KPMG
Meijburg & Co
Tax Lawyers

Dutch Supreme Court follows Court of Justice of the European Union in the per element approach

1. Introduction

On October 19, 2018, the Supreme Court rendered its final judgment in two important corporate income tax cases, in which it had previously requested a preliminary ruling from the Court of Justice of the European Union (CJEU) and on which it had received a ruling at the beginning of 2018 (see our previous memorandum). Both cases have a common key issue, i.e. whether taxpayers, despite being unable to enter into a fiscal unity with subsidiaries established elsewhere in the EU, are nevertheless eligible for benefits from separate elements of the fiscal unity regime as if a fiscal unity with foreign subsidiaries can be entered into (the 'per element' approach).

In one of the cases, which concerned an interest deduction limitation (profit shifting, Section 10a Corporate Income Tax Act 1969), the Supreme Court has now ruled – in accordance with the CJEU – that this is contrary to the freedom of establishment. A bill with emergency repair measures had moreover already been submitted on June 4, 2018, in response to the CJEU judgment (see our previous memorandum). These measures mean that some corporate income tax and dividend withholding tax rules – even in domestic relationships – will have to be applied as if there is *no* fiscal unity.

With regard to the other case, which involves the deduction of foreign exchange losses on EU participations, the Supreme Court has followed the CJEU and now ruled that there is no violation of EU law.

Both cases and their practical implications are addressed below.

2. Profit shifting (Section 10a Corporate Income Tax Act 1969)

As stated above, this case concerned an interest deduction limitation. A Dutch company borrowed from the Swedish top holding company of a group of which it was a member and then used the borrowed funds to make a share contribution in an Italian subsidiary, which, in turn, used these funds to delist another Italian group company. In dispute was the application of Section 10a Corporate Income Tax Act 1969 (CITA), given that this involved a loan from a related entity for the purposes of making a contribution in a related entity. One of the questions that arose was whether Section 10a CITA is contrary to EU law.

Interim Supreme Court judgment (July 2016)

According to the Supreme Court, that is in principle not the case, but this could be different due to the overlap with the fiscal unity regime (the per element approach). If the Italian subsidiary had been established in the Netherlands, then according to the Supreme Court it could have been included in a fiscal unity with the Dutch company, in which case the contribution would not be a tainted transaction. In light of this, the Supreme Court requested a preliminary ruling from the CJEU. The question posed to the CJEU was, in short, whether Section 10a CITA is contrary to the freedom of establishment in those cases where the application of that provision in national situations would be avoided by setting up a fiscal unity.

CJEU judgment (February 2018)
The CJEU ultimately answered this question in the affirmative. Elaborating on the judgment in the Groupe Steria case, the CJEU concluded that each separate tax benefit obtained by the fiscal unity, other than the tax benefit of the transfer of losses, must be assessed as to whether a Member State can exclude this particular tax benefit in cross-border situations. According to the CJEU, the per element approach must thus also be applied to the Dutch fiscal unity regime.

The CJEU ultimately ruled that the refusal to grant an interest deduction for a loan taken out by a related entity to finance a capital contribution in an EU subsidiary is contrary to the freedom of establishment, given that this would be permissible if the capital contribution was made to a resident subsidiary that is a member of a fiscal unity.

Final Supreme Court judgment (October 2018)
With reference to the CJEU's conclusions, the Supreme Court ruled that these are objective comparable cases that are, without justification, treated differently. Therefore, Section 10a CITA must be disregarded in the present case. In addition, the Supreme Court also noted that a comparison does *not* have to be made with the hypothetical situation in which there is a cross-border fiscal unity.

3. Foreign exchange losses on a UK participation
The other case concerned a Dutch parent company of a fiscal unity, which held direct and indirect participations, some of which were established in the UK. An interest in a Dutch company was held via this UK branch. Internal reorganizations took place in 2008 and 2009, which also involved intercompany debt. After the reorganizations, the Dutch company was held directly by the fiscal unity, while the UK branch was held indirectly via a Luxembourg company. As a result of the reorganizations a foreign exchange loss was incurred on the capital invested in the UK branch. The application of the participation exemption means that such foreign exchange losses are, in principle, non-deductible. The question that arose was whether EU law would nevertheless require their deduction.

Interim Supreme Court judgment (July 2016)
The Supreme Court ruled that it is not beyond reasonable doubt whether the taxpayer is justified in invoking the Groupe Steria judgment. One of the questions it therefore asked the CJEU was whether the EU freedom of establishment requires that foreign exchange losses incurred on the capital invested in an EU subsidiary be deducted if this is also permitted in domestic situations?

CJEU judgment (February 2018)
According to the CJEU, internal and cross-border situations are not objectively comparable in this context. A Dutch company cannot incur any foreign exchange losses on its Dutch participation, other than in the very exceptional event that this participation is denominated in another currency than the one in which the result of the parent company is denominated. But even in that case it can be disputed whether there is a difference in treatment, because for a resident subsidiary that is *a member of a fiscal*

unity the participation relationship is not visible, so that even then no deductible exchange loss on the participation can be recognized. Lastly, the CJEU reiterated its conclusion in the X judgment that a Member State does not have to deduct losses if positive results are not taxable. This is the case under the Dutch participation exemption.

The CJEU concluded that not allowing the deduction of foreign exchange losses incurred on EU subsidiaries is not contrary to the freedom of establishment.

Final Supreme Court judgment (October 2018)
In this case too, the Supreme Court ruled in accordance with the CJEU judgment. The foreign exchange losses therefore cannot be deducted.

4. Follow-up
As stated above, the government had already submitted a bill with emergency repair measures on June 4, 2018. A letter that the Deputy Minister of Finance recently sent to the Lower House shows that the retroactive effect contained in the bill, to 11:00 a.m. on October 25, 2017, will be limited to January 1, 2018 (see our previous memorandum). At the beginning of August 2018, the Lower House submitted its questions about the bill. The Deputy Minister of Finance's answers to these questions are expected soon. Lastly we would like to point out that the government previously indicated that it would soon be following up its emergency repair measures with a future-proof group regime. The preparations for a draft bill that can be opened for internet consultation are expected to be completed in mid-2020.

We will, of course, keep you informed of developments. Please feel free to contact your Meijburg advisor if you have questions or wish to discuss, for example, whether as a result of the current status of this matter an existing fiscal unity, acquisition or financing structure should be left in place.

Meijburg & Co
October 2018

The information contained in this memorandum is of a general nature and does not address the specific circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.