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CJEU rules Netherlands fiscal unity regime incompatible with EU law

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The Court of Justice of the European Union (CJEU) issued a decision on 12 June 2014 (joined cases C-39-41/13), concluding that the fiscal unity regime in the Netherlands Corporate Income Tax Act is incompatible with the freedom of establishment principle in the Treaty on the Functioning of the European Union (TFEU) and that there is no valid justification for the regime. The CJEU decision generally follows the opinion issued by Advocate General Kokott on 27 February 2014.

The fiscal unity regime allows a group of companies to file a single tax return and to calculate Dutch corporate income tax on a consolidated basis. However, fiscal consolidation is not allowed between a Dutch parent and its Dutch second (or lower) tier subsidiary held by one or more EU intermediary companies, nor is it possible for two Dutch subsidiary companies held by an EU parent company to form a fiscal unity between themselves.

The CJEU specifically held that EU law is violated to the extent the Dutch rules:

- Allow domestic parent companies to form a fiscal unity with their domestic sub-subsidiaries only where the intermediary subsidiary also is established in the Netherlands or where it is established in another EU member state but has a permanent establishment (PE) in the Netherlands; and
- Allow domestic subsidiaries to form a fiscal unity with each other only if their parent company also is Dutch, or where the parent company is established in another member state but has a Dutch PE.

Overview of fiscal unity regime

Fiscal unity status offers several benefits: entities within the group can offset profits and losses; intragroup transactions are ignored; and tax compliance is facilitated because the group can submit a consolidated tax return. Since only one company will exist for Dutch corporate income tax law purposes, losses incurred by one company in the fiscal unity can be offset against the profits of another company.

The following requirements must be met to form a fiscal unity:

- The head of the fiscal unity must hold at least 95% of the shares of each entity in the group;
- The companies to be consolidated must have a qualifying legal form;
- The companies to be consolidated must be resident in the Netherlands (this includes a Dutch PE of a foreign company);
- All companies in the fiscal unity must use the same financial year and the same rules for the determination of their profits; and
- A fiscal unity request must be made by all participating companies.

Indirectly held companies can be included in a fiscal unity, provided all intermediary companies are included. As a result, in practice, a fiscal unity can exist only between a Dutch parent company and its sub-subsidiary if the indirectly held company is at least 95% held (directly) by another Dutch entity and the intermediary company is included in the fiscal unity. A similar rule exists for sister companies, i.e. sister companies can form a fiscal unity only if the connecting joint parent company (and potential other intermediary companies) are included in the fiscal unity.

Background on joined cases

The three joined cases relating to the Dutch fiscal unity regime involve different group structures, but have the common feature that some companies in the group are established in another EU member state. The cases primarily involved two fact patterns:

- A Dutch resident company held 100% of the shares of another EU company that, in turn, held 100% of the shares in a second Dutch resident company; and
- Two Dutch resident sister companies were held by a joint parent company resident in another EU member state.

In all of the cases, the fiscal unity request was limited to the Dutch resident companies—the connecting EU companies and the nonresident parent company were not included.

The specific details of the two fact patterns are as follows:

1) A Dutch parent company held 100% of the shares of its German subsidiary that, in turn, held 99% of the shares of a Dutch subsidiary. The parent submitted a request to the Dutch tax authorities to form a fiscal unity with its Dutch (second-tier) subsidiary, but without the German intermediary company. The tax authorities denied the request because the German intermediary was not included in the fiscal unity. As noted above, Dutch corporate income tax law requires that *all* intermediary companies be included in a fiscal unity. In the case, the intermediary company could not be included because it was a resident of another EU member state and did not have a PE in the Netherlands.

2) Three sister companies established in the Netherlands were held, directly or indirectly, by a common German parent company that did not have a PE in the Netherlands. The sister companies filed an application to form a fiscal unity without the German parent. The application was denied for the same reasons as above.

The situation in 1) is similar to the fact pattern that led to the 2008 CJEU decision in the *Papillon* case, which involved France's tax consolidation regime. Under French rules, a parent company could form a group to consolidate the profits and losses of group companies and, like under Dutch tax law, the French rules required all companies in the consolidated group to be resident in France and any intermediary companies to be part of the group (meaning they must be French resident companies). The French parent in *Papillon* held 100% of the shares in its French sub-subsidiaries through its Dutch intermediary company. The French tax authorities denied the consolidation of the French sub-subsidiaries. The CJEU concluded that a denial of a tax consolidation in this situation violated the freedom of establishment principle because, had the intermediary company been a French resident company, the results of the French parent company and its sub-subsidiary could have been consolidated (including the results of the French intermediary company).

Following the *Papillon* decision, the European Commission initiated an infringement procedure against the Netherlands on the grounds that Dutch law denying a fiscal unity between two sister companies (that does not involve a joint parent company that is a resident of another EU member state) infringed EU law. At the same time, a similar case was brought before the Dutch lower tax courts.

When the joined cases were appealed to the Second Instance Tax Court of Amsterdam, the taxpayers argued that the denial of a fiscal unity between the Dutch parent and its resident second (or lower tier) subsidiary, or between Dutch sister companies, is incompatible with the freedom of establishment. The Amsterdam court referred the cases to the CJEU to determine whether the denial of a fiscal unity in these circumstances violates EU law.

CJEU decision

The CJEU decision generally follows the *Papillon* ruling by concluding that the Dutch fiscal unity rules are incompatible with EU law.

The Dutch tax authorities rejected the fiscal unity applications in the joined cases based solely on the grounds that the connecting company was not resident in the Netherlands. The EU companies, however, were not allowed to be included in the fiscal unities. The CJEU considered it irrelevant that, in a purely domestic situation with Dutch connecting companies, it also would not have been possible to form a fiscal unity between the Dutch resident parent and its sub-subsidiary or between the Dutch sister companies. In those cases, however, the CJEU noted that it at least would have been possible to form a fiscal unity by including the connecting entities; this would not have been possible where the connecting entity is established in another EU member state.

The CJEU rejected the arguments that the restrictions of the freedom of establishment of both the domestic parent companies and the intermediary foreign subsidiaries could be justified by an overriding reason in the public interest. The governments of several EU member states had argued that the risk of double loss deductions and the need to maintain coherence of the tax system were sufficient reasons to justify the Dutch regime. (Double loss relief would be possible if a sub-subsidiary had operating losses that could be offset against the profits of the parent company if a fiscal unity was granted (loss compensation 1). This could lead to a deduction for the decrease in the value of the sub-subsidiary by the EU intermediary company (loss compensation 2) and, subsequently, to a deduction of the value of the EU intermediary company at the level of the parent

company (loss compensation 3).) The CJEU held that the risk of double loss relief and coherence of the tax system could not constitute a justification.

Comments

The CJEU's conclusion on the Dutch fiscal unity regime was expected. The Netherlands Ministry of Finance has not yet announced whether or how the fiscal unity decree will be amended. In principle, however, a fiscal unity now will be extended to include indirectly held Dutch resident entities with an EU connecting company, regardless of whether the connecting company is a joint parent or an intermediary company. Whether the principles of the CJEU decision also will be extended to situations in which the connecting company is a third country (i.e. a non-EU) resident entity is uncertain, although it appears unlikely.

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