

## **X-Holding judgment: ECJ accepts restriction cross-border loss relief**

On 25 February 2010, the European Court of Justice (“ECJ”) delivered its judgment in the X Holding case. The ECJ ruled that the fact that the Netherlands tax regime makes it possible for a parent company to form a fiscal unity for corporate income tax purposes with its resident subsidiary but does not allow the formation of such a fiscal unity with a non-resident subsidiary is not in conflict with EC law, due to the fact that the profits of that non-resident subsidiary are not subject to the fiscal legislation of the Netherlands.

In 2003, X Holding B.V., a company resident in the Netherlands, requested to be included in a fiscal unity for corporate income tax purposes with its subsidiary F, a company resident in Belgium. The Netherlands tax authorities refused the fiscal unity, since F does not meet the applicable requirements that it is either resident in the Netherlands for tax purposes, or that it has a permanent establishment in the Netherlands. According to X Holding B.V., the refusal to allow a (cross-border) fiscal unity is incompatible with EC law.

The ECJ ruled that the fact that only domestic subsidiaries may be included in a fiscal unity whereas foreign subsidiaries cannot, constitutes, in principle, a restriction on the freedom of establishment (Article 43 in conjunction with Article 48 of the EC Treaty). The ECJ however ruled that – due to the fact that the parent company is at liberty to include or exclude a subsidiary in the fiscal unity – acceptance of the possibility to include non-resident subsidiaries in the fiscal unity would offer the parent company the opportunity to choose freely in which EU member state the subsidiary’s losses would be taken into account. For that reason, the refusal of a cross-border fiscal unity is justified in view of the need to safeguard the allocation of the power to impose taxes.

Practically all ECJ considerations seem to be focussed on whether or not cross-border loss relief should be allowed. Unlike Advocate General Kokott in her opinion, the ECJ does not specifically address the opportunities a fiscal unity offers for tax neutral reorganization, transfer of assets and internal transactions. The Advocate General followed the approach that the justification of the discrimination in the Netherlands fiscal unity legislation should be tested on an element-for-element basis. It is not fully clear whether the ECJ adheres to this view. It could be that the ECJ did not discuss these elements since such elements did not play a role in the case at hand.

In December 2009, the Dutch government announced plans to limit the deductibility of permanent establishment losses. Such plans could be reconsidered in the light of

this ECJ judgment. The recent fall of the Dutch government may have as a side-effect that such measures will be postponed until a new government has been installed.