OPINION OF ADVOCATE GENERAL KOKOTT

delivered on 19 November 2009 [1]

I — Introduction

1. Netherlands tax law gives resident companies the option to form a tax entity with their domestic subsidiaries. The consequence of this is, in particular, that the profits and losses of the absorbed companies are consolidated at the level of the parent company and transactions effected within the group are neutral for tax purposes. Subsidiaries established in another Member State may not be absorbed into a tax entity.

2. The Hoge Raad has doubts whether this difference in treatment of domestic and foreign subsidiaries is justified on the grounds developed in *Marks & Spencer* [2] and the subsequent decisions, [3] in particular safeguarding the balanced allocation between the Member States of the power to impose taxes.

3. The Member States taking part in the proceedings consider the Netherlands rules on tax entities to be compatible with freedom of establishment. X Holding BV ('X Holding') and the Commission take the opposite view. They point out that Netherlands law permits foreign permanent establishments of a Netherlands company to be absorbed into the tax entity. This should therefore also be possible for subsidiaries in other Member States.

II — Legal context

4. The Agreement for the Avoidance of Double Taxation concluded between the Netherlands and Belgium on 5 June 2001 [4] ('the Double Taxation Agreement') provides

1 — Original language: German.

2 — Case C-446/03 [2005] ECR I-10837.

3 — See, in particular, Case C-470/04 *N* [2006] ECR I-7409; Case C-231/05 *AA* [2007] ECR I-6373; and Case C-414/06 *Lidl Belgium* [2008] ECR I-3601.

4 — *Trb.* 2001, 136.

in Article 7(1), based on the OECD model agreement, that

'The profits of an undertaking of a Contracting State shall be taxable only in that State unless the undertaking carries on business in the other Contracting State through a permanent establishment situated therein. If the undertaking carries on business in that way, the profits of the undertaking may be taxed in the other State, but only to the extent that they are attributable to that permanent establishment.'

5. Where a taxpayer resident in the Netherlands receives income which, in accordance with Article 7 of the Double Taxation Agreement, is taxable in Belgium, the Netherlands must exempt that income pursuant to Article 23(2) of the Agreement, by granting relief on its tax, for which provision is made under the Netherlands rules on the avoidance of double taxation. [5]

6. Article 15(1) of the 2003 version of the Wet op de vennootschapsbelasting 1969 (Law on corporation tax 1969) lays down the following rules on tax entities:

'Where a taxpayer (the parent company) holds, legally and economically, at least 95% of the shares in the nominal paid-up capital of another taxpayer (the subsidiary) and where both taxpayers so request, tax shall be levied on them as if they were a single taxpayer, which means that the activities and assets of the subsidiary form part of the activities and assets of the parent company. Tax shall be levied on the parent company. More than one subsidiary may form part of a tax entity.'

7. Under Article 15(3)(c) of the Wet op de vennootschapsbelasting, a tax entity may be formed only by taxpayers resident in the Netherlands. Article 15(4) makes an exception to this rule for companies resident in the European Union provided they have a permanent establishment in the Netherlands whose income is subject to taxation in the Netherlands on the basis of a double taxation agreement.

8. According to the referring court, the rules on tax entities mean that the profits and losses of different companies belonging to a tax

5 — See the provisions of the Besluit voorkoming dubbele belasting 2001 (Decree on the avoidance of double taxation 2001) described in points 10 and 11 of this Opinion.

entity may be offset against one another in the same tax year. Furthermore, the transfer of assets between two companies belonging to the tax entity and the services provided within the entity remain neutral for tax purposes.

9. Where a subsidiary is not absorbed into a tax entity, losses incurred by that company may not be offset against the parent company's profits. The shares in that subsidiary represent a shareholding for the parent company. Under Article 13(1) of the Wet op de vennootschapsbelasting, profits made or losses incurred in the context of a shareholding are disregarded in the determination of profits. In principle, a loss on a shareholding (write-down loss) may not therefore be deducted from the parent company's taxable profit. However, Article 13d of the Wet op de vennootschapsbelasting allows the option, under certain conditions, of deducting from profits any loss incurred in the event of the liquidation of a holding.

10. With regard to the tax treatment of the income of foreign permanent establishments, Article 33 of the Besluit voorkoming dubbele belasting 2001 provides that such income is to be added to the tax base of the principal company in the Netherlands. At the same time, it is exempted from taxation in that an amount equivalent to the pro rata share of domestic corporation tax on that income is deducted from the tax liability.

11. Where a loss incurred by a non-resident permanent establishment has been deducted from the Netherlands tax base, Article 35 of that decree stipulates that future profits of the permanent establishment may be exempted only if they exceed the losses previously deducted (recovery arrangement).

III — Facts, questions referred and procedure

12. X Holding BV is a capital company established in the Netherlands. It holds all the shares in F NV, a company resident in Belgium. F has no permanent establishment in the Netherlands, nor is it liable to corporation tax in the Netherlands.

13. In 2003 X Holding and F applied for recognition as a tax entity. The Tax Inspectorate rejected that application because F was not established in the Netherlands. After X Holding had raised an unsuccessful legal challenge against that rejection at first instance, it brought an appeal on a point of law before the Hoge Raad. It bases its appeal on an infringement of the freedom of establishment guaranteed under Articles 43 EC and 48 EC.

14. The Hoge Raad has referred the following question to the Court for a preliminary ruling:

'Must Article 43 EC, in conjunction with Article 48 EC, be interpreted as precluding national rules of a Member State … which allow a parent company and its subsidiary to opt to have the tax for which they are liable levied on the parent company established in that Member State as if they were a single taxpayer, but which reserve that option to companies which, for the taxation of their profits, are subject to the fiscal jurisdiction of the Member State concerned?'

15. In the proceedings before the Court of Justice, X Holding, the Netherlands, German, Spanish, French, Portuguese, Swedish and United Kingdom Governments and the Commission of the European Commission submitted observations.

IV — Legal assessment

16. The referring court seeks an interpretation of Article 43 EC in conjunction with Article 48 EC with respect to the compatibility of the Netherlands rules on taxable entities with freedom of establishment.

17. National provisions which are applicable only to shareholdings giving the holder definite influence on the company's decisions and allowing them to determine its activities come within the scope of freedom of establishment. [6] Legislation which governs only relations within a group of companies primarily concerns the abovementioned fundamental freedom. [7]

18. The formation of a tax entity under the rules applicable in the main proceedings requires a taxpayer (the parent company) to hold, legally and economically, at least 95% of the shares in the nominal paid-up capital of another taxpayer (the subsidiary).

19. The Netherlands rules on taxable entities therefore regulate only situations where there is a shareholding with a controlling influence. They thus come within the scope of freedom of establishment.

20. There is no need for an additional separate examination on the basis of the

6 — See Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 21; *AA*, cited in footnote 3, paragraph 20; Case C-360/06 *Heinrich Bauer Verlag* [2008] ECR I-7333, paragraph 27; and Case C-282/07 *Truck Center* [2008] ECR I-10767, paragraph 25.

7 — See Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, paragraph 118, and *AA*, cited in footnote 3, paragraph 23.

provisions on free movement of capital, even though the transactions in question could also be regarded in principle as an exercise of that freedom. [8]

A — *Restriction of freedom of establishment*

21. Freedom of establishment includes the right of companies or firms formed in accordance with the laws of a Member State and having their registered office, central administration or principal place of business within the European Community to pursue their activities in other Member States through a subsidiary, a branch or an agency. [9]

22. Even though, according to their wording, the provisions of the Treaty concerning freedom of establishment are directed to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering or making less attractive the establishment in another Member State of one of its nationals or of a company incorporated under its legislation. [10]

23. The rules on tax entities permit only the absorption of domestic subsidiaries. Netherlands companies and their subsidiaries established in another Member State must therefore be taxed independently of one another. However, according to X Holding, the separate taxation of the individual companies in a group of companies has four disadvantages compared with treatment as a tax entity:

— All the companies have to make their own tax return, which entails higher expenditure than a single tax return for the entire group.

— The companies' profits and losses may not directly be offset against one another.

8 — See, to that effect, Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, paragraph 33; *AA*, cited in footnote 3, paragraph 24; and Case C-303/07 *Aberdeen Property Fininvest Alpha* [2009] ECR I-5145, paragraph 35.

9 — Case C-307/97 *Saint-Gobain* [1999] ECR I-6161, paragraph 35; *Marks & Spencer*, cited in footnote 2, paragraph 30; and *Aberdeen Property Fininvest Alpha*, cited in footnote 8, paragraph 37.

10 — See Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 21; *Marks & Spencer*, cited in footnote 2, paragraph 31; and Case C-418/07 *Papillon* [2008] ECR I-8947, paragraph 16.

— It is not possible to implement restructuring within the group of companies (e.g. transferring assets) without this having fiscal implications.

— Transactions between the companies are not neutral for tax purposes. This increases administrative expenditure as documentation of transfer prices is necessary, for example.

24. As the referring court also confirms, the formation of a tax entity is therefore advantageous. It accords the same tax treatment to the organisational form of a group, divided into several companies, as to an integrated company with several permanent establishments. Any disadvantages resulting from the consolidation into a tax entity, for example the fact that the low rate of taxation for profits up to EUR 22 689 applies only once, are negligible in comparison.

25. However, this fiscally advantageous possible form is available to parent companies resident in the Netherlands only in relation to their domestic subsidiaries. This difference in treatment according to the residence of the subsidiary is likely to hinder or make less attractive the formation, acquisition or holding of relevant shares in companies in another Member State. It therefore constitutes a restriction of freedom of establishment.

26. However, the Netherlands, German and Portuguese Governments object that the case of a domestic subsidiary is not comparable with the case of a subsidiary established in another Member State, as the latter is not subject to the fiscal jurisdiction of the State of establishment of the parent company. It cannot therefore be integrated into a tax entity whose total income is taxed at the place where the parent company is established. The difference in treatment of those situations does not therefore constitute unlawful discrimination or — in the view of the Netherlands Government — a restriction of freedom of establishment.

27. It is settled case-law that a company's registered office for the purposes of Article 48 EC serves as the connecting factor with the legal system of a particular Member State in the same way as does nationality in the case of a natural person. In tax law, a company's registered office may constitute a factor that might justify national rules involving different treatment for resident and non-resident taxpayers. However, the registered office is not always a proper distinguishing factor. To accept that the Member

State of establishment may freely apply different treatment solely because a company's registered office is situated in another Member State would deprive Article 43 EC of all meaning. [11]

28. Consequently, fiscal jurisdiction based on the registered office likewise does not mean that purely domestic situations and situations with links to another Member State a priori cannot be compared.

29. Rather, in each specific situation, it is necessary to consider whether the fact that a tax advantage is available solely to resident taxpayers is based on relevant objective elements apt to justify the difference in treatment. [12] In examining justification, particular attention may be paid to protecting the allocation of the power to impose taxes. [13]

B — *Justification*

30. A restriction of freedom of establishment is permissible only if it is justified by overriding reasons in the public interest. It is further necessary, in such a case, that its application be appropriate to ensuring the attainment of the objective in question and not go beyond what is necessary to attain that objective. [14]

31. In *Marks & Spencer*, as we know, the Court recognised the safeguarding of the allocation of the power to impose taxes between the Member States as an overriding reason in the public interest which may justify a restriction of the fundamental freedoms. [15] In this connection it originally cited as related elements the avoidance of the danger that losses would be used twice and combating the risk of tax avoidance. [16] [17] Subsequently, the Court has recognised safeguarding the

11 — See Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 18; Case C-330/91 *Commerzbank* [1993] ECR I-4017, paragraph 13; Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, paragraph 42; *Marks & Spencer*, cited in footnote 2, paragraph 37; *AA*, cited in footnote 3, paragraph 30; and *Papillon*, cited in footnote 10, paragraph 26.

12 — *Marks & Spencer*, cited in footnote 2, paragraph 38.

13 — See my Opinion in Case C-231/05 *AA* [2007] ECR I-6373, point 27.

14 — *Marks & Spencer*, cited in footnote 2, paragraph 35; *Lidl Belgium*, cited in footnote 3, paragraph 27; and *Aberdeen Property Fininvest Alpha*, cited in footnote 8, paragraph 57.

15 — *Marks & Spencer*, cited in footnote 2, paragraph 45.

16 — Footnote does not concern the English version.

17 — *Marks & Spencer*, cited in footnote 2, paragraphs 47, 49 and 51.

balanced allocation of the power to impose taxes as a justification even where those additional elements are not both present. [18]

32. In recognising this ground for justification, the Court takes account of the fact that direct taxation essentially falls within the competence of the Member States. [19] In the absence of harmonisation at Community law level it is likewise a matter for the Member States to lay down criteria for allocating their powers to impose taxes by the conclusion of double taxation conventions or by unilateral measures. [20] As the Court has also held, it is not unreasonable for the Member States to find inspiration in international practice and the model conventions drawn up by the OECD. [21]

33. Whilst the *Marks & Spencer*, *AA* and *Lidl* cases each concerned the transfer of losses or profits between domestic and foreign companies or permanent establishments, the rules on tax entities are further-reaching. Thus, X Holding identifies a total of four advantages linked with the formation of a tax entity which it is denied in relation to the foreign subsidiary (see point 23 above).

34. In so far as X Holding mentions the possibility of a tax return for the entire tax entity, it should be pointed out at this stage that such a simplified option is manifestly precluded in a cross-border situation. For companies resident in different Member States to be able to be taxed, in accordance with the allocation of fiscal jurisdiction, in their State of residence under the applicable rules there, they must make separate tax returns to the competent fiscal authorities. It would only be conceivable, where a cross-border tax entity is formed, for the operating results of the foreign subsidiary of a Netherlands company to be taken into account *additionally* in the tax return made by the parent company. However, that would hardly represent a simplification for the subsidiary, as it also has to make its own tax return in its State of residence.

35. Nevertheless, it must be examined whether it is justified not to accord the other advantages of the tax entity, in particular the consolidation of the pre-tax results of parent companies and subsidiaries, in the case of cross-border shareholdings.

18 — *AA*, cited in footnote 3, paragraph 60, and *Lidl Belgium*, cited in footnote 3, paragraph 40.

19 — See *Marks & Spencer*, cited in footnote 2, paragraph 29; *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited in footnote 8, paragraph 40; and *Aberdeen Property Fininvest Alpha*, cited in footnote 8, paragraph 24.

20 — See Case C-336/96 *Gilly* [1998] ECR I-2793, paragraphs 24 and 30; Case C-513/03 *Van Hilten-Van der Heijden* [2006] ECR I-1957, paragraph 47; and *AA*, cited in footnote 3, paragraph 52.

21 — *Gilly*, cited in footnote 20, paragraph 31; *Van Hilten-Van der Heijden*, cited in footnote 20, paragraph 48; and *Lidl Belgium*, cited in footnote 3, paragraph 22.

1. The preclusion of consolidation of profits and losses

36. The Member States participating in the proceedings take the view that restriction of the tax entity regime to domestic companies is justified in order to safeguard a balanced allocation of the power to impose taxes.

— Safeguarding of the allocation of the power to impose taxes

37. The Member States stress that under the Double Taxation Agreement the Netherlands does not have the right to tax the profits of a company which is established in Belgium. They submit that, in accordance with this power to impose tax which is allocated according to the territorial principle, Belgium has the right to tax the income of F, as the State of residence of that company. F cannot therefore be absorbed into a tax entity under the umbrella of X Holding, which is liable to pay tax in the Netherlands.

38. X Holding and the Commission do not contest that the profits of a foreign subsidiary are not subject to tax in the Netherlands. However, they do point out that the formation of a tax entity in the Netherlands means that subsidiaries are treated for tax purposes in the same way as permanent establishments. By analogy, they claim that foreign subsidiaries in the context of a cross-border tax entity should be treated in the same way as foreign permanent establishments. X Holding argues that this had been the previous practice and had even been approved by the Hoge Raad in a judgment in 2002. [22]

39. In their view, the losses incurred by a foreign permanent establishment can be offset against the profits of the principal company in the same taxation period. Under the 'recovery arrangement' the profits of the permanent establishment in the Netherlands in subsequent years are not exempt from tax until the transferred losses are cancelled out again. The allocation of the power to impose taxes is not therefore affected, but it is possible to avoid the cash-flow disadvantage which would arise if the losses incurred by the permanent establishment could only be offset in a subsequent taxation period against the establishment's own profits in its State of establishment.

40. It must be stated in this regard that the safeguarding of the allocation of the power to impose taxes between Member States may

22 — Judgment No 37 220 of 24 May 2002, BNB 2002/320.

make it necessary to apply to the economic activities of companies established in one of those States only the tax rules of that State in respect of both profits and losses. [23] This is required by the principle of the symmetry of tax treatment of profits and losses. [24]

41. However, the alternative proposed by X Holding and the Commission to the full application of the tax entity regime does precisely amount to the losses being taken into account in isolation at the place of residence of the parent company.

42. According to case-law, to give companies the option to have their losses taken into account in the Member State in which they are established or in another Member State would significantly jeopardise a balanced allocation of the power to impose taxes between Member States, as the taxable basis would be increased in the first State and reduced in the second to the extent of the losses transferred. [25]

43. In this connection, the Commission objects that, unlike in the case of a pure group relief arrangement as was examined in *Marks & Spencer*, the absorption of foreign subsidiaries into a tax entity does not permit losses to be shifted freely between the Member States. The tax entity to which alone the losses can be attributed is always liable to tax at the place of residence of the parent company.

44. However, this factor cited by the Commission does not remove the interference in the allocation of the power to impose taxes which would be threatened if a cross-border tax entity as desired by X Holding were permitted.

45. Because taxpayers are free to combine into a tax entity or to dissolve such an entity, the group could freely choose the tax regime applicable to the losses incurred by the subsidiary and the place where the losses are taken into account. Without the absorption of F into the tax entity, its losses would be taken into account solely at its registered office in Belgium. If, on the other hand, X Holding and F could form a tax entity in the manner described, the losses incurred by F would reduce the taxable profits of X Holding in the Netherlands.

46. The fact that the transfer of losses according to the model advocated by X

23 — *Marks & Spencer*, cited in footnote 2, paragraph 45; *AA*, cited in footnote 3, paragraph 54; and *Lidl Belgium*, cited in footnote 3, paragraph 31.

24 — See *Lidl Belgium*, cited in footnote 3, paragraph 33, and Case C-157/07 *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt* [2008] ECR I-8061, paragraphs 42 and 44.

25 — *Marks & Spencer*, cited in footnote 2, paragraph 46, and *AA*, cited in footnote 3, paragraph 55.

Holding and the Commission is possible in only one direction, as it were, namely only from the foreign subsidiary to the parent company in the Netherlands, does not affect the abovementioned interference in the allocation of the power to impose taxes. In *Lidl* the Court was also required only to assess the treatment of losses incurred by foreign permanent establishments in connection with the taxation of the domestic principal company. As we know, it did not consider it necessary to take account of the losses, on grounds of the allocation of the rights to impose tax. [26]

47. However, it must be examined whether the complete exclusion of subsidiaries in another Member State from the system of consolidation of profits and losses by a tax entity is disproportionate because it goes beyond what is necessary to safeguard the allocation of the power to impose taxes.

48. In this respect it must be borne in mind that the rules on the offsetting of losses incurred by foreign permanent establishments have only a temporary effect because of the recovery arrangement. The application of those rules to foreign subsidiaries might therefore constitute a less onerous means than the complete preclusion of the transfer of losses. That would be the case if such rules impaired freedom of establishment less, but still took due account of the allocation of the power to impose taxes.

49. However, in *Lidl* — contrary to the suggestion made in the Opinion of Advocate General Sharpston [27] — the Court did not consider it necessary for a temporary transfer of losses linked with a subsequent taxation arrangement to apply in order to avoid a cash-flow disadvantage.

50. Of course, the Member States are at liberty to apply such favourable rules for permanent establishments in another Member State. [28] However, freedom of establishment does not require them to do so. When a Member State accepts the temporary offsetting of the losses incurred by a foreign permanent establishment against the profits of the domestic company, it waives immediate taxation of those profits. It thus accepts a cash-flow disadvantage by taking account of the foreign losses, even though it must exempt the positive income of the permanent establishment from taxation under the Double Taxation Agreement. [29] Until the subsequent

26 — *Lidl Belgium*, cited in footnote 3, paragraphs 31 to 34.

27 — Opinion in Case C-414/06 *Lidl* [2008] ECR I-3601, point 23 et seq.

28 — In *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt* (cited in footnote 24, paragraph 43), the Court considered a similar provision also to be coherent.

29 — It should be stressed that the present case is not comparable with the situation in Case C-347/04 *Rewe Zentralfinanz* [2007] ECR I-2647. In that judgment, the Court objected to a cash-flow disadvantage stemming from different rules in respect of write-downs to the book value of domestic and foreign shareholdings. That case therefore concerned the parent company's own losses which were to be taken into account for tax purposes in that company's State of residence (see paragraph 48 of the judgment in *Rewe*). In contrast, in the present case losses incurred by a subsidiary which is liable to taxation in another Member State are to be taken into account in the place of residence of the parent company.

taxation of the profits under the recovery arrangement, the symmetry of the taxation of profits and losses is not therefore guaranteed. [30]

51. If a Member State decides to permit the temporary offsetting of losses incurred by a foreign permanent establishment at the place of the company's registered office, that does not mean that it also has to extend that advantage to foreign subsidiaries. Permanent establishments and subsidiaries in another Member State are not in a comparable situation having regard to the allocation of the power to impose taxes.

52. It should be borne in mind in this respect that fiscal jurisdiction is generally linked to two criteria: the registered office of an undertaking and the place of its economic activity. A company is subject to unlimited tax liability in the State of its registered office in respect of all its global income. At the same time, in States in which it is economically active without having its office there, it is subject to limited tax liability in respect of the income earned in each case.

30 — This is also acknowledged by Advocate General Sharpston. However, she ultimately gives freedom of establishment precedence over the temporary impairment of the allocation of the power to impose taxes (Opinion in *Lidl Belgium*, cited in footnote 27, points 24 and 25).

53. Since a subsidiary is an autonomous legal person, it is subject to unlimited tax liability in the State of its registered office. The State of the registered office of the parent company has no right to impose taxes on the non-distributed profits of its non-resident subsidiary. A permanent establishment, on the other hand, is not an autonomous legal person. Its income is regarded as the income of the company which maintains it and is subject to unlimited tax liability at the registered office of that company. At the same time, the State in which the permanent establishment is located has a limited right to impose taxes on that income.

54. Article (1) of the Double Taxation Agreement accordingly allocates the power to impose taxes. In order to avoid double taxation of income of permanent establishments, Article 23(2) of the Double Taxation Agreement requires the State in which the company is resident to exempt that income from tax. Even if that Member State thus waives its right to impose taxes on the operating income in order to avoid double taxation, however, it continues to exist latently. This is particularly clear where the offsetting method is chosen instead of the exemption method in order to avoid double taxation.

55. With the creation of a foreign subsidiary, the parent company as it were leaves the fiscal jurisdiction of its State of residence and subjects the subsidiary to unlimited tax liability in the host Member State. By setting up a permanent establishment, the under-

taking also enters the fiscal jurisdiction of the host State, but *without* withdrawing that part of the undertaking completely from the fiscal jurisdiction of the State of origin.

56. The *mutatis mutandis* application of the rules on the tax treatment of foreign permanent establishments to foreign subsidiaries would therefore have the effect of extending the fiscal jurisdiction of the State of residence of the parent company. [31]

57. X Holding objects that such an extension of fiscal jurisdiction is not to the detriment of the State of residence of the subsidiary if it is limited to a temporary offsetting of the losses incurred by the subsidiary against the profits of the parent company. In reply to that objection, it should be stated that taking the losses incurred by the non-resident subsidiary into account in isolation impairs the right of the State of residence of the parent company to tax that company's profits and is contrary to the concept of symmetrical taxation of profits and losses.

58. It is true that the second sentence of the first paragraph of Article 43 EC expressly leaves traders free to choose the appropriate legal form in which to pursue their activities in another Member State and that freedom of choice must not be limited in the host State by discriminatory tax provisions. [32]

59. With regard to the obligations of the Member State of origin, however, the Court has held that the fiscal autonomy enjoyed by the Member States in the current state of harmonisation of Community tax law means that the Member States are at liberty to determine the conditions and the level of taxation for different types of establishments chosen by domestic companies operating abroad, on condition that those companies are not treated in a manner that is discriminatory in comparison with comparable domestic establishments. [33]

60. The Court therefore takes as the basis for comparing the tax treatment of foreign activities of a domestic undertaking only the rules governing the corresponding type of establishment domestically. Domestic permanent establishments are comparable with foreign permanent establishments and

31 — Such an extension of the fiscal jurisdiction of a company's State of residence to the profits of its foreign subsidiary is not completely excluded, however, under Community law. It may be justified in a very limited number of cases in order to combat abuse (see *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited in footnote 8, paragraph 59). No such exceptional situation is present here, however.

32 — See *Commission* v *France*, cited in footnote 11, paragraph 22; Case C-253/03 *CLT-UFA* [2006] ECR I-1831, paragraph 14; *AA*, cited in footnote 3, paragraph 40; and the order of 4 June 2009 in Joined Cases C-439/07 and C-499/07 *KBC Bank* [2009] ECR I-4409, paragraph 77.

33 — Case C-298/05 *Columbus Container Services* [2007] ECR I-10451, paragraphs 51 and 53, and order in *KBC Bank*, cited in footnote 32, paragraph 80.

domestic subsidiaries with foreign subsidiaries. However, Community law does not preclude the Member State of origin applying to foreign permanent establishments a different tax regime than to foreign subsidiaries.

61. These findings regarding the obligations of the host Member State, on the one hand, and the Member State of origin, on the other hand, are not contradictory, but correspond to the differing scopes of the taxation powers.

62. Because the host Member State generally subjects any economic activity carried on in its territory to tax, whether it is carried on by a subsidiary (resident taxpayer) or by a permanent establishment of a company with its (registered) office in another Member State (non-resident taxpayer), it may not treat those types of establishment differently in levying tax. The Member State of origin, on the other hand, enjoys only the right to tax a foreign permanent establishment, but not the right to tax a subsidiary resident in another Member State. Therefore, the Member State of origin is also not required to accord equal treatment to those two types of establishment abroad in levying tax.

63. The interim conclusion must therefore be that the restriction of freedom of establishment stemming from the fact that a subsidiary established in another Member State cannot be absorbed into a tax entity under Netherlands law with a view to consolidation of profits or losses is justified in order to safeguard the allocation of the power to impose taxes between the Member States.

— Danger that losses will be taken into account twice

64. The Court has also recognised that Member States must be able to prevent the danger of losses being taken into account twice. [34]

65. In the view of the referring court and the Governments taking part in the proceedings, this danger exists if the losses incurred by F could be offset against the profits of X Holding in the context of a tax entity in the Netherlands. It is conceivable that the losses incurred by F would also be taken into account in Belgium, for example in the event of incorporation into a tax entity there, through a transfer to a third party or through a carryover or a carryback to other tax years.

34 — *Marks & Spencer*, cited in footnote 2, paragraph 47; *Rewe Zentralfinanz*, cited in footnote 29, paragraph 47; and *Lidl Belgium*, cited in footnote 3, paragraph 35.

66. X Holding claims that the recovery arrangement precludes losses offset in the context of a tax entity in the Netherlands being used more than once through a carry-over by F. Furthermore, in Belgium none of the other methods of further use of losses mentioned by the Hoge Raad is legally possible. The Commission adds that offsetting of losses in the Netherlands could be linked to proving that the loss has not already been taken into account in the State of establishment of the subsidiary.

67. In fact, under the conditions described by the referring court and the Governments taking part in the proceedings, losses could possibly be offset in the same tax period both in the place of establishment of the parent company and in the place of establishment of the subsidiary. [35]

68. The exclusion of foreign subsidiaries from a Netherlands tax entity is liable to eliminate this danger that losses will be taken into account twice, but could go beyond what is necessary.

69. The national rules do not permit the absorption of a foreign subsidiary into a tax entity even where the undertakings show that it is not possible for losses to be used twice because of the form taken by tax law in the State of establishment of the subsidiary. As the Commission suggests, another possible less onerous measure would be taking account of the foreign losses if the taxpayer can prove that the losses were not actually used in some other way at the place of establishment of the subsidiary. [36] However, the State of residence of the parent company would also have to be able to verify that information, for example pursuant to Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation and taxation of insurance premiums. [37] [38]

70. It is not necessary, however, to give a definitive opinion on this question as it is in any case justified, with a view to safeguarding the allocation of the power to impose taxes, to preclude the formation of cross-border tax entities with the aim of offsetting losses. This

35 — On the danger that losses will be taken into account twice in the case of cross-frontier groups of undertakings, see also *Papillon*, cited in footnote 10, paragraph 46 et seq.

36 — See, to that effect, *Papillon*, cited in footnote 10, paragraph 55 et seq.

37 — OJ 1977 L 336, p. 15, last amended by Council Directive 2006/98/EC of 20 November 2006 (OJ 2006 L 363, p. 129).

38 — In the case of non-member countries, including the States of the European Economic Area, that directive does not apply. In that case, however, information clauses in double taxation agreements could possibly ensure the exchange of information necessary for monitoring (see my Opinion of 16 July 2009 in Case C-540/07 *Commission* v *Italy* [2009] ECR I-10983, point 75 et seq.).

ground of justification holds even if there is no danger of losses being taken into account twice or if that danger can be eliminated in some other way. [39]

— Danger of tax avoidance

71. Lastly, as regards the third ground for justification mentioned in *Marks & Spencer*, the danger of tax avoidance, [40] I have already pointed out in my Opinion in *AA* that I do not consider it to be a separate ground of justification in addition to the safeguarding of the allocation of the power to impose taxes where it is a question of precluding cross-border profit transfers. [41] This also applies where losses incurred by a foreign subsidiary are offset in connection with the taxation of the domestic parent company.

72. If tax avoidance is taken to mean that an undertaking may freely choose, in contravention of the allocation of the power to impose taxes, in which State it subjects its income to tax, then that ground of justification also applies in the present case. If a group were free to include foreign subsidiaries in the tax entity or to remove them from the consolidated group again, the companies could control the way the losses were taken into account and influence the basis for assessment at the place of establishment of the tax entity. [42]

2. Tax-neutral restructuring and transfer of assets

73. X Holding further claims that in addition to losses relief a tax-neutral restructuring of companies is also precluded if they cannot form a tax entity. In particular, the transfer of assets between a Netherlands parent company and its subsidiary in another Member State is not possible without fiscal implications.

74. It is clear from the examination carried out above that the tax entity regime in any case does not essentially have to be extended to cross-border groups of companies in order to take account of freedom of establishment. However, the referring court considers applying only specific aspects of that regime in cross-border cases. Nevertheless it would seem uncertain whether restructuring can be

39 — See above, point 32 of this Opinion, with further references. In *Lidl Belgium* this ground of justification was significantly not even raised separately.

40 — *Marks & Spencer*, cited in footnote 2, paragraph 49.

41 — Opinion in *AA*, cited in footnote 13, points 62 and 63.

42 — See above, points 42 and 45 of this Opinion.

implemented or assets can be transferred between undertakings in a tax neutral manner if those undertakings' profits and losses are not consolidated at the same time.

75. In so far as this is nevertheless an issue, in the view of the referring court, it should be pointed out, first of all, that the fiscal implications of cross-border restructuring have been harmonised by Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States. [43] Any obstacles to the exercise of freedom of establishment in connection with operations which come under the scope of that directive, in support of whose existence no evidence was however put forward in the case at issue, should therefore have largely been removed.

76. On the other hand, no more specific provision is made in Community law on what tax treatment is to be given to hidden reserves in the case of the cross-border transfer of assets or shareholdings which does not take place as part of a transaction covered by Directive 90/434. There could be a restriction of freedom of establishment if such transactions are treated less favourably than transfers between domestic companies, for example because hidden reserves must be discovered and taxed at that moment, whereas that is not the case with domestic transfers.

77. Such a restriction is possibly justified, however, in order to safeguard the allocation of the power to impose taxes between the Member States.

78. It should be noted that the transfer of assets between two domestic undertakings does not affect the fiscal jurisdiction of the State in question. Where hidden reserves are transferred, they continue to be subject to the fiscal sovereignty of that State. In the case of a subsequent sale, profits may still be taxed there.

79. If it is assumed that a latent increase in the value of an asset is in principle subject to tax in the State in which it arose, [44] a cross-border

43 — OJ 1990 L 225, p. 1, last amended by Council Directive 2006/98/EC of 20 November 2006 adapting certain Directives in the field of taxation, by reason of the accession of Bulgaria and Romania (OJ 2006 L 363, p. 129).

44 — See, to that effect, Case C-470/04 *N* [2006] ECR I-7409, paragraph 46, and point 97 of my Opinion of 30 March 2006 in that case.

transfer of assets may impair the allocation of the power to impose taxes. If hidden reserves are thereby moved to another Member State, the State in whose territory they were built up can subsequently no longer easily tax profits made by liquidating the reserves.

80. However, rules to counter such an interference in the allocation of the power to impose taxes must be appropriate to ensuring the attainment of that objective and not go beyond what is necessary to attain that objective. [45]

81. It is for the referring court, if necessary, to examine the extent to which the national rules governing the transfer of assets and the tax treatment of hidden reserves, about which the Court does not have any information, observe those principles.

45 — See point 30 above and the cited case-law.

3. Neutralisation of transactions within a tax entity

82. Lastly, X Holding points out that transactions between domestic undertakings which are combined into a tax entity remain neutral for tax purposes, whereas similar cross-border transactions between related undertakings which cannot form a tax entity are taken into account in taxation.

83. In order to prevent the tax base being shifted from one Member State to another Member State in the course of cross-border transactions, it is necessary for those transactions to be effected under normal market conditions and to be recorded in the tax accounts. [46] The additional expenditure connected with the documentation of the transfer prices does impair transactions between related undertakings resident in different Member States. However, national rules on transfer prices, in so far as they constitute a restriction of freedom of establishment, are justified in order to safeguard the allocation of the power to impose taxes, provided they take account of the principle of proportionality.

46 — For more details on national rules to guarantee observance of the arm's length principle, see my Opinion of 10 September 2009 in Case C-311/08 *SGI*, pending before the Court.

V — Conclusion

84. On the basis of these considerations, I propose that the Court answer the question referred by the Hoge Raad as follows:

Article 43 EC in conjunction with Article 48 EC does not preclude legislation of a Member State which gives a domestic company and one or more of its subsidiaries resident domestically the option to form a tax entity, with the result that the tax for which they are liable is levied on the parent company as if they were a single taxpayer, but which does not permit the inclusion of subsidiaries resident in another Member State in a tax entity.