EU Direct Tax Newsalert

CJEU judgment on compatibility of Dutch group taxation regime with EU fundamental freedoms

On 22 February 2018, the Court of Justice of the European Union (CJEU) issued its judgment in *Joined Cases C-398/16 and C-399/16 X BV and X NV v Staatssecretaris van Financiën*. These cases, which were referred to the CJEU by the Dutch Supreme Court in July 2016, relate to the consequences of the 'per element' approach, as established by the CJEU in *C-386/14 Groupe Steria*, for the Dutch group taxation regime particularly concerning interest deductibility and currency losses. The CJEU followed the conclusion of AG Campos Sánchez-Bordona of 25 October 2017.

Case C-398/16 (interest deductibility)

This case dealt with the non-deductibility of interest on a loan received by a Dutch company from a Swedish group company to equity finance the acquisition of an Italian shareholding. The non-deductibility results from the application of Article 10a of the 1969 Dutch Corporate Income Tax Act (CITA). Within the Dutch group taxation regime, pursuant to Article 15 CITA, the acquisition would not be visible and as a result, the rule would not be applicable. The taxpayer argued that if it had been permitted to have its Italian subsidiary take part in the Dutch group taxation regime, it could have deducted the interest on the loan. Because the right to take part in a Dutch group taxation regime is however reserved for Dutch resident companies, the taxpayer argued that its freedom of establishment (Art. 49-Art. 54 TFEU) had been restricted due to the non-deductibility of interest since investing in a non-resident subsidiary was less attractive than investing in the Netherlands.

The CJEU has now ruled in favour of the taxpayer. First, in line with its judgment in *C-337/08 X Holding*, it held that there was a difference in treatment of two objectively comparable situations in light of the purpose of the Dutch group taxation regime. This amounted to a restriction on the freedom of establishment, which according to the CJEU could not be justified based on the balanced allocation of taxing rights, the need to maintain the coherence of the fiscal unity regime or the need to prevent tax avoidance and tax evasion. Consequently, the Dutch group taxation regime, in combination with the rule on interest deductibility, is in breach with EU law.

Case C-399/16 (currency losses)

This case concerned a Dutch company, which was part of a Dutch group taxation regime and which held the shares of a UK subsidiary. These shares were subsequently contributed to another UK subsidiary. As a result of exchange rate fluctuations, the Dutch company incurred a currency loss on its contributed UK subsidiary, the deduction of which was denied by the Dutch tax authorities under the participation exemption. The taxpayer claimed that, had it been permitted to have its UK subsidiary take part in the Dutch group taxation regime, it would have been able to deduct the currency loss incurred. Because that right was however reserved for Dutch resident companies, the taxpayer argued that its freedom of establishment (Art. 49-54 TFEU) had been restricted due to Article 13 CITA, laying down the rules for the participation exemption pursuant to which neither the advantages derived from a shareholding nor the costs when that shareholding is sold or purchased are taken into account. However, Article 13 CITA is not applicable within the Dutch group taxation regime.

The CJEU ruled that the two situations were not comparable since a Dutch resident company with a Dutch subsidiary cannot in principle suffer any currency losses, except for highly particular cases in which the participation would be expressed in a different currency. However, even in that exceptional case, the participation exemption was, according to the CJEU, fiscally neutral since a decrease in the value of the participation of the parent company in its subsidiary could not be taken into account regardless of whether it resulted from an exchange rate fluctuation or any other reason. Lastly, in referring to its earlier judgment in *C- 686/13 X AB*, the CJEU reiterated that it cannot be inferred from the TFEU that Member States would be required to exercise their taxing powers asymmetrically so as to permit the deduction of losses from operations whose results, if they were positive, would not in any event be taxed.

Takeaway

This judgment has a significant impact on the Dutch group taxation regime. Immediately after the publication of the AG's conclusion on 25 October 2017, emergency measures were announced by the Dutch government on the basis of which certain provisions within the Dutch CITA and the Dutch Dividend Withholding Tax Act would have to be applied within a Dutch tax group as if such group was not present.

Now, immediately after the publication of the CJEU judgment (22 February 2018), the Dutch government announced that new legislation will be proposed in the second quarter of 2018 in order to implement the emergency measures with retroactive effect starting from 25 October 2017 at 11:00. The emergency measures will in the future be followed by a new group taxation regime that is future-proof from both a technical and legal perspective. We will keep you informed of further developments.

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