

Israel Desk E-mail Bulletin

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Advocate General Kokott accepts restriction of crossborder losses

On 19 November 2009, Advocate General Kokott issued her Opinion in the proceedings before the European Court of Justice (ECJ) in the case of X Holding BV (case C-337/08). According to the A-G, the Netherlands is not obliged to allow a cross-border fiscal unity for Dutch corporate income tax purposes for the sake of horizontal carry-over losses. The A-G does, however, leave open the possibility that other advantages of the fiscal unity do have to be allowed to Netherlands parent companies of foreign subsidiaries.

In 2003, X Holding BV, 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 BV, the refusal to allow a (cross-border) fiscal unity is incompatible with EC law.

According to the A-G, 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). With regard to the justification of this restriction, the A-G found the following:

- The refusal of a cross-border fiscal unity with the view to excluding cross border carry-over losses is justified by safeguarding of the allocation of the power to impose taxes.
- The refusal to allow (by refusal of cross-border fiscal unity) a fiscally neutral reorganisation and to transfer assets free of tax could also be justified by safeguarding of the allocation of the power to impose taxes, but the Netherlands rule must be suitable and necessary in order to achieve this object. The A-G leaves this up to the Supreme Court to decide.
- The A-G stated the same about the taxing of internal transactions as a consequence of the refusal of a cross-border fiscal unity.

Please note that the A-G's Opinion only represents an advice to the ECJ. The ECJ is not required to follow this advice. The ruling of the ECJ is expected in the first half of 2010.

**E-mail bulletin number 14,
23 November 2009**

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The emphasis in the A-G's Opinion lies strongly on the question of whether it should be possible to set off losses of a foreign subsidiary against profits of a Netherlands parent company.

By answering this question separately, apart from the other aspects of the fiscal unity mentioned, the A-G follows the approach taken in the recent case law of the Netherlands Supreme Court, whereby the justification of the discrimination in the Netherlands fiscal unity legislation is tested element-for-element.

The A-G has now thus come to the conclusion that a fiscal unity may be refused in order to exclude cross-border carry-over losses. In the 'element-for-element' approach, however, all other aspects of the fiscal unity will have to be tested separately – where necessary in new proceedings – as to whether they constitute a disproportionate restriction. This applies, for example, to the possibility already referred to by the A-G to carry through tax free reorganisations within the fiscal unity, but equally to the mitigating effect that the fiscal unity has on the interest deduction measures which were proposed in the Consultation Document of 15 June 2009.

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