Cases C-398/16 *X BV* and C-399/16 *X NV*
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Cases C-398/16 *X BV* and C-399/16 *X NV*

CJEU rules on compatibility with freedom of establishment of Dutch provisions limiting the deduction of interest expenses and currency losses in cases of investments in foreign subsidiaries

The judgement concerns Dutch rules regarding the deductibility of interest and currency losses in cases of investments in foreign subsidiaries. In case C-398/16, a Dutch parent (*X BV*) was denied the deduction of interest expenses on an intra-group loan obtained in order to finance a capital contribution in an Italian subsidiary. In case C-399/16, another Dutch parent (*X NV*), was denied the deduction of currency losses related to the shareholding in a UK subsidiary.

In both cases, the taxpayers argued that the deduction of interest and currency losses would be allowed if the investments were made in resident, rather than non-resident, companies, since in such a case the latter companies could be included in a Dutch fiscal unit and, as a consequence, the costs could be deducted. The taxpayers claimed the existence of a violation of the freedom of establishment since Dutch rules had the effect of restricting the investment in foreign subsidiaries.

In its analysis, the CJEU relied on its prior decision in *Groupe Steria* (C-386/14, §§ 27 and 28) and reiterated that a violation of the freedom of establishment may arise if tax advantages, other than the transfer of tax losses, are granted to companies belonging to a domestic fiscal unit whereas such advantages are excluded in cross-border situations where there is no possibility to opt for such a fiscal unit (§ 24). The CJEU then analyzed the two cases separately.

With regard to the deduction of interest, the CJEU ruled in favor of the taxpayer. It pointed out the existence of a different treatment between the domestic and the cross-border situation (§ 31). The CJEU assessed the comparability between those situations and, relying on its prior decision in the X Holding case (C-337/08), it upheld that, with regard to the objective of the Dutch fiscal unit regime, the situation of a Dutch parent wishing to form a fiscal unit with a resident subsidiary and that of a Dutch parent wishing to form a fiscal unit with

a non-resident subsidiary are objectively comparable (§ 36). The CJEU examined whether the different treatment of comparable situations could be justified by overriding reasons in the public interest and rejected all justification grounds. With regard to (i) the justification based on the need to safeguard the allocation of taxing power, the CJEU clarified that the tax advantage related to interest deduction is not specifically linked to the fiscal unit regime (§ 40) and that, moreover, the Dutch rules on interest deduction do not take into account the place of taxation of the income comprising the interest paid (§ 41). In respect of (ii) the justification based on the coherence of the Dutch fiscal unit regime, the Court held that such justification could not be accepted since the Dutch Government failed to demonstrate why the regime would be jeopardized if the deduction of interest were permitted (§ 44). Finally, with regard to (iii) the justification based on the need to prevent abuses, the CJEU highlighted that the Dutch fiscal unit regime was not specifically targeted at countering abusive schemes (§ 49) and, in addition, that the acquisition of foreign subsidiaries did not carry a higher risk of abuse than the acquisition of domestic subsidiaries (§ 50).

With regard to the deduction of currency losses, the CJEU ruled against the taxpayer. The CJEU took the position that the situation of a Dutch parent holding shares in a UK company is not comparable to that of a Dutch parent holding shares in a Dutch subsidiary. In the latter case, in fact, the Dutch parent may not sustain currency losses on its shareholding in the resident subsidiary, except in the very special case where that shareholding is denominated in foreign currency (§ 56). The CJEU also questioned the existence of a difference in treatment, by arguing that within a fiscal unit the parent cannot deduct the depreciation of the shareholding in a domestic entity (§ 57). Lastly, the CJEU found that the Dutch rules at stake are symmetrical, in the sense that the denial of deduction of currency losses is inseparable from the symmetrical advantage related to the absence of taxation of currency gains (§ 59).

Case C-28/17, *NN*

AG Campos Sánchez-Bordona issued his opinion on the compatibility with the TFEU of Danish legislation limiting the use, within domestic fiscal units, of losses incurred by Danish PEs of EU companies

On 21 February 2018, AG Campos Sánchez-Bordona of the Court of Justice of the European Union ("Court") issued his opinion in Case C-28/17, *NN*. The case concerns a Danish parent company that included in its fiscal unit a Danish permanent establishment ("PE") of a Swedish subsidiary. The Danish PE incurred losses, which the Danish parent was not allowed to use within its fiscal unit since, under Danish law, the deduction of the losses incurred by domestic PEs from the profits of the fiscal unit is subject to the requirement that such losses cannot be used in the State of residence of the companies of which the PEs are part (the "Residence State").

The AG confirmed that Danish PEs are comparable to Danish companies for the purposes of the fiscal unit regime, as the Court already stated in the *Philips Electronics* case (C-18/11). As a consequence, by treating comparable situations differently, the Danish legislation restricts the freedom of establishment.

The AG then suggested that, in the light of the recent legislative developments, particularly the adoption of Directive (EU) 2016/1164 (ATAD I) and Directive (EU) 2017/952 (ATAD II), which implement within the EU some of the best practices recommended by the OECD as a result of the BEPS Project, the Court should change the stand taken in the *Philips Electronics* decision and consider the objective of preventing the double use of losses as a standalone justification

applicable in the case at stake. Such justification, however, might be upheld only to the extent that the losses are effectively deducted twice, i.e. once in the State of the PE (Denmark) and once in the Residence State (Sweden).

The conclusions of the AG are difficult to reconcile with ATAD II. Indeed, with regard to intra-EU situations, article 9 of the latter Directive provides that double deductions should be avoided by the State of the investor (i.e. the Residence State), which should deny the use of the losses unless a double inclusion occurs. The State of the PE, on the other hand, should continue to allow the loss deduction according to its standard regime.

If the conclusions of the AG were to be upheld by the Court, the case could provide the basis for the Italian legislature to amend the current rules on tax consolidation, which do not make the use of losses incurred by domestic PEs subject to the requirement that they are not also deducted in the Residence State. In any case, the legislature should have due regard to the fact that, as previously mentioned, ATAD II imposes an obligation to eliminate the double deduction on the Residence State (and not on the PE State) and that Italy is bound to implement that directive by 31 December 2019.

For further information: **Maisto e Associati**

Milan
Piazza F. Meda 5
20121
T: +39.02.776931

Rome
Piazza d'Aracoeli 2
00186
T: +39.06.45441410

London
2, Throgmorton Avenue
EC2N 2DG
T: +44.207.3740299
