# Euro Tax Flash from KPMG's EU Tax Centre

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## CJEU decision on use of losses incurred in another member state

Freedom of establishment – Transfer of place of effective management – Corporate tax – Carry-forward losses – Final losses – Czech Republic

On February 27, 2020, the Court of Justice of the European Union (CJEU) rendered its decision in the case of *AURES Holdings a.s. v Odvolací finanční ředitelství* (C-405/18). The case concerned the submission of a loss-relief claim in the Czech Republic in respect of losses incurred by the company while it was resident for tax purposes in another EU Member State.

The CJEU determined that the freedom of establishment does not preclude a Member State from restricting the use of tax losses in its jurisdiction where those losses were incurred in another Member State before the transfer of a company's place of effective management.

## Background

AURES Holdings a.s. (Aures) is the successor of a company that was incorporated in the Netherlands. Aures had its place of effective management in the Netherlands, by virtue of which, was considered to be Dutch tax resident. The company incurred losses in the Netherlands in the 2007 tax year. On January 1, 2009, the company transferred its place of effective management from the Netherlands to the Czech Republic, becoming Czech tax resident from that date onwards as a result. The company retained its registered seat and entry in the commercial register in the Netherlands.

Under Czech tax law, tax losses are available to be carried-forward and offset against future profits in the five accounting periods immediately following the period in which the loss arose. This provision of Czech tax law is only applicable in respect of losses incurred in the Czech Republic.

Aures submitted a claim to deduct the losses generated in 2007 in the Netherlands against its Czech taxable profits for the 2012 tax period. In rejecting the claim and raising a corporate tax assessment against the company, the Czech tax authorities highlighted that Czech law does not allow for the deduction of a tax loss in the event of a change in tax residency and does not provide for the transfer of such a loss from any Member State other than the Czech Republic.

In its appeal, the company argued that it had exercised the freedom of establishment when transferring its place of effective management from the Netherlands to the Czech Republic and that the restriction on the utilisation of tax losses incurred in the Netherlands (which it argued could no longer be utilised in the Netherlands) amounted to an unjustified restriction on that freedom.

The Supreme Administrative Court in the Czech Republic therefore asked the CJEU whether the freedom of establishment covers a simple transfer of the place of a company's effective management from one Member State to another Member State and whether it precludes a national law from disallowing the use of a tax loss incurred in another Member State prior to the relocation of its place of business or place of management.

## The CJEU decision

In addressing the first question, the Court upheld its previous decisions and confirmed that the transfer of the place of a company's effective management from one Member State to another Member State falls within the scope of the freedom of establishment (Article 49 of the Treaty of the Functioning of the European Union), which may be relied upon to challenge the tax treatment in the Member State to which a company has relocated. The Court noted that the exclusion of a loss incurred by a company before it transferred its tax residency to the Czech Republic represented a difference in tax treatment when compared against a Czech incorporated and tax resident company that incurred losses in the same tax year. As such, this difference in tax treatment could result in a company incorporated in a Member State being dissuaded from transferring its place of effective management to another Member State to pursue its economic activities there. This difference potentially represented a restriction on the freedom of establishment which could only be permissible if it related to cases which are not objectively comparable or if it is justified by an overriding reason in the public interest.

The Court determined that, in light of the aims of the disputed national provisions – the preservation of the allocation of taxing rights and the prevention the risk of double deduction of losses – a company which has incurred a loss in a Member State was not in a comparable situation to a company which had transferred its place of effective management to that host Member State and was seeking to utilise losses incurred in its Member State of origin. In reaching its decision, the Court noted that the Czech Republic had not asserted taxing rights over the claimant company in the period in which the loss was incurred as the company was resident in the Netherlands for tax purposes and did not have a permanent establishment in the Czech Republic at that time.

On this basis, the Court found that the freedom of establishment does not preclude the national legislation of a Member State from excluding the possibility for a company, which has transferred its place of effective management and, as a result, its tax residency to that Member State, from claiming a tax loss incurred, prior to that transfer, in another Member State, in which it has retained its registered seat.

## EU Tax Centre comment

It is interesting to note that the CJEU draws a parallel between the Aures case and its existing case law on exit taxation (e.g. in the *National Grid Indus* case C-371/10). The Court re-iterated that, while EU law protects the freedom of establishment, that freedom does not guarantee that the transfer of a company's tax residency between Member States will be tax neutral and should not be understood to mean that a Member State has to adjust its tax rules so as to eliminate disparities in comparison to another Member State, whether those disparities lead to a tax advantage or not. Similarly to the conclusion that EU law does not preclude a Member State from taxing unrealised capital gains upon a taxpayer's exit from its jurisdiction, it also does not require a Member State to take into account losses that were incurred prior to a company's entry into that states taxing jurisdiction.

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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