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Proposal for a Council Directive concerning the harmonization of systems of company taxation and of withholding taxes on dividends

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Explanatory memorandum

General considerations

1. The need to harmonize systems of company taxation and withholding taxes on dividends has been pointed out by the institutions of the Community on many occasions; moreover in its resolution of 22 March 1971 on the achievement by stages of economic and monetary union,[1] the Council decided that this harmonization should form part of the first stage.

2. The differences at present existing between national legislations in this field are a constraint on the free movement of capital, which is one of the fundamental objectives of the EEC Treaty; international dividend flows are currently impeded by a series of discriminations, double taxations and complicated administrative formalities, which contribute to the separation of capital markets. Certain taxation provisions may in addition give rise to abnormal movements of capital, provoked by taxation considerations and not by the traditional financial motives.

3. It is also necessary to move towards taxation neutrality as regards conditions of competition: the need here is to reduce the present differences in the taxation of the profits of business enterprises. The adoption of a common system of company taxation would be a first step in this direction.

Company taxation

4. Studies that have been carried out have shown that only two systems merit consideration: the so-called 'classical' system, which preserves full economic double taxation of dividends, and the imputation system, which relieves this double taxation by granting a tax credit to the recipient of the dividends. This credit, which represents part of the corporation tax, can be deducted from the recipient's tax liability.

After long studies and numerous consultations, the Commission came out in favour of a common imputation system partly relieving the economic double taxation of dividends, in spite of the technical problems which the operation of such a system gives rise to in international transactions. It appears that solutions to these problems can in fact be found and that the choice of this system is justified by various advantages:

Neutrality with regard to various forms of company financing

5. The classical system, because it does nothing to relieve the economic double taxation of dividends, tends to discourage distributions and therefore favours self-financing of enterprises as against financing from outside sources. In addition, it increases the advantage of issuing loans, the interest on which is deductible from profits, rather than increasing capital through new share issues. The imputation system, on the other hand, tends to encurage distributions and to put loan and equity financing on a more equal footing.

6. Moreover the classical system, which has the effect of restricting distributions of profits and their reinvestment, through the market, in the most profitable sectors, removes investment from control by the market and prevents a better allocation of resources.

7. The encouragement of self-financing is not necessarily a bad thing in all circumstances. Nevertheless the Commission believes that in the long run it is better that the choice of means of financing should not depend on taxation considerations.

Neutrality with regard to the various legal forms of undertakings

8. One-man businesses in all the Member States and partnerships in most of them are not subject to corporation tax, but their profits are directly taxed at the level of the owner of the undertaking or the partners respectively.

Where the profits are substantial, such people more often than not have to pay personal income tax at the maximum rate, which may be appreciably above that of corporation tax.

The wider the gap between the rates, the more such individuals and partnerships are at a disadvantage

[1] OJ C 28 of 27.3.1971.

compared to companies with regard to ploughed-back profits. (As regards distributed profits, on the contrary, joint-stock companies are at a disadvantage.)

Owing to a higher rate of corporation tax,[1] the gap under the imputation system is smaller than under the classical system. The imputation system is therefore more neutral.

Fairness of taxation

9. From the angle of fairness of taxation, the following comments may be made:

With regard to the taxation of dividends, the classical system, by involving economic double taxation, has the effect of making shareholders whose rate of personal income tax is low subject to a tax burden which is heavier relatively than that of shareholders whose rate of personal income tax is high. This tax burden may appear excessive in respect of fairness of taxation; the tax credit system has the effect of reducing it.

Under the classical system, the interest of the major shareholders, who frequently determine a company's distribution policy, lies far more in self-financing than in distribution, which costs them too much. The classical system is therefore to their advantage when profits are ploughed back.

On the other hand, the at times excessive self-financing induced by the classical system is disadvantageous to the small shareholders, who have a particular interest in the yield from their shares. It therefore follows that the imputation system, which tends to encourage distributions and relieves the economic double taxation of them, reduces the small shareholders' disadvantage.

Tax avoidance by persons with large tax liabilities

10. Because the classical system does not give relief for distributed profits, the corporation tax rate, applying to non-distributed as well as distributed profits, is lower under it than under the imputation system on the assumption that the total tax yield remains the same. Where the rate of corporation tax, as under the classical system, is appreciably lower than the maximum rate of personal income tax, it is highly tempting for very rich taxpayers to have any income they wish to save paid into a company set up for this purpose which they completely control: the company will accumulate the income so that it is taxed at a rate not exceeding that of corporation tax. The imputation system, with its higher rate, is less likely to encourage such taxpayers to use this form of tax avoidance.

Development of the share market

11. It appears that the development of the share market will increasingly depend in the long run on whether or not funds are invested by medium-scale savers and even by those whose savings are modest. It will be increasingly difficult for the market to continue to develop in this way if tax arrangements discourage dividend distributions and penalize shareholders with low rates of personal income tax. In this connection, the imputation system seems more likely to attract new classes of saver to the share market.

12. In international relations the classical system operates relatively simply and very largely succeeds in avoiding distortions. This is its greatest advantage. Under the imputation system, in order to avoid any discrimination, it is necessary for all a company's shareholders, whatever the Member State in which they reside, to receive the tax credit attaching to that company's dividends. Transferring the tax credit across frontiers, however, may involve technical difficulties, especially where an indirect shareholder is concerned, that is to say where the dividend reaches the final shareholder through the intermediary of a parent company.

The Commission considers, however, that its proposals go sufficiently far in reducing these difficulties, which are in any case largely outweighed by the advantages of the system.

Withholding tax on dividends

13. The tax credit granted to the recipient of dividends under an imputation system has the effect of a withholding tax; like a withholding tax, it is a pay-

[1] Point 10.

ment on account of the recipient's final tax liability. The question then arises whether there is any need for withholding tax to complement the proposed company taxation system.

In the Commission's view, a withholding tax is essential to discourage tax evasion. The tax credit provided by Article 8 represents a deduction at source of about one-third of the taxable income. It is not enough to ensure fairness of taxation, since many shareholders have an appreciably higher personal tax rate. At a time when the Community is concerned to combat tax evasion, it is essential to have a higher total deduction at source. For this reason the Commission proposes the introduction of a withholding tax of 25 % of the distributed dividend, which has the effect of raising the total deduction at source to the region of 50 % of the taxable income.

Comments on certain articles

Article 2

14. The first three definitions refer to the proposed Directive on parent-subsidiary relationships[1] and the fourth to the proposed Directive on mergers.[2]

15. The definition of 'corporation of a Member State' excludes bodies that are not subject to corporation tax in a Member State.

16. The adoption of the definition of 'parent corporation' found in the proposed parent-subsidiary Directive[1] means that if a State avails itself of the right therein provided to treat any of its corporations as parent corporations even when their participation is less than 20 %, then the national definition of parent corporation is determinant. It follows that the provisions in the present proposed Directive that relate to parents and subsidiaries will have to be applied.

17. The definition of dividends given here is intended to oblige Member States to treat all payments so defined in the manner laid down in the Directive. This definition excludes in particular distributions of profits or surpluses arising on liquidation, because the view taken of them differs too much from one State to another. Member States nevertheless retain freedom to grant tax credit on dividends which are outside the scope of the common definition. There appears to be little likelihood that the exercise of this freedom will lead to serious distortions.

18. Paragraph 2 is intended to enable Member States to settle for themselves the problems posed by dividends which are transmitted through financial intermediaries of the 'unit trust' type until harmonization is brought about in this field. It has always been accepted that the taxation treatment of the investment income, whether dividends or interest on securities, received and redistributed by these organizations will have to be the subject of a special technical Directive when the main principles of the harmonization have been decided.

Article 3

19. When a common imputation system is adopted it is necessary, to ensure taxation neutrality in regard to capital movements, that the rates of corporation tax and of tax credit[3] shall not vary too much from one State to another, so that they do not influence investment decisions. Paragraph 1 lays down tolerable variations and establishes the principle of a single corporation tax rate.[4]

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[1] Proposal for a Directive of the Council on the common system of taxation applicable to parent companies and their subsidiaries of different Member States, transmitted by the Commission on 16 January 1969; OJ C 39 of 22.3.1969.

[2] Proposal for a Directive of the Council on the common system of taxation applicable to mergers, divisions and contributions of assets involving companies of different Member States, transmitted to the Council by the Commission on 16 January 1969; OJ C 39 of 22.3.1969.

[3] Article 8.

[4] The normal corporation tax rates at present in force in the Member States are:
Belgium: 42 % (from 1976, therefore applied to income of 1975, the rate is 48 %).
Denmark: 37 %.
Germany (FR):
— non-distributed profits: 51 %
— distributed profits: 15 % (nominal rates) 23.44 % (effective rate).
For some years past, these rates have been increased by 3 % ('Ergänzungsabgabe': repeated for 1975 and 1976) and raised respectively to 52.33 % and 24.55 %.
France: 50 %.
Ireland: Company profits are at present subject to two taxes:
— corporation profits tax : 23 %,
— income tax : 35 %.
As the amount of the company profits tax is deductible in

20. Paragraph 2 grants States the possibility of applying a different corporation tax rate or even complete exemption in certain cases, after having consulted the Commission. For those cases already in existence before the common system comes into force, a similar information procedure is provided in Article 20.

21. Paragraph 3 permits the increase or reduction of the corporation tax rate for the purpose of regulating the economy.

Article 4

22. Paragraph 1 lays down the principle of tax credit and defines the conditions which must be fulfilled by the recipient of the dividends in order to be entitled to this credit.

Although paragraph 1 requires that the recipient shall be subject to tax, it appears possible to leave Member States freedom to grant tax credit to persons that are not subject to tax in respect of the dividends they receive but that are of public interest (for example: charitable institutions, pension funds, trade unions).

In order to avoid distortions, it is necessary that where tax credit is given it shall not be restricted to dividends of domestic origin. Paragraph 2 establishes these principles.

Article 5

23. This Article sets out the principle that as far as the recipient of the dividend is concerned the tax credit is given by the Member State to whose tax on income or profits he is subject. The right of that State to recoup itself from the source State is laid down in Article 13.

Example: A dividend of 100 has a tax credit of 50 attached to it. The taxable income is 150. If the recipient is taxable at a rate of 40 %, the amount of tax he has to pay is: 60−50 = 10. If his tax liability is less than 50, he receives payment of the difference between the tax credit and the amount of the tax. If the recipient's income does not reach the minimum amount on which tax is payable, the full tax credit is paid to him.

Article 7

24. This Article permits the granting of tax credit where the distribution does not constitute a dividend within the meaning of Article 2 but is treated as such under the law of the source State.

Article 8

25. This Article is closely related to Article 3. Its purpose is to fix tolerable limits for the tax credit rates by linking them to the normal rate of corporation tax.

26. The formula adopted in paragraph 2 covers not only the distribution of a profit taxed at the normal rate but also those cases where the distributed profit has been taxed at higher than the normal rate or a compensatory tax has been levied.[1]

27. To arrive at the tax credit rate expressed as a percentage of the amount of the dividend, the following formula is used:

$$\frac{a}{100 - a} \cdot b$$

a = the normal rate (percentage) of corporation tax referred to in Article 3, paragraph 1;
b = the rate referred to in Article 8, paragraph 2.

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arriving at the amount on which income tax is charged, the total of the two taxes represents about 50 %.
These two taxes will shortly be replaced by a single corporation tax.
Italy: 25 % (35 % for the years 1974 and 1975).
Luxembourg: 40 % (for incomes of 1 312 000 francs and above).
Netherlands: 48 %.
United Kingdom: 52 %.

[1] The present rates of tax credit and the percentages they represent of the amount of corporation tax in accordance with the formula in Article 8, paragraph 2, are as follows in the Member States which already operate an imputation system:
Belgium: 45 % of the net divided (gross less withholding tax), i.e. 36 % of the gross dividend. 49.52 % of the amount of corporation tax. This credit can only be set off against the tax charged on the dividend itself and is not repayable.
France: 50 % of the dividend, i.e. 50 % of the corporation tax.
Ireland: It is expected that under the new corporation tax system, the tax credit will be 7/13 of the dividend, i.e. 53.85 % of the corporation tax. The present system gives almost the same result in a different form.
United Kingdom: 7/13 of the dividend. Previously 33/67 of the dividend, i.e. 45.47 % of the corporation tax.

Example:
Normal rate of corporation tax = 45 %
Rate referred to in Article 8, paragraph 2 = 55 %
Rate of tax credit as a percentage of the dividend:

$$\frac{45}{100-45} \cdot 55 = 45\ \%$$

If the amount of a dividend is 550, the tax credit attached to it is 45 % of 550 = 247.5

(Profit distributed	1 000
corporation tax (45 %)	450
Dividend	550

Tax credit 55 % of 450 = 247.5).

Article 9

28. The purpose of paragraphs 1 and 3 is to limit the benefit of the tax relief to those cases where economic double taxation really exists. Since the technique of variable tax credit is not very practical and has for that reason been rejected, it is necessary to charge a compensatory tax neutralizing the tax credit where the dividends have not borne corporation tax. This is what France does by means of the 'précompte'. A similar procedure is applied where the profits have been taxed at a reduced rate.

29. The charging of a special compensatory tax is not necessary if, as in the United Kingdom, the legislation provides that every distribution of dividends gives rise to an advance payment of corporation tax equal to the tax credit. In order that this advance payment shall really play the part of a compensatory tax, it is moreover necessary that it shall not be repayable, as is indeed the case in the United Kingdom.

30. Paragraph 4 makes it possible for the States to repay the compensatory tax when the recipient is not entitled to the tax credit. In such circumstances, indeed, the compensatory tax does not appear necessary.

Article 10

31. Paragraph 1 deals with relations between parent corporations and subsidiaries in different Member States. The principle of non-discrimination requires that direct and indirect shareholders shall be treated in the same way. This means that the tax credit attached to the dividends of a subsidiary must be passed on to the shareholders of the parent when the latter redistributes those dividends. As variable tax credit is technically impractical, the shareholder in the parent corporation will receive tax credit at the rate in force in that corporation's State. To obtain the desired result, it is therefore necessary to make adjustments at the level of the parent corporation. The technique used is to set off the tax credit attached to the subsidiary's dividends against the compensatory tax or advance corporation tax of the parent at the time when the latter redistributes the dividends.

Example: A parent corporation wishes to redistribute a dividend of 100 received from a subsidiary, to which a tax credit of 41 is attached. If the tax credit rate in force in the parent's State is 50 % of the dividend, the computation proceeds as follows:

basis for compensatory tax 100+41 =141

gross amount of compensatory tax at 33⅓ %[1]	= 47
tax credit to be set off	= 41
net amount of compensatory tax	= 6

The parent corporation, which received 100, therefore has to pay 6 and redistributes a dividend of 94 to which is attached a tax credit of 50 %, i.e. 47. The taxable income of the parent's shareholders is therefore: 94+47 = 141.

A direct shareholder in the subsidiary would receive 100 and benefit from a tax credit of 41. His taxable income is also 141. The principle of non-discrimination is thus respected.

If the tax credit rate is higher in the subsidiary's State than in the State of the parent, it would be theoretically correct to pay the excess to the parent corporation. Such a procedure would, however, entail practical difficulties; for this reason it appears preferable to depart from the principle of non-discrimination and not to make such a payment.

[1] The compensatory tax must equal the tax credit. If the latter is equal to 50 % of the dividend, it only represents 33⅓ % of the taxable income, which is made up of the dividend plus the tax credit.

As quite a long time may elapse between the receipt of dividends from subsidiaries and their redistribution, the task of tracing the parent's distributions back to the various sources from which they are derived may become complicated.[1] To prevent these complications from becoming too great, the set-off of the subsidiary's tax credit against the compensatory tax is restricted to redistributions of dividends received within the last five years.

32. Paragraph 2, which deals with relations between parent corporations and subsidiaries resident in the same Member State, does not oblige the Member States to apply this corrective mechanism. This is not necessary, because in these circumstances there is no difference in the rates of tax credit.

Article 11

33. In this Article the rules laid down for subsidiaries in paragraph 1 of Article 10 are adapted to cover permanent establishments.

When a company head office distributes profits earned by a permanent establishment in another Member State:

— the permanent establishment's State grants tax credit on those profits;
— the company's State applies the compensatory tax and set-off rule laid down for dividends from subsidiaries (with the same five-year limit).

If the profits of the permanent establishment, under the laws of the State where it is situated, are regarded as untaxed, that State charges the compensatory tax or advance corporation tax payment laid down in Article 9. It can however only do so when it is ascertained that the head office, in the State where the company is resident, has distributed those profits.

Article 12

34. This Article lays down rules for establishing the origin of sums distributed as dividends, so that the compensatory tax and set-off mechanisms of Articles 10 and 11 can be correctly applied and so that the financial compensations between Member States provided by Article 13 can be carried out.

The Article establishes the principle that a company's distributions are derived in the first place from those profits that carry tax credit. This solution, which is the most favourable one for the companies, since it limits as far as possible the number of cases where the compensatory tax will be levied at the full rate, has been adopted particularly in order not to penalize companies which receive substantial profits from permanent establishments or subsidiaries in third countries.

On the other hand, no distinction is made between profits originating within the distributing company's State and those derived from other Member States, provided that they carry an entitlement to tax credit. They are all pooled and are deemed to be distributed on a strictly proportional basis. But to minimize calculations the profits of the last accounting period are treated as distributed before profits put to reserves.

Article 13

35. The purpose of this Article is to make the source State bear the budgetary cost of the tax credit and to establish the principle of financial compensations between States. If, however, any two Member States agree bilaterally to share the budgetary cost between them, there need be no objection from the Community standpoint, provided of course that the shareholder's entitlement to receive full tax credit from his own Member State is not affected. Paragraph 4 therefore gives the States this option.

36. The following is a possible procedure for granting tax credit and financial compensation in the case of a direct shareholder: The shareholder receives from the distributing company or from the paying bank a voucher, accompanying the dividend, on which it is certified that tax credit is attached to the dividend. The shareholder must attach this voucher to his tax declaration in his own State if he is to receive the tax credit there. The shareholder's State then sends these vouchers to the source State in support of the claim to financial compensation.

[1] Article 12.

37. As regards parent corporations and subsidiaries, the financial compensation is not to exceed a maximum determined by reference to the tax credit rate in force in the parent's State. The reason is that if the tax credit rate in the subsidiary's State is higher than that in the parent's State, the excess will not be paid to the parent corporation.[1]

A similar solution is adopted for profits derived from permanent establishments.

Article 14

38. Paragraph 1 establishes the principle of a withholding tax of 25 %.[2]

39. Paragraph 2 departs from this principle where a dividend is paid by a subsidiary to its parent. Since the latter is not taxable on this income, a withholding tax is not justified here.

40. Paragraph 3 allows States not to apply the withholding tax when they are in a position to identify the recipient of the dividends, the risk of evasion being then removed.

Article 16

41. Since the withholding tax is intended to be a payment on account of the final liability of the recipient of the dividend, it is natural that the tax shall be set against the final liability or shall be repaid if the recipient is not liable to pay any tax. This is laid down by the general rule in paragraph 1, which moreover provides that, to avoid complications, the repayment shall be made by the State in which the recipient is resident. This State will however be able to obtain financial compensation from the source State by virtue of the provisions of Article 17.

42. Paragraph 2 introduces an exception to the general rule in order to counter possible abuses. It applies neither to physical persons nor to corporations that are subject to corporaion tax, but only to tax-exempt bodies.

Article 17

43. This Article deals with financial compensations between States in connection with the withholding tax. It is similar to Article 13, which is concerned with compensations relating to tax credit, and is drawn up in the same spirit.

Article 19

44. The Member State of the recipient of a dividend is here given complete freedom to withhold credit if it considers that there would be an unjustified advantage if credit were given. It is apparent that Member States take different views of what constitutes an unjustified advantage, especially when a share is acquired shortly before a dividend is paid or where a share is transferred from an individual to an enterprise. If the Member State of the recipient decides to give credit, the Member State of the source is obliged to give that State financial compensation under Article 13, even if it would have refused credit under its own national rules in similar circumstances. The same applies with regard to the withholding tax.

Article 20

45. Where a parent company or a company head office distribute dividends after the date when the directive comes into force, but in such circumstances that, by virtue of paragraphs 1 and 2 of this Article, Articles 10 or 11 are not applied, the State of that parent company or of that head office can charge the compensatory tax, which will enable it to cover the cost of the tax credit attached to those dividends.

As regards the distribution of domestic profits earned before the directive enters into force, a compensatory tax or an advance payment of corporation

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[1] Article 10.

[2] For residents, the rates of withholding taxes on dividends at present in force in Member States are:

Belgium:	20 %	
Denmark:	30 %	
Germany (FR)	25 %	
France:	0 %	
Ireland:	0 %	
Italy:	10 %	(as payment on account)
	30 %	(on request, as final tax)
Luxembourg:	15 %	
Netherlands:	25 %	
United Kingdom:	0 %	

tax must in any case be charged—possibly at a reduced rate—where the distributed profits have been taxed at a rate below the lower of the two rates set out in Article 3 (1).[1]

Article 21

46. This paragraph lays down a principle of non-discrimination that is of wide and general application, since it is not limited to the treatment of tax credit or the withholding tax. A dividend received by a resident of one Member State from a source in another Member State, must not be treated less favourably than a similar dividend received from a source in the first State. The principle of non-discrimination also applies to the formalities that may be needed to establish the right of the Member State of the recipient of the dividend to obtain financial compensation from the source State.

[1] Article 9(1) second subparagraph and (3).

Proposal for a Council Directive concerning the harmonization of systems of company taxation and of withholding taxes on dividends

15-16

The Council of the European Communities,

Having regard to the provisions of the Treaty establishing the European Economic Community and particularly Article 100,

Having regard to the Proposal from the Commission,

Having regard to the Opinion of the Economic and Social Committee,

Having regard to the Opinion of the European Parliament,

Whereas the free circulation of capital within the Community and the elimination of distortions of competition are fundamental objectives of the treaty;

Whereas the present systems of company taxation and of withholding tax on dividends have the consequence that the international movements of dividends are hampered by a series of discriminations, double taxations and complicated administrative formalities which tend to reinforce the separation of financial markets; whereas furthermore certain differences that exist between these systems may give rise to abnormal capital movements;

Whereas, in order to ensure greater neutrality in the conditions of competition, it is necessary to reduce the differences that exist in the taxation of the profits of enterprises;

Whereas the harmonization of systems of company taxation and of withholding taxes is therefore essential; whereas this harmonization was moreover set out as an objective by the Council in the resolution of 22 March 1971 relating to the achievement by stages of economic and monetary union;[1]

Whereas, in so far as company taxation is concerned, the imputation system, which provides a tax credit for the recipient of dividends, is the most suitable solution for ensuring neutrality as regards not only the various forms of financing enterprises but also the various legal forms under which they may be organized, for reducing the opportunities for tax avoidance by taxpayers with large incomes and for developing the share market through attracting new savers to this form of investment; whereas it has in addition certain advantages in relation to fairness of taxation; whereas it ought therefore to be adopted as the common system;

Whereas it is necessary, for reasons of taxation neutrality, that the rates of corporation tax and of tax credit shall not differ too much from one Member State to another;

Whereas, in order to avoid discrimination, the tax credit attached to the dividends of a company ought to be granted to all the recipients of those dividends, wherever in the Community they are resident; whereas however, exceptions apart, only those recipients who are subject to a tax on income or on profits ought to be entitled to this tax credit; whereas the tax credit ought to constitute taxable income and ought to be deducted from the tax due by the recipient of the dividend and paid to him insofar as it exceeds the amount of that tax; whereas, to avoid complicated formalities, this payment ought to be made by the Member State in which the recipient is resident;

Whereas, where dividends are derived from profits that have not borne corporation tax at the normal rate, it is necessary to charge a compensatory tax or a non-repayable advance payment of corporation tax so as to offset the tax credit attached to those dividends;

Whereas, where a parent corporation redistributes dividends received from a subsidiary, the recipient of those dividends ought to be treated as far as possible as if he had received them directly from the subsidiary; whereas this principle ought also to be applied to dividends derived from permanent establishments;

Whereas in principle there are grounds for requiring the budgetary cost of the tax credit to be borne by the State where the profits from which the dividends are derived have been subjected to corporation tax; whereas nevertheless there need be no objection to Member States agreeing bilaterally to share this cost;

Whereas the tax credit plays the part of a withholding tax but whereas the rate of this credit is insufficient to discourage recipients of dividends who have large incomes from not declaring their dividends; whereas there are therefore grounds for providing a common withholding tax in order to ensure both taxation neutrality and fairness of taxation; whereas a rate of 25 % appears appropriate for this

1. OJ C 28 of 27.3.1971.

purpose; whereas it is nevertheless not necessary to charge this withholding tax where there is no risk of tax evasion;

Whereas the withholding tax ought to be simply a payment on account of the final tax liability of the recipient of the dividends; whereas in order to avoid complicated formalities, any excess of tax withheld ough to be repaid by the State in which the recipient is resident; whereas Member States must nevertheless be permitted to rectify the budgetary consequences of applying the common withholding tax system;

Whereas there are grounds for making certain transitional arrangements to facilitate the introduction in Member States of the common system of company taxation;

Whereas, in order to ensure taxation neutrality, it is essential that every Member State shall treat dividends received by its residents in the same way, wherever in the Community those dividends have their source;

Whereas the harmonization of systems of company taxation and of withholding taxes ought to be brought about at the latest on the first day of January of the third year following the date on which the present directive is adopted;

Has adopted this Directive:

I. General provisions and definitions

Article 1

1. The Member States shall adopt:

— a common imputation system of corporation tax;

— a common system of withholding tax on dividends

in accordance with the provisions of the following Articles.

2. The Member States shall not maintain or introduce any other provisions the aim of which is to effect a general reduction in the taxation of dividends alone.

Article 2

1. For the purposes of the present Directive, the expression or the term:

— 'corporation of a Member State' means any corporation which fulfils the conditions laid down in Article 2 of Council Directive No ... of ...;[1]

— 'parent corporation' means any corporation that is recognized as a parent corporation by virtue of the provisions of Council Directive No ... of ...;[1]

— 'subsidiary' means any corporation that is recognized as a subsidiary by virtue of Council Directive No ... of ...;[1]

— 'permanent establishment' means any fixed place of business recognized as a permanent establishment by virtue of the provisions of Council Directive No ... of ...;[2]

— 'dividend' means that part of the profits of any corporation of a Member State, other than a corporation in liquidation, distributed by it by virtue of a proper decision of its competent authorities and divided among its members in proportion to their rights as members of the corporation; distributions of bonus shares are not regarded as dividends within the meaning of the present directive;

— 'tax on income or profits' means any one of the following taxes and any identical or substantially similar taxes which are imposed in addition to, or in place of, the existing taxes:

Belgium:	impôt des personnes physiques – personenbelasting impôt des personnes morales – rechtspersonenbelasting impôt des sociétés – vennootschapsbelasting
Denmark:	indkomstskat selskabsskat
Germany:	Einkommensteuer Körperschaftsteuer

[1] Proposal for a Council Directive on the common system of taxation applicable to parent companies and their subsidiaries of different Member States, transmitted by the Commission on 16 January 1969; OJ C 39 of 22.3.1969.

[2] Proposal for a Council Directive on the common system of taxation applicable to mergers, divisions and contributions of assets involving companies of different Member States, transmitted to the Council by the Commission on 16 January 1969; OJ C 39 of 22.3.1969.

France:	impôt sur le revenu impôt sur les sociétés
Ireland:	income tax corporation profits tax
Italy:	imposta sul reddito delle persone fisiche imposta sul reddito delle persone giuridiche
Luxembourg:	impôt sur le revenu des personnes physiques impôt sur le revenu des collectivités
Netherlands:	inkomstenbelasting vennootschapsbelasting
United Kingdom:	income tax corporation tax.

2. The provisions of the present Directive do not concern dividends that the final beneficiary receives through the intermediary of investment funds or unit trusts.

II. Provisions relating to corporation tax

Article 3

1. Each Member State shall apply a single rate of corporation tax to the profits, whether distributed or undistributed, of its corporations. This rate, called the normal rate, may not be lower than 45 % nor higher than 55 %.

2. By way of derogation from the provisions of paragraph 1, a Member State may, in particular cases and for well defined reasons of economic, regional or social policy, apply a rate different from the normal rate or complete exemption, either permanently or for a limited period.

If a Member State wishes to avail itself of this option, it shall communicate the proposed provisions to the Commission, which shall make its views known to the Member State concerned within thirty days of the receipt of the communication. The Member State concerned shall not bring into force the provisions in question until this period has expired or after the Commission has made its views known to it.

3. Without prejudice to the application of Article 9(1) of Council Decision 74/120/EEC of 18 February 1974 on the attainment of a high degree of convergence of the economic policies of the Member States of the European Economic Community,[1] the provisions of paragraphs 1 and 2 shall not be an obstacle to the application by a Member State, for the purpose of regulating the economy, of temporary increases or reductions of corporation tax. No account shall be taken of these increases or reductions for the purpose of applying the provisions of Article 8(2).

III. Provisions relating to tax credit

Article 4

1. A dividend distributed by a corporation of a Member State shall confer on its recipient a right to a tax credit at the rate referred to in Article 8, provided:

(*a*) that he is resident in a Member State, and

(*b*) that he is subject to a tax on income or profits in such a way that the full amount of the dividend increased by the tax credit is taken into account in arriving at the amount of his taxable income or profits.

2. By way of derogation from the provisions of paragraph 1(b), the tax credit may be granted to a person resident in a Member State who is exempt from all tax on income or profits either in respect of the whole of his income or in respect of that part of it consisting of dividends, provided that the person in question is an institution which is of public interest.

If use is made of this option, the tax credit shall be granted whatever the Member State in which the dividends have their source.

3. By way of derogation from the provisions of paragraph 1(b) the tax credit may be granted to the recipient of a dividend where, for reasons of administrative convenience, final taxation is levied, whether by means of a withholding tax or other-

[1] OJ L 63 of 5.3.1974.

wise, on the amount of the dividend not increased by the tax credit.

4. The Council, acting by qualified majority on a Proposal of the Commission, shall in case of need adopt any measures necessary for the application of the provisions of paragraph 2, first subparagraph, and paragraph 3.

Article 5

The tax credit shall be set off against the amount of tax on income or profits to which the recipient of the dividend is liable. Where the tax credit exceeds that amount, the excess shall be paid to him by the Member State which charges that tax.

Article 6

By way of derogation from the provisions of Article 4(1) tax credits may, pursuant to double taxation agreements, be granted in whole or in part to persons resident in third countries. In no circumstances, however, may such persons be treated more favourably than persons resident in the Community.

The Member States shall cooperate with each other and with the Commission with a view to adopting a common position on this matter.

Article 7

If a corporation of a Member State makes a distribution of profits that does not constitute a dividend within the meaning of Article 2 to a person resident in another Member State, the provisions of Articles 4 and 5 shall apply insofar as that distribution is considered under the legislation of the first Member State to be a dividend conferring a right to tax credit.

Article 8

1. Each Member State shall fix the rate of the tax credit attached to the dividends distributed by the corporations of that State.

2. There shall be only one such rate in each Member State. It shall be determined in such a way that the tax credit shall be neither lower than 45 % nor higher than 55 % of the amount of corporation tax at the normal rate on a sum representing the distributed dividend increased by such tax.

Article 9

1. Insofar as a corporation distributes dividends derived from profits in respect of which it has not borne corporation tax, the Member State of that corporation shall charge a compensatory tax equal to the tax credit attached to those dividends.

Where the dividends are derived from profits that have borne tax at a reduced rate, the compensatory tax shall likewise be charged but may to an appropriate extent be reduced.

2. The Member States shall have power to charge the compensatory tax referred to in paragraph 1 where the dividends are derived from profits which have borne corporation tax but which have been placed to reserve for more than five years.

3. The provisions of paragraphs 1 and 2 shall not apply where the legislation of the Member State in question provides that the distribution of dividends gives rise to an advance payment of corporation tax at least equal to the tax credit, provided that this advance payment is not repayable and that it can be deducted from the corporation tax of accounting periods ended within the previous five years.

4. This compensatory tax or this advance payment in so far as it is not effectively deducted from the corporation tax of the preceding accounting period or periods, may be repaid to the recipient of the dividends if he is not entitled to the tax credit.

If use is made of this option, the repayment must be made regardless of the Member State in which the recipient of the dividends is resident.

Article 10

1. Where a parent corporation redistributes dividends received during accounting periods ended not more than five years earlier from a subsidiary

resident in another Member State, the amount of the tax credit attached to the dividends from the the subsidiary shall be included in the basis used in calculating the amount of the compensatory tax or advance payment referred to in Article 9 to which the parent company is liable and shall then be set off against the amount of that tax or advance payment, but any excess shall not be rapayable.

2. Where a corporation of a Member State is not subject to corporation tax on the dividends which it receives from a corporation of that State and it redistributes those dividends, then:

— either the set-off rule referred to in paragraph 1 shall apply; in this case, the Member State in question may authorize the set-off even if the dividends have been received during accounting periods ended more than five years earlier;

— or, by way of derogation from the provisions of Article 9(1) and (3), no compensatory tax or advance payment shall be required.

Article 11

In so far as dividends distributed by a corporation of a Member State are derived from the profits of accounting periods ended not more than five years earlier of a permanent establishment situated in another Member State,

— the profits of the permanent establishment shall confer a right to the tax credit in force in the State where the establishment is situated and the rules for corporations laid down in Article 9 shall be applied to this establishment;

— the tax credit attached to the profits of the permanent establishment shall be included in the basis used in calculating the amount of the compensatory tax or advance payment referred to in Article 9 to which the corporation is liable and shall then be set off against the amount of that tax or advance payment, but any excess shall not be repayable.

Article 12

1. For the application of this Directive, the dividends distributed by a corporation of a Member State shall be considered to be derived:

— firstly from those profits of the last completed accounting period which confer an entitlement to relief from the economic double taxation of dividends, the parts attributable to profits originating within that State, to dividends from subsidiaries in other Member States and to the profits of permanent establishments in other Member States being determined on a proportional basis;

— then, if necessary, from those profits of accounting periods ended not more than five years before the distribution which confer an entitlement to relief from the economic double taxation of dividends, the parts attributable to profits originating within that State, to dividends from subsidiaries in other Member States and to the profits of permanent establishments in other Member States being determined on a proportional basis by reference to the whole of those profits and dividends.

— then, if necessary, from those profits of accounting periods ended more than five years before the distribution which originated within that State, if they confer an entitlement to relief from the economic double taxation of dividends;

— finally, if necessary, from any other sources.

2. For the purpose of this Article, the expression 'profits which confer an entitlement to relief from the economic double taxation of dividends' means profits which, if they were distributed, would not give rise to the charging of the compensatory tax or in respect of which, if they were distributed, the advance payment of corporation tax referred to in Article 9(3) would be effectively deducted from the tax of the accounting period or of previous accounting periods, and also means the profits referred to in Articles 10 and 11.

Article 13

1. Subject to the provisions of paragraphs 3 and 4, the budgetary cost of the tax credit shall be borne by the Member State of the corporation which distributes the dividends.

2. The provisions of paragraph 1 shall also apply where the recipient of the dividends is an institution which is of public interest and which is not entitled to receive the tax credit.

3. Where a parent corporation resident in a Member State distributes dividends derived from dividends of a subsidiary resident in another Member State, the State of the subsidiary shall pay to the State of the parent corporation the amount of the tax credit attached to the dividends of the subsidiary.

This payment shall not exceed the amount which would result from applying to the dividends of the subsidiary the rate of tax credit in force in the State of the parent corporation at the date when that corporation makes its distribution.

4. Where a corporation of a Member State distributes dividends derived from the profits of a permanent establishment situated in another Member State, the State in which the permanent establishment is situated shall pay to the State of the corporation the amount of the tax credit attached to those profits.

This payment shall not exceed the amount which would result from applying to the profits of the permanent establishment the rate of tax credit in force in the State of the corporation at the date of the distribution.

5. By way of derogation from the provisions of paragraphs 1 to 4, the Member States may share the cost of the tax credit, under bilateral agreements, provided that such agreements shall in no way affect the rights of recipients of dividends as set out in the present directive.

IV. Provisions relating to the withholding tax on dividends

Article 14

1. Subject to the provisions of the conventions concluded between Member States and third countries, each Member State shall impose a withholding tax of 25 % on the dividends distributed by the corporations of that State, no matter who is the recipient of those dividends.

2. By way of derogation from the provisions of paragraph 1, no Member State shall impose a withholding tax on a dividend distributed by a subsidiary to a parent corporation resident in any Member State.

3. By way of derogation from the provisions of paragraph 1 of this Article, the Member States shall have power not to impose a withholding tax on the dividends distributed to their own residents:

— where the name and address of the recipient and the amount of the dividends received are automatically communicated to the taxation administration, or

— where the securities representing a corresponding share in the capital of the distributing corporation are registered in the names of the holders.

Article 15

Where a Member State imposes a withholding tax on a distribution of profits which does not constitute a dividend within the meaning of Article 2, the provisions of the present directive relating to the withholding tax shall apply.

Article 16

1. The tax withheld under Article 14 shall be set off against the amount of the tax on income or profits to which the recipient of the dividends is liable in respect of them.

The tax withheld shall be repaid to the recipient by the Member State which charges the tax on income or profits referred to in the previous subparagraph, to the extent that it exceeds the amount of that tax, or where the recipient has no net liability to tax.

2. By way of derogation from the provisions of paragraph 1, a Member State shall not repay the withholding tax to any body that is not subject in that Member State to a tax on income or profits, where it appears that such repayment would be incompatible with the principle of taxation neutrality.

The Council, acting by qualified majority on a proposal of the Commission, shall in case of need adopt any measures necessary for the application of this provision.

Article 17

1. In so far as withholding tax collected by a Member State is set off or repaid in another Member State, the State which collected the withholding tax shall refund it to that other Member State.

2. The provisions of paragraph 1 shall also apply where the tax on income or profits is deemed to correspond, or is restricted, to the amount of the withholding tax.

3. By way of derogation from the provisions of paragraph 1, the Member States may share the amount of the withholding tax, under bilateral agreements, provided that such agreements shall in no way affect the rights of recipients of dividends as set out in the present directive.

V. Provisions common to tax credit and to the withholding tax on dividends

Article 18

The provisions of the present directive shall not be an obstacle to the application of national provisions whose purpose is to reduce administrative work and which provide for the non-repayment of tax credit or of withholding tax where the sums in question are very small.

Article 19

The provisions of the present directive shall not be an obstacle to the application of national provisions whose purpose is to prevent the recipient of a dividend from obtaining an unjustified advantage and which make it possible to refuse the set-off or repayment of tax credit or withholding tax.

VI. Transitional provisions

Article 20

1. Where a parent corporation redistributes, after the date referred to in Article 22, a dividend received from a subsidiary before that date, the State of the parent corporation shall have power to charge the compensatory tax referred to in Article 9(1).

The provisions of Article 10(1) and of Article 13(3) shall apply only in the event of agreement between the Member State of the parent corporation and the Member State of the subsidiary.

2. Where a corporation of a Member State distributes, after the date referred to in Article 22, profits earned by a permanent establishment before that date, the State of that corporation shall have power to charge the compensatory tax referred to in Article 9(1).

The provisions of Article 11 and Article 13(4) shall only apply in the event of agreement between the Member State of the corporation and the Member State in which the permanent establishment is situated.

3. Within three months from the date of notification of the present directive the Member States shall communicate to the Commission particulars of the provisions referred to in Article 3(2) first subparagraph, that are in force on that date.

Within sixty days of the date of that communication the Commission shall make known to the Member States concerned its position with regard to those provisions.

VII. Final provisions

Article 21

Without prejudice to the application of the provisions of Article 92 of the EEC Treaty, a dividend distributed to a person resident in a Member State by a corporation of another Member State shall not be subjected, in the first Member State, to any less favourable taxation treatment or to any more burdensome requirement connected therewith—other than a requirement imposed by the first Member State for the purposes of Article 13 or Article 17—than if that dividend had been distributed by a corporation of the first Member State.

Article 22

1. The Member States shall bring into force the necessary legislative and administrative provisions in order to comply with the provisions of the present Directive not later than the first day of January of the third year following the year of its adoption, and shall immediately communicate them to the Commission.

2. The Member States shall ensure that the texts of any further main provisions of national law that they adopt in the field covered by the present Directive are communicated to the Commission.

Article 23

The present Directive is addressed to the Member States.

Done at ....., ... For the Council

The President