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JUDGMENT OF THE COURT (Fifth Chamber)

18 September 2003 (1)

(Freedom of establishment - Taxation - Taxes on company profits - Limitation of the deductibility in one Member State of costs connected with holdings of a parent company in its subsidiaries established in other Member States - Coherence of the tax system)

In Case C-168/01,

REFERENCE to the Court under Article 234 EC by the Hoge Raad der Nederlanden (Netherlands) for a preliminary ruling in the proceedings pending before that court between

Bosal Holding BV

and

Staatssecretaris van Financiën,

on the interpretation of Article 52 of the EC Treaty (now, after amendment, Article 43 EC), of Article 58 of the EC Treaty (now Article 48 EC), and of Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ 1990 L 225, p. 6),

THE COURT (Fifth Chamber),

composed of: M. Wathelet, President of the Chamber, C.W.A. Timmermans, D.A.O. Edward (Rapporteur), P. Jann and S. von Bahr, Judges,

Advocate General: S. Alber,

Registrar: D. Louterman-Hubeau, Head of Division,

after considering the written observations submitted on behalf of:

- Bosal Holding BV, by F.C. de Hosson, advocaat,

- the Netherlands Government, by H.G. Sevenster, acting as Agent,

- the United Kingdom Government, by J.E. Collins, acting as Agent, and R. Singh QC,

- the Commission of the European Communities, by R. Lyal and H. van Vliet, acting as Agents

having regard to the Report for the Hearing,

after hearing the oral observations of Bosal Holding BV, represented by F.C. de Hosson, of the Netherlands Government, represented by H.G. Sevenster, of the United Kingdom Government, represented by J.E. Collins, R. Singh and M. Hoskins, Barrister, and of the Commission, represented by R. Lyal and H. van Vliet, at the hearing on 11 July 2002,

after hearing the Opinion of the Advocate General at the sitting on 24 September 2002,

gives the following

Judgment

1. By judgment of 11 April 2001, received at the Court on 19 April 2001, the Hoge Raad der Nederlanden (Supreme Court of the Netherlands) referred to the Court for a preliminary ruling under Article 234 EC two questions on the interpretation of Article 52 of the EC Treaty (now, after amendment, Article 43 EC), of Article 58 of the EC Treaty (now Article 48 EC), and of Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ 1990 L 225, p. 6).

2. Those questions were raised in a dispute between Bosal Holding BV (Bosal), a limited liability company (besloten vennootschap) established in the Netherlands and the inspector of the Belastingdienst/Grote ondernemingen Arnhem (Arnhem Tax Office/Large Undertakings; the inspector) concerning the latter's refusal to allow the sum of NLG 3 969 339, representing the amount of the costs in relation to Bosal's holdings in its subsidiaries in other Member States, to be deducted from the computation of that company's taxable profits for the financial year 1993.

Legal background

Community Law

3. According to the first paragraph of Article 52 of the Treaty:

Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be abolished by progressive stages in the course of the transitional period. Such progressive abolition shall also apply to restrictions on the setting up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

4. The first paragraph of Article 58 of the Treaty provides:

Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.

5. The third recital in the preamble to Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ 1990 L 225, p. 6; the directive), states:

Whereas the existing tax provisions which govern the relations between parent companies and subsidiaries of different Member States vary appreciably from one Member State to another and are generally less advantageous than those applicable to parent companies and subsidiaries of the same Member State; whereas cooperation between companies of different Member States is thereby disadvantaged in comparison with cooperation between companies of the same Member State; whereas it is necessary to eliminate this disadvantage by the introduction of a common system in order to facilitate the grouping together of companies.

6. Article 1 of the directive provides:

1. Each Member State shall apply this Directive:

- to distributions of profits received by companies of that State which come from their subsidiaries of other Member States,

- to distributions of profits by companies of that State to companies of other Member States of which they are subsidiaries.

2. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse.

7. Article 4 of the directive reads:

1. Where a parent company, by virtue of its association with its subsidiary, receives distributed profits, the State of the parent company shall, except when the latter is liquidated, either:

- refrain from taxing such profits, or

- tax such profits while authorising the parent company to deduct from the amount of tax due that fraction of the corporation tax paid by the subsidiary which relates to those profits and, if appropriate, the amount of the withholding tax levied by the Member State in which the subsidiary is resident, pursuant to the derogations provided for in Article 5, up to the limit of the amount of the corresponding domestic tax.

2. However, each Member State shall retain the option of providing that any charges relating to the holding and any losses resulting from the distribution of the profits of the subsidiary may not be deducted from the taxable profits of the parent company. Where the management costs relating to the holding in such a case are fixed as a flat rate, the fixed amount may not exceed 5% of the profits distributed by the subsidiary.

3. Paragraph 1 shall apply until the date of effective entry into force of a common system of company taxation.

The Council shall at the appropriate time adopt the rules to apply after the date referred to in the first subparagraph.

The national legislation

8. Article 13(1) of the Wet op de Vennootschapsbelasting 1969 (Law on Corporation Tax of 1969 - 1993 version - the 1969 Law) provides:

In determining profit no account shall be taken of gains acquired from a holding or of the costs relating to a holding, unless it is evident that such costs are indirectly instrumental in making profit that is taxable in the Netherlands (exemption relating to holdings). In any event, the interest on and costs of loans taken up in the six months preceding the acquisition of the holding shall, except where it is likely that these loans have been taken up for a purpose other than the acquisition of the holding, be regarded as costs relating to a holding.

The dispute in the main proceedings and the questions referred

9. Bosal is a company which carries on holding, financing and licensing/royalty related activities and which, as a taxpayer, is subject to corporation tax in the Netherlands. For the 1993 financial year, it declared costs amounting to NLG 3 969 339 in relation to the financing of its holdings in companies established in nine other Member States. In an annex to its declaration concerning that financial year, Bosal claimed that those costs should be deducted from its own profits.

10. The inspector refused to allow the deduction sought, and the Gerechtshof te Arnhem (Netherlands), before which Bosal brought an action against the dismissal of its claim, confirmed the inspector's position. It is in those circumstances that Bosal appealed on a point of law to the referring court.

11. Taking the view that an interpretation of Community law was necessary in order to resolve the dispute before it, the Hoge Raad der Nederlanden decided to stay the proceedings and refer the following questions to the Court for a preliminary ruling:

1. Does Article 52 of the EC Treaty, read in conjunction with Article 58 thereof ..., or any other rule of EC law, preclude a Member State from granting a parent company subject to tax in that Member State a deduction on costs relating to a holding owned by it only if the relevant subsidiary makes profits which are subject to tax in the Member State in which the parent company is established?

2. Does it make any difference to the answer to Question 1 whether, where the subsidiary is subject to tax based on its profits in the Member State concerned but the parent company is not, the relevant Member State takes account of the abovementioned costs in levying tax on the subsidiary?

The questions referred

12. By its questions, which it will be convenient to examine together, the referring court effectively asks whether Community law precludes a national provision which, when determining the tax on the profits of a parent company established in one Member State, makes the deductibility of costs in connection with that company's holding in the capital of a subsidiary established in another Member State subject to the condition that such costs are indirectly instrumental in making profits which are taxable in the Member State where the parent company is established.

13. By way of a preliminary remark, it is apparent from the written observations of the Netherlands Government that the deductibility of costs provided for in Article 13(1) of the 1969 Law in relation to the taxable profit of the parent company depends solely on the question whether those costs are indirectly instrumental in the making of profits taxable in the Netherlands, without there being any requirement, however, that those profits be made by subsidiaries themselves established in that Member State or established abroad but having a stable establishment in the latter. A parent company established in the Netherlands would thus have the right to deduct from its taxable profit in that State costs in connection with the financing of its holdings in subsidiaries themselves established in the Netherlands or in subsidiaries established in other Member States but having a stable establishment in the Netherlands.

14. The Hoge Raad der Nederlanden points out that making the deductibility of those costs subject to the condition that they must be instrumental in making profits taxable in the State of establishment of the parent company constitutes a hindrance to the freedom of establishment, as it may have a negative influence on the decision of a parent company to set up a subsidiary in another Member State. The Hoge Raad is uncertain, however, as to whether that hindrance might be justified having regard to the need to ensure the coherence of the Netherlands tax system.

15. It indicates in that respect that the treatment of holding costs in relation to taxable profits lacks coherence for three reasons. First, those costs may be deducted from the profits of the Netherlands parent company without the size of the profits of the subsidiary being taken into account, even if the latter made no profit during the year in question. Second, where the subsidiary makes profits but the parent makes none, the costs in relation to the holding have no influence, from a global standpoint, on the taxation of the subsidiary's profits. Finally, the costs in relation to the holding which are indirectly instrumental in taxable profits being made in the Netherlands are not deductible where those profits are made by a Netherlands subsidiary of a foreign parent company.

16. Bosal considers that, by allowing costs to be deducted only if they are instrumental in taxable profits being made in the Netherlands, the 1969 Law inhibits the exercise of the freedom of establishment, as it penalises the creation of subsidiaries in another Member State. Therefore, the option recognised to Member States by the directive not to allow deductibility of holding costs in the capital of a subsidiary cannot be limited to holdings in subsidiaries which do not generate taxable profits in the Member State where the parent company is established, but should be applied to all holdings, even if they generate, directly or indirectly, taxable profits in that Member State.

17. By contrast, the Netherlands and United Kingdom Governments, and the Commission, consider that the 1969 Law is not contrary to Community law because it does not contain any restriction on the freedom of establishment or because, even if such a restriction did exist, it would be objectively justified in any event.

18. First, according to the Netherlands Government, the subsidiaries of parent companies established in the Netherlands which do make taxable profits in that Member State and those which do not are not in an objectively comparable situation. The government relies on the principle of territoriality to argue that there is a great difference between subsidiaries according to whether or not they carry on business abroad. In the first case, it is not the whole of the profits made by the group of companies concerned which is made subject to the Netherlands tax, whereas that is the case with the second hypothesis. That difference in situation between subsidiaries of parent companies established in the Netherlands justifies different treatment, in relation to those parent companies, of the costs connected with the holdings of the latter in the capital of such subsidiaries.

19. Second, the Netherlands and United Kingdom Governments and the Commission argue that the refusal to grant to parent companies which do not have subsidiaries

generating taxable profits in the Netherlands the right to deduct from their taxable profit in that Member State the costs arising from the financing of holdings in the capital of their subsidiaries is, in any event, justified by the need to maintain the coherence of the Netherlands tax system (Case C-204/90 *Bachmann* [1992] ECR I-249; Case C-300/90 *Commission* v *Belgium* [1992] ECR I-305).

They argue that there is a direct link between, on the one hand, the costs connected with the parent company's holding in the capital of the subsidiary and, on the other, the profits of the latter taxable in the Netherlands, being profits which those costs are instrumental in generating before their deduction.

20. Third, the Netherlands Government and the Commission argue that the limitation of the deductibility of costs incurred in relation to holdings is justified by the objective of avoiding an erosion of the tax base going beyond a mere diminution in tax receipts.

21. Finally, the Netherlands and United Kingdom Governments and the Commission argue that the 1969 Law is compatible with the directive because, under Article 4 of the directive, it is lawful for Member States to provide that costs in relation to holdings are not in any way deductible from the taxable profits of the parent company. That would imply that Member States have the possibility of refusing the deductibility of such costs in part.

22. Concerning that latter point, the Court notes as a preliminary observation that, as appears particularly from the third recital in its preamble, the directive seeks to eliminate any disadvantage resulting from the fact that tax provisions governing relations between parent companies and subsidiaries of different Member States are, in general, less favourable than those applicable to relations between parent and subsidiary companies of the same Member State, and thereby to facilitate the grouping together of companies at Community level (Case C-294/99 *Athinaïki Zythopoiïa* [2001] ECR I-6797, paragraph 25).

23. Concerning the specific question of the tax treatment of costs connected with the holding of a parent company, established in one Member State, in the capital of a subsidiary company established in another, Article 4(2) of the directive leaves each Member State the option of providing that any charges relating to that holding may not be deducted from the taxable profits of the parent company.

24. Whereas, pursuant to Article 4(3) of the directive, Article 4(1) thereof applies only until the date of effective entry into force of a common system of company taxation, Article 4(2), authorising Member States not to deduct the costs in relation to the holding from the taxable profit of the parent company, is not accompanied by any condition or special rule concerning the destination or purpose of the profits obtained by the parent company or its subsidiary, or concerning the applicability in time of Article 4(2). Therefore, that provision remains applicable even after the effective entry into force of a common system of company taxation.

25. It follows that, in so far as Article 13(1) of the 1969 Law merely implements the possibility offered by Article 4(2) of the directive to refuse the deduction of costs incurred by parent companies in connection with holdings in the capital of their subsidiaries, it is compatible with the directive.

26. However, that possibility may be exercised only in compliance with the fundamental provisions of the Treaty, in this case Article 52 thereof. It is therefore in relation to that provision that it is necessary to examine the question whether the directive authorises a Member State only partially to allow, as does Article 13(1) of the 1969 Law, the deductibility of costs in relation to holdings.

27. As the referring court has pointed out, the limitation laid down in Article 13(1) of the 1969 Law of the deductibility of costs incurred by the parent company established in the Netherlands in connection with the capital of subsidiaries established in other Member States to cases where the latter generate, even if only indirectly, profits which are taxable in the Netherlands constitutes a hindrance to the establishment of subsidiaries in other Member States. In the light of that limitation, a parent company might be dissuaded from carrying on its activities through the intermediary of a subsidiary established in another Member State since, normally, such subsidiaries do not generate profits that are taxable in the Netherlands.

28. Moreover, such a limitation goes against the objective set forth by the directive, spelt out in the third recital of its preamble, according to which it is necessary to introduce a common system and eliminate the disadvantage due to the application of tax provisions governing relations between parent companies and subsidiaries of different Member States which are less advantageous than those applicable to parent companies and subsidiaries of the same Member State.

29. As regards the argument concerning the need to preserve the coherence of the tax system, the Court of Justice pointed out in its judgment in Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraph 57, that, in *Bachmann* and *Commission* v *Belgium*, a direct link existed, in the case of

one and the same taxpayer, between the grant of a tax advantage and the offsetting of that advantage by a fiscal levy, both of which related to the same tax.

30. Where there is no such direct link, because, for example, one is dealing with different taxes or the tax treatment of different taxpayers, the argument based on the coherence of the tax system cannot be relied upon (see, to that effect, Case C-251/98*Baars* [2000] ECR I-2787, paragraph 40).

31. In the main proceedings in this case, there is no direct link of that kind. Nor is there any direct link between, on the one hand, the granting of a tax advantage (the right to deduct costs connected with holdings in the capital of their subsidiaries from their taxable profit) to parent companies established in the Netherlands and, on the other, the tax system relating to the subsidiaries of parent companies where the latter are established in that Member State.

32. Unlike operating branches or establishments, parent companies and their subsidiaries are distinct legal persons, each being subject to a tax liability of its own, so that a direct link in the context of the same liability to tax is lacking and the coherence of the tax system cannot be relied upon.

33. Moreover, the limitation of the deductibility of costs incurred by a parent company established in the Netherlands in connection with its holdings in the capital of subsidiaries established in other Member States is not compensated for by a corresponding advantage. The effect of implementing that limitation appears to be that costs which should normally be deductible are not taken into consideration when calculating the amount of the tax liability.

34. Such overtaxation cannot be justified by reference to the need to preserve the coherence of the tax system.

35. Nor is there any direct link between the costs which a parent company may deduct from its taxable profit in the Netherlands and the potential taxable profits of its subsidiary established in that Member State or of the stable Netherlands establishment of its foreign subsidiary. In that respect, the order for reference shows that the costs incurred in relation to holdings may be deducted from the profits of such a parent company without any account being taken of the size of the profits of the subsidiary, even if the latter did not make any profit during the year concerned.

36. Moreover, as the referring court and the Commission have pointed out, one is entitled to question the coherence of a system of taxation based on the existence of a link between costs incurred in relation to holdings and the existence of profits taxable in the Netherlands within the same group of companies, while subsidiaries of parent companies established in other Member States cannot deduct from their profits taxable in the Netherlands the costs in relation to holdings of those parent companies.

37. An argument based on the principle of territoriality, as recognised by the Court of Justice in Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, paragraph 22, has also been relied upon by the Netherlands Government in order to justify the difference in tax treatment under the 1969 Law. According to the government, the costs in connection with activities abroad, including financing costs and costs in relation to holdings, should be set off against the profits generated by those activities and the deduction of those costs is linked solely to the making or non-making of profits outside the Netherlands. According to the Netherlands Government, there is therefore no discrimination, the subsidiaries which do make profits taxable in the Netherlands and those which do not being in a situation which is not comparable.

38. In that respect, it should be noted that the application of the territoriality principle in *Futura Participations and Singer* concerned the taxation of a single company which carried on business in the Member State where it had its principal establishment and in other Member States from secondary establishments.

39. Having regard to the facts of the main dispute, and as the Advocate General has stated in points 50 and 51 of his Opinion, the argument that the differentiated tax treatment of parent companies is justified by the fact that subsidiaries which make profits taxable in the Netherlands and those which do not are not in comparable situations is irrelevant. The difference in tax treatment in question concerns parent companies according to whether or not they have subsidiaries making profits taxable in the Netherlands, even though those parent companies are all established in that Member State. As regards the tax situation of the latter in relation to the profits of their subsidiaries, however, it must be noted that those profits are not taxable in the hands of those companies, whether the profits come from subsidiaries taxable in the Netherlands or from other subsidiaries.

40. Moreover, in a case concerning the tax treatment of a subsidiary which varied in relation to the seat of the parent company, the Court has held that the difference in the tax treatment of parent companies depending on whether or not they are resident cannot justify denial of a tax advantage to subsidiaries, resident in the United Kingdom, of parent companies having their seat in another Member State where that advantage is available to subsidiaries, resident in the United Kingdom, of parent companies also resident in the United Kingdom, since all those subsidiaries are liable to mainstream corporation tax on their profits irrespective of the place of residence of their parent companies (Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, paragraph 60).

41. In addition, the directive does not provide for any exception concerning the territory where the profits of the subsidiaries might be taxed. In those circumstances, the directive cannot be interpreted as authorising a law such as the 1969 Law.

42. As for the argument of the Netherlands Government and the Commission that the limitation on deductibility is justified by the aim of avoiding an erosion of the tax base going beyond mere diminution of tax revenue, this cannot be accepted. Such a justification does not differ in substance from that concerning the risk of a diminution in tax revenue. In that respect, the case-law of the Court of Justice shows that such a justification does not appear amongst the grounds listed in Article 56(1) of the EC Treaty (now, after amendment, Article 46(1) EC) and does not constitute a matter of overriding general interest which may be relied upon in order to justify a restriction on the freedom of establishment (see, to that effect, Case C-264/96 *ICI* v *Colmer* [1998] ECR I-4695, paragraph 28).

43. The answer to the questions must therefore be that, interpreted in the light of Article 52 of the Treaty, the directive precludes a national provision which, when determining the tax on the profits of a parent company established in one Member State, makes the deductibility of costs in connection with that company's holding in the capital of a subsidiary established in another Member State subject to the condition that such costs be indirectly instrumental in making profits which are taxable in the Member State where the parent company is established.

Costs

44. The costs incurred by the Netherlands and United Kingdom Governments and by the Commission, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties in the main action, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT (Fifth Chamber),

in answer to the questions referred to it by the Hoge Raad der Nederlanden by judgment of 11 April 2001, hereby rules:

Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, interpreted in the light of Article 52 of the EC Treaty (now, after amendment, Article 43 EC) precludes a national provision which, when determining the tax on the profits of a parent company established in one Member State, makes the deductibility of costs in connection with that company's holding in the capital of a subsidiary established in another Member State subject to the condition that such costs be indirectly instrumental in making profits which are taxable in the Member State where the parent company is established.

Wathelet
Timmermans
Edward

Jann
von Bahr

Delivered in open court in Luxembourg on 18 September 2003.

R. Grass

M. Wathelet

Registrar

President of the Fifth Chamber

1: Language of the case: Dutch. </HTML