Reports of Cases

JUDGMENT OF THE COURT (Fourth Chamber)

21 February 2013 *

(Freedom of establishment — Article 49 TFEU — Tax legislation — Merger of a parent company established in one Member State with a subsidiary established in another Member State — Deductibility by the parent company of the subsidiary's losses arising from its activity — Exclusion for non-resident subsidiaries)

In Case C-123/11,

REQUEST for a preliminary ruling under Article 267 TFEU from the Korkein hallinto-oikeus (Finland), made by decision of 7 March 2011, received at the Court on 9 March 2011, in the proceedings brought by

A Oy,

THE COURT (Fourth Chamber),

composed of L. Bay Larsen, acting as President of the Fourth Chamber, J.-C. Bonichot (Rapporteur), C. Toader, A. Prechal and E. Jarašiūnas, Judges,

Advocate General: J. Kokott,

Registrar: L. Hewlett, Principal Administrator,

having regard to the written procedure and further to the hearing on 7 June 2012,

after considering the observations submitted on behalf of:

— A Oy, by A. Blomqvist, asianajaja,

— the Finnish Government, by M. Pere, acting as Agent,

— the German Government, by K. Petersen, acting as Agent,

— the French Government, by G. de Bergues and J.-S. Pilczer, acting as Agents,

— the Italian Government, by G. Palmieri, acting as Agent, and M. Santoro, avvocato dello Stato,

— the Swedish Government, by A. Falk and S. Johannesson, acting as Agents,

— the United Kingdom Government, by C. Murrell, acting as Agent, and K. Bacon and R. Hill, Barristers,

* Language of the case: Finnish.

— the European Commission, by R. Lyal and I. Koskinen, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 19 July 2012,

gives the following

Judgment

1 This request for a preliminary ruling concerns the interpretation of Articles 49 TFEU and 54 TFEU.

2 The request has been made in proceedings brought by A Oy ('A'), a company governed by Finnish law, against a decision of the Keskusverolautakunta (Central Tax Board) that A could not, in the context of a merger with a Swedish subsidiary, deduct from tax the subsidiary's losses.

Legal context

International law

3 Article 7(1) of the Convention between the Nordic countries for the avoidance of double taxation with respect to taxes on income and capital, concluded in Helsinki on 23 September 1996, (SopS 26/1997) provides:

'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.'

Finnish law

4 Law 360/1968 on the taxation of business income (Laki elinkeinotulon verottamisesta, 360/1968), which was intended inter alia to transpose Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States (OJ 2009 L 310, p. 34), sets out the legal framework for mergers/absorptions of companies.

5 Paragraph 52a(2) of that law defines the concept of merger as follows:

'Merger means an operation by which:

…

2. the merging company, on being dissolved without liquidation, transfers all its assets and liabilities to the receiving company which holds all the shares representing the share capital of the merging company, or to a share company which wholly owns such a company.'

6 Law 1535/1992 on income tax (Tuloverolaki, 1535/1992) of 30 December 1992 ('the Law on income tax') specifies the tax rules for losses of companies.

7 Paragraph 117 of that law provides that a loss arising from business activity is deducted from income in the following years.

8 Paragraph 119(1) and (2) of that law specifies:

‘A loss in the tax year from business activity … is deducted from the income from business activity … during the following ten tax years in so far as income arises.

A loss from business activity means a loss-making result calculated in accordance with [Law 360/1968] on the taxation of business income …’.

9 Paragraph 123(2) of the law lays down the conditions under which the receiving company may take over for tax purposes the losses of the merging company, as follows:

‘After companies have merged … the receiving company has the right to deduct from its taxable income the loss of the merged … company in accordance with Paragraphs 119 and 120, if the receiving company or its shareholders or members or the company and its shareholders or members together have, from the beginning of the loss-making year, owned more than half of the merged or divided company’s shares. …’.

The dispute in the main proceedings and the questions referred for a preliminary ruling

10 A is a Finnish undertaking whose business is retailing furniture. A has a subsidiary in Sweden (‘B’), whose entire capital it owns, and which carries on a similar activity in Sweden from three leased trading sites. A does not itself have other subsidiaries or branches in Sweden.

11 Following trading losses, B closed its three sales outlets, one in December 2007 and the other two in March 2008. B did not intend to continue trading in Sweden, but it remained bound by two long-term leases of business premises. Its losses amounted to SEK 44.8 million for the period from 2001 to 2007.

12 After B ceased trading, A planned to merge with B. The merger would be justified from an economic point of view and would in particular make it possible for B’s leases to be transferred to A. It would also be a transparent procedure which could be easily carried out and would allow the structure of the group to be simplified.

13 As a result of that operation, the assets, liabilities and residual obligations of B would be transferred to A, and the parent company would no longer have a subsidiary or permanent establishment in Sweden.

14 A applied to the Keskusverolautakunta for an advance decision on whether, once the operation had been carried out, it would be able to deduct B’s losses in accordance with Paragraph 123(2) of the Law on income tax.

15 By advance decision of 25 March 2009, the Keskusverolautakunta gave a negative answer, on the ground that B’s losses had been ascertained pursuant to Swedish tax law. It considered that the losses could not therefore fall within the scope of Paragraph 119 of the Law on income tax.

16 A contested that decision before the Korkein hallinto-oikeus (Supreme Administrative Court), relying in particular on freedom of establishment.

17 The Korkein hallinto-oikeus observes that, if a resident company absorbs a Finnish company, it can deduct from tax that company's losses under the conditions set out in Paragraphs 119 and 123 of the Law on income tax, provided that the operation has not been carried out for the sole purpose of obtaining a tax advantage.

18 The court points out that Finnish law does not, on the other hand, give any indication of the conditions under which that deduction could be made if the company absorbed is situated in another Member State.

19 The court therefore raises the question whether the Finnish legislation contains a restriction of freedom of establishment and, if so, whether the restriction may be regarded as justified on the public interest grounds relied on by the Finnish authorities, namely the need for the Member States to preserve a balanced allocation of their power to impose taxes and to guard against the risks of the double use of losses and tax avoidance.

20 In those circumstances, the Korkein hallinto-oikeus decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

'1. Do Articles 49 TFEU and 54 TFEU require that a receiving company may, in the context of its taxation, deduct the losses of a company which was resident in another Member State and which has merged with the receiving company, when those losses arise from the merged company's activity there in the years prior to the merger and when the receiving company has no permanent establishment in the State of residence of the merged company and, under national law, the receiving company may deduct losses of the merged company only if the latter is a resident company or the losses arose in the permanent establishment situated in that State?

2. If the answer to the first question is in the affirmative, do Articles 49 TFEU and 54 TFEU have a bearing on whether the loss to be deducted is calculated in accordance with the tax legislation of the receiving company's State of residence, or should the losses ascertained pursuant to the law of the State of residence of the company which is to be merged be considered as deductible losses?'

Question 1

21 By its first question the referring court essentially asks the Court whether Articles 49 TFEU and 54 TFEU preclude legislation of a Member State under which a resident parent company, following a merger with a subsidiary established in another Member State, cannot deduct from its taxable income losses incurred by the subsidiary in respect of tax years prior to the merger, while that national legislation allows such a possibility when the merger is with a resident subsidiary.

22 As a preliminary point, it should be noted that Directive 2009/133 does not address the question of the taking over in such a situation of any losses that the merged company may have made.

23 Moreover, the German, Finnish, Italian and United Kingdom Governments submit that freedom of establishment does not apply to the case in the main proceedings, because the merged company ceased its economic activity before the merger and the sole motive for the restructuring is in fact the search for a tax advantage, consisting in the deduction of the merged subsidiary's losses from the taxable income of the receiving parent company.

24 In this respect, it must be recalled, first, that cross-border merger operations, like other company transformation operations, respond to the needs for cooperation and consolidation between companies established in different Member States. They are thus regarded as constituting particular methods of exercise of freedom of establishment, important for the proper functioning of the internal

market, and are therefore among those economic activities in respect of which Member States are required to respect the freedom of establishment laid down by Article 49 TFEU (Case C-411/03 *SEVIC Systems* [2005] ECR I-10805, paragraph 19).

25 It must be observed, next, that in the circumstances of the main proceedings the setting up by A of a subsidiary B in Sweden derives from the exercise by A of its right to freedom of establishment, as a consequence of which Articles 49 TFEU and 56 TFEU apply.

26 Finally, the fact that a merger operation is motivated solely by tax considerations and that the companies concerned are in fact attempting by that means to evade their national legislation is not in itself capable of making those provisions inapplicable.

27 The question of the application of those articles is different from the question whether a Member State may adopt measures in order to prevent attempts by certain of its nationals to evade national legislation by having recourse to the possibilities offered by the Treaty (see, to that effect, Case C-212/97 *Centros* [1999] ECR I-1459, paragraph 18).

28 In the light of all those factors, it must be considered that freedom of establishment applies in a situation such as that at issue in the main proceedings.

Obstacle to freedom of establishment

29 Since freedom of establishment applies to the case in the main proceedings, it must be recalled that, according to settled case-law, although direct taxation is a matter within the competence of the Member States, they must none the less exercise that competence in a manner consistent with European Union law (see, inter alia, Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, paragraph 29 and the case-law cited).

30 Freedom of establishment, which Article 49 TFEU grants to nationals of the European Union, includes, in accordance with Article 54 TFEU, for companies formed pursuant to the law of a Member State and having their registered office, central administration or principal place of business within the European Union, the right to exercise their activity in the Member State concerned through a subsidiary, a branch or an agency (see, inter alia, Case C-307/97 *Saint-Gobain ZN* [1999] ECR I-6161, paragraph 35, and Case C-337/08 *X Holding* [2010] ECR I-1215, paragraph 17).

31 The possibility granted by Finnish law to a resident parent company of taking a resident subsidiary's losses into account when it merges with that subsidiary constitutes a tax advantage for the parent company.

32 The exclusion of such an advantage in relations between a resident parent company and a subsidiary established in another Member State is liable to make establishment in the latter State less attractive and hence to deter the company from setting up subsidiaries there.

33 For such a difference in treatment to be compatible with the provisions of the FEU Treaty on freedom of establishment, it must relate to situations which are not objectively comparable or be justified by an overriding reason in the public interest (see, by analogy with the free movement of capital, Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, paragraph 167). According to the Court's case-law, the comparability of a cross-border situation with an internal one must be examined having regard to the aim pursued by the national provisions at issue (see, by analogy, Case C-231/05 *Oy AA* [2007] ECR I-6373, paragraphs 36 to 38).

34 In tax law, the taxpayers' residence is a factor that may justify differences of treatment between resident and non-resident taxpayers, but that is not always the case. To accept that the Member State of establishment may in all cases apply different treatment solely because the registered office of a company is situated in another Member State would deprive Article 49 TFEU of its content (see, inter alia, *Marks & Spencer*, paragraph 37).

35 In this respect, the situation of a resident parent company which wishes to merge with a resident subsidiary and benefit in that connection from the possibility of deducting from tax that subsidiary's losses, on the one hand, and the situation of a resident parent company which wishes to carry out the same operation with a non-resident subsidiary, on the other, are objectively comparable from the point of view of the aim of tax legislation such as that at issue in the main proceedings, which is intended to allow the parent company to benefit from the tax advantage consisting in being able to deduct from tax the losses incurred by the subsidiary.

36 The German and United Kingdom Governments submit, however, that the refusal to allow the deduction from tax of the losses is not a restriction of freedom of establishment, since, as follows from the findings of the referring court referred to in paragraph 17 above, deduction from taxable income of the merged company's losses would also have been refused, in the same circumstances, if the merger had been with a resident subsidiary, on the ground that the sole motive for the operation was to obtain a tax advantage.

37 However, it is for the national court alone to assess whether that is the case in the main proceedings. If so, A would indeed be unable to plead a difference in treatment between resident and non-resident companies.

38 In the absence of further detail in the order for reference, the Court must in any event rule also on the question whether, assuming that the refusal to allow deduction of the losses is based on other grounds, the difference in treatment with respect to non-resident companies is justified by an overriding reason in the public interest.

39 For that purpose, it must be ascertained whether the difference in treatment is appropriate for ensuring attainment of the objective pursued and does not go beyond what is necessary to achieve that objective (see, to that effect, *Marks & Spencer*, paragraph 35).

Justification of the obstacle

40 The governments which have submitted observations to the Court take the view that the difference in treatment at issue in the main proceedings is justified by the need to safeguard the allocation of the power to impose taxes between the Member States and to avert the risks of the double use of losses and tax avoidance.

41 As regards, first, the need to safeguard the allocation of the power to tax between the Member States, that may be capable of justifying a difference in treatment where the system in question is designed to prevent conduct liable to jeopardise the right of a Member State to exercise its powers of taxation in relation to activities carried on in its territory (see, to that effect, Case C-347/04 *Rewe Zentralfinanz* [2007] ECR I-2647, paragraph 42, and *Oy AA*, paragraph 54).

42 Thus the preservation of the allocation of the power to impose taxes between Member States might 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 (*Marks & Spencer*, paragraph 45).

43 To give companies the right to elect to have their losses taken into account in the Member State in which they are established or in another Member State would seriously undermine a balanced allocation of the power to impose taxes between the Member States (see *Oy AA*, paragraph 55), in that the taxable bases would be altered in both States to the extent of the losses transferred.

44 As regards, next, the risk that losses would be used twice, such a risk does indeed exist if, in connection with a merger such as that at issue in the main proceedings, the parent company established in another Member State enjoys the possibility of deducting from its taxable income the losses of the merged subsidiary. That risk is averted by a rule which excludes that possibility (see, to that effect, *Marks & Spencer*, paragraphs 47 and 48).

45 As regards, finally, the risk of tax avoidance, the possibility of transferring the losses of a non-resident subsidiary to a resident company on the occasion of a merger entails the risk that that sort of restructuring will be organised within a group of companies so that the losses are taken into account in the Member States which apply the highest rates of tax and in which the tax value of the losses is therefore the highest (see, to that effect, *Marks & Spencer*, paragraph 49).

46 In the light of the above justifying factors taken together, it must be accepted that legislation of a Member State under which, in the context of a merger such as that at issue in the main proceedings, a parent company established in that Member State is denied the possibility of deducting from its taxable income the losses of the merged subsidiary established in another Member State, first, pursues legitimate objectives compatible with the Treaty and justified by overriding reasons in the public interest and, secondly, is appropriate to ensuring the attainment of those objectives (see, to that effect, inter alia, *Marks & Spencer*, paragraph 51).

47 It must none the less be examined whether such legislation goes beyond what is necessary to attain those objectives (see, to that effect, inter alia, *Marks & Spencer*, paragraph 53).

48 With respect to the proportionality of the obstacle to freedom of establishment, it must be observed, first, that granting the parent company the possibility of taking into account the losses of its non-resident subsidiary in connection with a cross-border merger is not a priori such as to allow the parent company to choose freely from one year to the next the tax scheme applicable to its subsidiaries' losses (see, a contrario, *X Holding*, paragraph 31).

49 It follows, secondly, from the Court's case-law that a restrictive measure such as that at issue in the main proceedings goes beyond what is necessary to attain the essential part of the objectives pursued in a situation in which the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account (see, to that effect, *Marks & Spencer*, paragraph 55). It is for the parent company to show that that is the case (see, to that effect, *Marks & Spencer*, paragraph 56).

50 As regards the main proceedings, it appears from the documents in the case transmitted to the Court that Swedish law provides for the possibility of taking a taxpayer's losses into account in future tax years for the purpose of calculating the taxable basis.

51 However, A submits that, once the merger operation has been carried out, B will be liquidated, and A will no longer have a subsidiary or a permanent establishment in Sweden. Neither of those two companies would thus appear to have the possibility of relying in Sweden, after the merger, on the losses incurred by B in Sweden before the merger.

52 Nevertheless, those specific circumstances are not in themselves capable of showing that there is no possibility of taking into account the losses that exist in the subsidiary's State of residence.

53 Thus several Member States which have intervened in the case consider, on the contrary, that the possibility of taking B's losses into account in Sweden continues to exist. The German Government submits that those losses can be deducted from the income, admittedly very small, which B continues to receive in Sweden. It adds that B is still involved in leases which could be assigned. The French Government also submits that Swedish law allows companies to take losses into account in previous tax years or on the occasion of the taxation of capital gains made on the assets and liabilities of the merged company. The Italian Government submits that Sweden is entitled to evaluate the assets transferred and to tax the merged company on the profit thus realised.

54 It is therefore for the national court to determine whether A has in fact proved that B has exhausted all the possibilities of taking account of the losses which exist in Sweden.

55 Were the referring court to reach the conclusion that such proof has been produced, it would be contrary to Articles 49 TFEU and 56 TFEU for A to be denied the possibility of deducting from its taxable profits in the Member State concerned the losses incurred by its non-resident subsidiary, in the context of the merger at issue in the main proceedings.

56 In the light of the foregoing, the answer to Question 1 is that Articles 49 TFEU and 56 TFEU do not, in the circumstances of the main proceedings, preclude national legislation under which a parent company merging with a subsidiary established in another Member State, which has ceased activity, cannot deduct from its taxable income the losses incurred by that subsidiary in respect of the tax years prior to the merger, while that national legislation allows such a possibility when the merger is with a resident subsidiary. Such national legislation is none the less incompatible with European Union law if it does not allow the parent company the possibility of showing that its non-resident subsidiary has exhausted the possibilities of taking those losses into account and that there is no possibility of their being taken into account in its State of residence in respect of future tax years either by itself or by a third party.

Question 2

57 By its second question the referring court asks the Court to specify, if the application of European Union law were to allow the parent company to take its non-resident subsidiary's losses into account in connection with a merger such as that at issue in the main proceedings, whether those losses should be determined in accordance with the law of the Member State of residence of the parent company or the law of the State of residence of the subsidiary.

58 It must be noted to begin with that, in the present state of European Union law, freedom of establishment does not as a matter of principle imply the application of a particular law to the calculation of the merged subsidiary's losses taken over by the parent company, in an operation such as that at issue in the main proceedings.

59 On the other hand, European Union law precludes those methods of calculation being such as to constitute an obstacle to freedom of establishment. It follows that, in principle, the calculation must not lead to unequal treatment compared with the calculation which would have been made in a similar case for the taking over of the losses of a resident subsidiary.

60 That question cannot, however, be addressed in an abstract and hypothetical manner, but must be analysed where necessary on a case-by-case basis.

61 In those circumstances, the answer to Question 2 is that the rules for calculating the non-resident subsidiary's losses for the purpose of their being taken over by the resident parent company, in an operation such as that at issue in the main proceedings, must not constitute unequal treatment compared with the rules of calculation which would be applicable if the merger were with a resident subsidiary.

Costs

62 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Fourth Chamber) hereby rules:

1. **Articles 49 TFEU and 56 TFEU do not, in the circumstances of the main proceedings, preclude national legislation under which a parent company merging with a subsidiary established in another Member State, which has ceased activity, cannot deduct from its taxable income the losses incurred by that subsidiary in respect of the tax years prior to the merger, while that national legislation allows such a possibility when the merger is with a resident subsidiary. Such national legislation is none the less incompatible with European Union law if it does not allow the parent company the possibility of showing that its non-resident subsidiary has exhausted the possibilities of taking those losses into account and that there is no possibility of their being taken into account in its State of residence in respect of future tax years either by itself or by a third party.**

2. **The rules for calculating the non-resident subsidiary's losses for the purpose of their being taken over by the resident parent company, in an operation such as that at issue in the main proceedings, must not constitute unequal treatment compared with the rules of calculation which would be applicable if the merger were with a resident subsidiary.**

[Signatures]