the case. Under Belgium's double tax conventions, an exemption method was applied to the income of foreign permanent establishments. But, under domestic law, Belgium taxed the income of Belgian permanent establishments of Belgian companies. Thus, the basis of assessment in Belgium of a Belgium company included the income of its Belgian permanent establishments but not the income of its foreign permanent establishments that benefited from a Belgian double tax convention which exempted such foreign income. The Court highlighted, in paragraphs 55 and 56, in relation to the second and third scenarios discussed above, that a Belgian company with a cross-border permanent establishment did not have a higher basis of assessment than a similar Belgian company with a Belgian permanent establishment. This assessment was subject to verification by the national court.

Therefore, there was no restriction in this case since the cross-border situation was not treated less favourably from a taxation point of view than a purely domestic one.

Verification

The outcome of *Argenta Spaarbank 2* is ultimately a matter for the Belgian courts since the CJEU can only give guidance on EU law to the national referring court.

Hence, in this case, the CJEU referred the matter back to the Belgian court to determine whether its analysis of the three scenarios was correct and whether its subsequent analysis of how the Belgian tax rules at issue affected the basis of assessment of Belgian companies establishing permanent establishments in other EU/EEA Member States.

The Court's approach in *Argenta Spaarbank 2* is similar to that which it adopted in its previous cases.

Thus, in *Bouanich 1*,[5] the Court explained in paragraph 51, that –

> "Since the tax system under the Franco-Swedish agreement, as interpreted in the light of the commentaries on the OECD Model Tax Convention, forms part of the legal background to the main proceedings and has been presented as such by the national court, the Court of Justice must take it into account in order to give an interpretation of Community law that is relevant to the national court. It is not for the Court to interpret national law or to assess its application in the present case …"

Under the Swedish-French double tax convention, Bouanich was entitled to be taxed at the maximum rate of 15% on the deemed dividend with a deduction for the nominal value of the shares that were repurchased, whereas a Swedish resident making the same investment would be taxed on the receipt of a capital gain related to the share repurchase at the rate of 30% with a deduction for the acquisition cost of the shares. The CJEU highlighted, in paragraphs 53-55, that –

> "it must be ascertained whether those shareholders are treated more favourably than non-resident shareholders. In order to do this, it is necessary to know the cost of acquisition of those shares as well as their nominal value…
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> In that regard, it must be recalled that the assessment and finding of the facts in a case are not matters for the Court of Justice but for the national court …
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> It is therefore a matter for the national court to determine in the proceedings before it whether the fact that non-resident shareholders are permitted to deduct the nominal value and are liable to a maximum tax rate of 15% amounts to treatment that is no less favourable than that afforded to resident shareholders, who have the right to deduct the cost of acquisition and are taxed at a rate of 30%".

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5 *Margaretha Bouanich v Skatteverket ("Bouanich 1"),* C-265/04, ECLI:EU:C:2006:51.

Concluding remarks

The judgment of the Court in *Argenta Spaarbank 2* is an example of an origin Member State situation, where the tax rules of that origin Member State treat a resident company with a foreign permanent establishment differently to a situation involving the creation of an origin Member State permanent establishment. In such circumstances, a fundamental freedom (establishment) is exercised and the origin Member State is obliged to comply with EU law and, in particular, respect the principle of equal treatment. The Court made this clear in its earlier case law, such as *de Groot*,[6] paragraph 94, where it indicated that –

> "as far as the exercise of the power of taxation so allocated is concerned, the Member States must comply with the Community rules … and, more particularly, respect the principle of national treatment of nationals of other Member States and of their own nationals who exercise the freedoms guaranteed by the Treaty".[7]

In *Argenta Spaarbank 2*, a double tax convention formed part of the legal background to the case because the profits of a permanent establishment situated in an EU/EEA Member State were exempt under Belgium's double tax convention with the State where the permanent establishment was situated. Therefore, as in *Bouanich 1*, discussed above, the double tax convention had to be taken into account in determining whether there was a restriction in this case. This meant that the exemption of the profits under the double tax convention might neutralise the restriction or difference in treatment that the Court identified in two of the three scenarios related to a cross-border situation. In the eyes of the Court, the restriction was neutralised in this case, but this was still a matter for the national court to determine.[8]

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6 *F.W.L. de Groot v Staatssecretaris van Financiën ("de Groot"),* C-385/00,

7 In 2018, in the *Sauvage* case, the Court confirmed that it was referring to the equal treatment principle. See *Benoît Sauvage and Kristel Lejeune v État belge ("Sauvage"),* C-602/17, ECLI:EU:C:2018:856, para. 24.

8 For a similar approach adopted by the Court, see *Amurta SGPS v Inspecteur van de Belastingdienst/Amsterdam ("Amurta"),* C-379/05, ECLI:EU:C:2007:655. For analysis, see Tom O'Shea, "ECJ Strikes Down Dutch Taxation of Dividends", Tax Notes International, Jan. 14, 2008, 103-106 at p.105.