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International Tax

European Union Tax Alert

28 February 2014

AG Kokott opines Netherlands fiscal unity regime incompatible with EU law

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AG Kokott of the Court of Justice of the European Union (CJEU) issued an opinion on 27 February 2014 (joined cases C-39-41/13), recommending that the CJEU declare the fiscal unity regime in the Netherlands Corporate Income Tax Act incompatible with the freedom of establishment principle in the Treaty on the Functioning of the European Union. Specifically, the AG ruled that EU law is violated to the extent the Dutch rules (1) allow domestic parent companies to form a fiscal unity with their domestic "sub-subsidiaries" only when 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 (2) allow domestic subsidiaries to form a fiscal unity with each other only if their parent company also is Dutch or where the parent is established in another member state but has a Dutch PE.

Overview of fiscal unity regime

Under the Dutch fiscal unity regime, two or more companies can be treated as a single taxpayer if certain requirements are met. Fiscal unity status offers a number of benefits: (1) entities within the group can offset profits and losses against each other; (2) intragroup transactions are ignored; and (3) 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, the profits and losses of all companies in the fiscal unity can be utilized.

The following requirements must be met for a fiscal unity regime to be formed:

- 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 request for application of the regime must be made by all participating companies.

Indirectly held companies can be included in a fiscal unity, but only if all intermediary companies also are included. As a result, in practice, a fiscal unity can exist between a Dutch parent company and its sub-subsidiary only if the indirectly held company is at least 95% directly held by another Dutch entity that is included in the fiscal unity as well.

Cases

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

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

In both situations, the fiscal unity request was limited to the Dutch resident companies; the connecting EU-resident companies and the EU-resident parent company were not included. The fiscal unities were denied in each case.

The basic facts of the cases are as follows:

1) A Dutch parent company held 100% of the shares of a German subsidiary that, in turn, held 99% of the shares of a Dutch subsidiary. The Dutch parent submitted a request to the Dutch tax authorities to form a fiscal unity with its Dutch (second tier) subsidiary, without the German intermediary company being included. 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 can form a group to consolidate the profits and losses of group companies and, like Dutch tax law, the French rules require all companies in the consolidated group to be resident in France and that any intermediary companies also must be part of the group (meaning they must be French resident companies). The French parent in *Papillon* held all of the shares in its French sub-subsidiaries through a Dutch intermediary company. The French tax authorities denied the consolidation of the French sub-subsidiaries. The CJEU ruled that a denial of a tax consolidation in this situation violates the freedom of establishment principle in EU law 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 intermediary company).

When the cases brought before the Second Instance Tax Court of Amsterdam, the taxpayers argued that the denial of a fiscal unity between the Dutch parent and its resident lower-tier subsidiary is incompatible with the freedom of establishment. The court then referred the case to the CJEU to determine whether the denial of a fiscal unity between a Dutch parent company and its domestic sub-subsidiary held through an intermediary subsidiary resident in another EU member state violates EU law.

AG opinion

Basing a considerable part of her opinion on the *Papillon* decision, AG Kokott concluded that the denial of the requested fiscal unities in the joined cases is incompatible with EU law.

The Dutch tax authorities had rejected the fiscal unity applications based solely on the grounds that the connecting companies were not resident in the Netherlands (and these companies were not to be included in the fiscal unity). The AG considered it irrelevant that, in a purely domestic situation involving Dutch connecting companies, it would not have been possible to form a fiscal unity between only the Dutch resident parent company and the sub-subsidiary or between only the Dutch sister companies. In those situations, however, AG Kokott noted that it would at least have been possible to form a fiscal unity by including the connecting entities. This would not be possible where the connecting entity was established in another EU member state.

AG Kokott added that the denial of fiscal unity status would infringe an intermediary company's free choice of legal form. For example, had the EU intermediary company elected to carry out its activities in the Netherlands through a PE instead of a company, a fiscal unity between the Dutch parent company and the Dutch PE of the EU subsidiary would have been allowed.

Finally, AG Kokott 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 relief and the objective of maintaining coherence of the tax system were sufficient reasons to justify the Dutch regime. Double loss relief would be available in the following situation: the sub-subsidiary had operating losses that could be offset against the profits of the parent company if a fiscal unity was allowed (loss compensation 1); the sub-subsidiary losses could lead to a deduction by the EU intermediary company for the decrease in value of the sub-subsidiary (loss compensation 2); and this subsequently could lead to a deduction at the level of the parent company for the decrease in value of the EU intermediary company (loss compensation 3). AG Kokott disagreed, referring to existing CJEU case law, in which the CJEU has held that operating losses and losses resulting from devaluation are not the same losses and, therefore, could not lead to double loss relief. The AG also rejected the argument that coherence of the tax system would be jeopardized by accepting *Papillon*-type fiscal unities.

Comments

The CJEU still must issue its decision in the cases, which may or may not follow the opinion of the AG. The comparison between the French rules at issue in the *Papillon* case and the Dutch fiscal unity regime in the pending cases, however, is notable Should the CJEU accept the AG's opinion, the Netherlands, in principle,

will have to allow fiscal unities where an EU intermediary company exists between Dutch resident companies and/or where sister Dutch resident companies have an EU parent company.

It also is likely that, in the event of a taxpayer-favorable decision by the CJEU, the Dutch government would amend the existing fiscal unity rules. It is not likely, however, that the CJEU will extend its decision to apply to third-country situations (i.e. it will not be possible to apply the free movement of capital principle to permit fiscal unities with third country intermediary companies).

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