

By PwC Deutschland | 09. Oktober 2024

ECJ: Limitation on deduction of interest for an intra-group but purely artificial loan in line with European law

In a most recent judgment, the European Court of Justice decided that Article 10a of the Dutch Corporate Income Tax Act providing for an interest deduction limitation rule in wholly artificial arrangements is compatible with EU law. Although this article introduces a difference in treatment between a domestic and a cross-border situation, such a difference is justified based on the need to combat tax fraud and tax evasion.

Background

The case concerned X, a company incorporated under Dutch law which belongs to a multinational group of companies. That group includes, inter alia, companies A and C, both established in Belgium. A is the sole shareholder of X and the majority shareholder of C. In 2000, X acquired the majority of the shares in F, a company incorporated under Dutch laws, in which A acquired the remaining shares. X financed that acquisition by means of loans contracted with C, which used for that purpose own funds obtained through a capital contribution made by A. In 2007, Dutch authorities refused to allow X to deduct interest paid to C. X challenged this, and in 2020, the Dutch Court of Appeal upheld the interest deduction limitation under Article 10a CITA as EU-law compliant. X appealed to the Dutch Supreme Court, which referred questions to the ECJ, seeking clarification based on the *Lexel AB* case, where the ECJ ruled that transactions at arm's length are not abusive/artificial.

ECJ decision

Article 49 TFEU does not preclude a local legislation under which, in determining the profit of a taxpayer, the deduction of interest paid in respect of a loan contracted with a related entity - and relating to the acquisition or increase of a holding in another entity which, as a result of that acquisition or increase, becomes a related entity of the taxpayer - is denied in full where the debt is considered to constitute a purely artificial arrangement or part of such an arrangement, even if the debt was contracted at arm's length and the amount of interest does not exceed that which would have been agreed between independent enterprises.

The ECJ had the following further comments (in brief):

First, the Dutch tax legislation at issue **establishes a presumption** that the interest paid in respect of intra-group debt constitutes or forms part of wholly artificial arrangements. The possibility for the taxpayer to rebut that presumption by demonstrating that the conditions laid down in Article 10a(3)(a) and (b) of the respective corporate tax act are satisfied makes it possible to limit the refusal to deduct loan interest only to situations where the borrowing is dictated by tax reasons to such an extent that the borrowing is not necessary for the attainment of economically justified objectives.

Second, as regards the question whether transactions established at arm's length do not, by definition, constitute wholly artificial arrangements, the ECJ emphasizes that the examination of compliance with arm's length conditions must relate not only to the terms of the loan agreement and the amount or rate of interest, but also on the economic logic of the loan in question and the legal operations related to it, in order to ensure the economic reality of the transactions.

In that regard, it cannot be inferred from the judgment in the *Lexel* case, which concerned Swedish legislation with different practical consequences, that, in the absence of an economic reason, the mere fact that the terms of the intra-group loan correspond to those which would have been agreed between independent undertakings means that that loan and the transactions connected with it do not constitute, by definition, purely artificial arrangements.

Third, the ECJ emphasizes that the **refusal to deduct the total interest paid** in respect of the intra-group loan **would go beyond the objective of preventing wholly artificial arrangements** where the artificial nature of a transaction results from an exceptionally high interest rate on such a loan which otherwise reflects economic reality. The principle of proportionality requires that only the portion of that interest paid which exceeds the usual market rate be disallowed. On the other hand, where the loan in question is devoid of economic justification and, in the absence of the special relationship between the companies concerned and the tax advantage sought, that loan would never have been contracted, it is consistent with the principle of proportionality to refuse from deduction all of that interest.

Note: For a separate and in-depth analysis from our tax experts, we refer to the **[EU DTG Newsalert of 4 October 2024](#)**.

Source

ECJ, decision of 4 October 2024 in the case **C-585/22** *Staatssecretaris van Financiën (Intérêts relatifs à un emprunt intragroupe)*. – At the time of publication of this article the ECJ judgment was only available in French, Dutch, Danish, Lithuanian, and Finnish language.

Schlagwörter

[interest deduction](#), [interest limitation](#)