Euro Tax Flash from KPMG's EU Tax Centre

Advocate General's Opinion in the *X* cases on the Dutch fiscal unity regime

Tax groups – Interest expenses – Foreign exchange losses – Freedom of establishment – The "per element" approach

On October 25, 2017, Advocate General (AG) Campos Sánchez-Bordona of the Court of Justice of the European Union (CJEU) published his Opinion in two corporate income tax cases referred to the CJEU by the Dutch Supreme Court (C-398/16 and C-399/16). The cases were dealt with jointly as they have a common factor, i.e. the Dutch parent company considers that the costs incurred from its relationship with its foreign subsidiaries, which cannot be deducted for corporate tax purposes, would have been deductible if it were allowed to form an integrated group with those non-resident subsidiaries. However, a tax integration scheme only applies to group companies resident in the Netherlands.

In essence, the CJEU was asked to decide whether taxpayers, despite being unable to enter into a fiscal unity with subsidiaries established elsewhere in the EU, are nevertheless eligible for benefits from separate elements of the fiscal unity regime as if a fiscal unity with foreign subsidiaries can be entered into (also referred to as the 'per element' approach).

In the first case, the AG concluded that the Dutch interest deduction limitation is contrary to the freedom of establishment. With regard to second case, which deals with the deduction of foreign exchange losses on EU participations, the AG concluded that there is no violation of EU law.

The interest deduction case

Background

Case C-398/16 concerns a Dutch company that borrowed funds from the Swedish top holding company of a group of which it was a member and then used those funds to make a share contribution in an Italian subsidiary. The subsidiary, in turn, used these funds to purchase shares in another Italian company, previously owned by third parties. In dispute was the application of Section 10a of the Netherlands Corporate Income Tax Act 1969 ("CITA"), based on which the Dutch tax authorities denied the deductibility of the interest cost paid by the Dutch entity to the Swedish lending company, i.e. expenses related to a loan from a related entity for the purposes of making a contribution in another related entity. The Dutch borrower argued that its freedom establishment has been limited as the interest would have been deductible if it had been allowed to form a fiscal unity with its Italian subsidiary – Section 10a of the CITA would not apply in those circumstances.

The AG's Opinion

The AG firstly noted, based on the CJEU's judgments in the *X Holding* (C-686/13) and – to a lesser extent – the *Groupe Steria* (C-386/14) cases, that the situation of a parent company wishing to form a fiscal unity with a non-resident subsidiary and the situation of a parent company wishing to form a single entity with a domestic subsidiary are objectively comparable from the perspective of the "per element" approach. The AG also noted that the treatment afforded to the comparable situations is undeniably different and therefore liable to represent a breach of EU law. The question then arises as to whether there is a justification for the difference in treatment, i.e. an overriding reason in the public interest.

The referring court and the Dutch government cited the coherence of the Netherlands tax integration scheme as a justification, but the AG did not find sufficient support for this argument. According to the AG, the Dutch government's arguments were not detailed enough or were too general. As regards the Netherlands government's comments on the use of the interest deduction limitation as a tool to fight against tax evasion, the AG noted that the likelihood of tax evasion is the same in a purely internal case as it is in a cross-border situation and that the same check can be carried out in both situations; therefore, this argument is not acceptable as a justification for discrimination. The AG therefore concluded that national legislation, which allows the deduction of interest paid in respect of a loan associated with a capital contribution made to a local subsidiary but disallows the deduction if that subsidiary is located in another EU Member State, is contrary to the EU freedom of establishment.

The currency losses case

Background

The second case (C-399/16) concerns a Dutch parent company of a fiscal unity, wishing to deduct a foreign exchange loss on a UK shareholding resulting from a group reorganization. The application of the Netherlands participation exemption rules means that such foreign exchange losses are, in principle, non-deductible. The Dutch parent company argued that the losses would have been deductible if it had been allowed to form a fiscal unity with the UK subsidiary.

The AG's Opinion

The AG noted that in this case the foreign exchange results are directly related to the value of the shares and not to the result of the investments made by the subsidiary. The AG concluded that an investment in a company established elsewhere in the EU is treated differently compared to an investment in a company established in the Netherlands and that is included in a fiscal unity. In his view, and with reference to the CJEU's judgment in the *X Holding* case, this treatment does not limit the freedom of establishment because any foreign exchange gains derived under this scenario would not be included in the corporation tax base either, i.e. the treatment is symmetrical.

EU Tax Centre comment

The AG's Opinion provides some clarity on the interpretation of previous CJEU decisions on fiscal unity regimes. In particular, the referring court interpreted the CJEU's judgment in the *X Holding* case as creating an 'all or nothing' rule with regards to a single tax entity regime, i.e. it is not permitted under EU law to choose only certain elements of such a regime. The AG clarified that an assessment of compliance with EU law should be made per element of a fiscal unity regime and that taxpayers may be eligible for benefits from separate components of such a regime.

Although the CJEU still has to render its judgments on these cases, the Dutch government has already announced emergency remedial measures by way of a letter dated October 25, 2017, which will be taken, depending on the final judgment in these cases. This is primarily due to the risk that this judgment, in light of the AG's Opinion in respect of Section 10a CITA, and the potential impact they will have on other elements of the fiscal unity regime, could lead to a considerable loss of tax revenue.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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