

CJEU rules on abuse and participation exemption

In the recent [Nordcurrent \(case C-228/24\)](#) judgment the Court of Justice of the European Union (CJEU) provided more clarity on the application of the participation exemption and the anti-abuse provision in the Parent-Subsidiary Directive. The CJEU ruled that it is in line with EU law for a Member State to refuse the participation exemption if the subsidiary is an artificial arrangement whose principal objective or one of its principal objectives is to obtain a tax benefit that undermines the purpose of the directive.

Background and request for a preliminary ruling

In 2018 and 2019 the Lithuanian parent company Nordcurrent group UAB (Nordcurrent UAB) received dividends from its subsidiary Nordcurrent Ltd established in the United Kingdom. Lithuania had a participation exemption for these dividends, as prescribed by the Parent-Subsidiary Directive. The Lithuanian tax authorities refused the exemption. They believed that the subsidiary was an artificial arrangement. Their conclusion was based on the fact that the UK subsidiary only had a small workforce, limited material resources and no own office space. The participation exemption was also refused pursuant to an anti-abuse provision in the Parent-Subsidiary Directive.

The Lithuanian court noted however that Nordcurrent Ltd is not a conduit company as defined by the CJEU in [the Danish judgments](#). In the past, Nordcurrent Ltd had received income from activities that it performed in its own name. The Lithuanian court further noted that the subsidiary had fulfilled a genuine function and had performed genuine activities from its incorporation in 2009 through to the years 2018 and 2019 (the years in dispute). Lastly, the Lithuanian court found that, at first glance, the subsidiary did not immediately provide a tax benefit. This was because the profits were taxed at 25% in the United Kingdom, while those same profits would be taxed at 15% in Lithuania.

The Lithuanian court therefore requested a preliminary ruling from the CJEU. The questions referred to the CJEU were:

1. Is it in line with the Parent-Subsidiary Directive to refuse the participation exemption if the parent company receives dividends from a subsidiary that, although generating its own profits – and thus not being a purely ‘conduit company’ – can nevertheless qualify as an abuse company due to the way it was set up?
2. When assessing whether there is an artificial arrangement is it permissible to only look at the situation at the time of the dividend distributions, although genuine economic activities were being performed *before* those distributions?
3. Is the qualification of the subsidiary as an ‘artificial arrangement’ in and of itself sufficient to conclude that by applying the participation exemption the parent company enjoys a tax benefit that runs counter to the aim or purpose of the Parent-Subsidiary Directive?

The CJEU's answers

Question 1

The CJEU answered that the anti-abuse provision in the Parent-Subsidiary Directive allows a Member State to not grant a participation exemption to a parent company for dividends received from a subsidiary in another Member State if that subsidiary is an artificial arrangement. The CJEU emphasized that this is only permitted if all elements of the abuse of law are met, i.e. that there must be an artificial arrangement that was set up without valid business reasons that reflect economic reality and with the principal objective or one of the principal objectives being to obtain a tax benefit that undermines the aim or the application of the directive. According to the CJEU, abuse may also be present if the subsidiary is not a conduit company and the dividends are paid out of profits generated in the subsidiary's own name.

Question 2

The CJEU answered that for the purposes of the anti-abuse provision one must not only look at the situation at the time of the dividend distribution. Previous circumstances relevant for determining whether the arrangement is artificial, must also be considered. Therefore, a Member State must not only base this on the situation existing at the date of the dividend distribution, certainly not if the subsidiary's incorporation and previous activities were business-motivated. The assessment of abuse requires a thorough analysis of all the relevant facts and circumstances surrounding all the steps of the arrangements.

Question 3

The CJEU pointed out that two elements must be demonstrated for there to be abuse of law: (1) the arrangement is artificial and (2) it was set up for the (principal) objective of obtaining a tax benefit that runs counter to the purpose of the directive. The mere circumstance that there is an artificial arrangement therefore does not suffice. The subjective element must also be examined: whether the parent company was actually using the subsidiary to obtain a tax benefit that undermines the directive. The overall tax effect of the arrangement in the relevant Member State must be assessed for this purpose. That the subsidiary is subject to a higher domestic tax rate may then be relevant for the question whether the principal objective of the arrangement was indeed to obtain a tax benefit within the meaning of the directive.

KPMG Meijburg & Co comments

This is the first judgment from the CJEU dealing with abuse and the participation exemption. What is of very practical relevance is that the CJEU has ruled that Member States may refuse the participation exemption pursuant to the anti-abuse provision in the Parent-Subsidiary Directive. When introducing the anti-abuse provision, the European Commission actually stated the opposite: that the national participation exemptions must not be affected by the anti-abuse provision. According to the European Commission, this provision only relates to the withholding exemption and not the participation exemption. In its judgment, the CJEU ignored these statements by the European Commission and found that Member States may indeed refuse the participation exemption pursuant to that anti-abuse provision.

The CJEU's answers with regard to assessing whether there is abuse all ensue from its well-known mantra that all the facts and circumstances of the case are relevant. For practical purposes, it is nevertheless relevant that the CJEU explicitly noted that in assessing whether there is abuse, more than only the circumstances at the time of the dividend distribution must be examined. What is of further practical relevance is that the CJEU noted "that the pursuit of a tax benefit that undermines the purpose of the directive" must be broadly interpreted. The circumstance that a higher CIT rate applies in the subsidiary's state is, for example, an objective fact that can be put forward as argument that the subsidiary is/was not used to pursue a tax benefit. It is now up to the Lithuanian court to rule on whether there actually is abuse in the Nordcurrent case. It is not yet known how the Dutch Ministry of Finance will react to this CJEU judgment.

If you would like to know more about this matter, feel free to contact us or your usual Meijburg tax advisor.

KPMG Meijburg & Co
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