Pending EU case reinforces position for horizontal tax consolidation in Spain

Executive summary

On 27 February 2014, the EU Advocate General Kokott confirmed in her conclusions on the joint cases C-39/13, C-40/13 and C-41/13 that the Dutch tax consolidation regime is not compatible with the EU freedom of establishment. These conclusions are in line with previous decisions by the Court of Justice of the European Union (CJEU) in the Papillon and the X Holding BV cases,¹ which have set the grounds for the compatibility of domestic tax consolidation regimes with EU Law.

Under the Dutch rules, a tax consolidation group can only be formed if all the companies included are Dutch tax residents and there are no intermediate holding companies which are residents outside of the Dutch territory. As a result, a Dutch holding company which owns a Dutch subsidiary through an intermediate EU company or two Dutch companies which have an EU tax resident common shareholder would not be able to form a tax consolidation group.

Spanish rules are similar to Dutch legislation and do not allow “horizontal tax consolidation,” i.e., two Spanish companies having a common EU shareholder cannot form a Spanish tax consolidation group.

If the CJEU rules in line with the Advocate General’s view, domestic rules governing tax consolidation groups would have to be amended to allow for horizontal tax consolidation.

In light of the Advocate General’s conclusions and previous case law, and considering the similarities between the Spanish and Dutch tax regimes, multinational groups with Spanish subsidiaries with a common EU shareholder may be allowed to form a tax consolidation group and should assess the possibility of filing for such regime.
Detailed discussion

Background
In the last few years, a number of cases dealing with the application of the Dutch tax consolidation regime to multinational groups, where some of the Dutch companies are held by other EU tax resident companies, have been analyzed by the Dutch domestic courts.

Three of these cases were brought before the CJEU to determine whether the Dutch tax consolidation regime is in breach of the EU principle of freedom of establishment.

Two of these cases raise the issue of whether Dutch subsidiaries, which are indirectly held by a Dutch parent company through EU tax resident subholdings, should be allowed to join the Dutch tax consolidation group. This is the same fact pattern which was addressed in the Papillon case.

In the third case the issue is whether three Dutch companies, with a common EU shareholder, should be allowed to form a tax consolidation group in The Netherlands.

CJEU case law on domestic tax consolidation regimes
The compatibility of domestic tax consolidation regimes with the EU principles was addressed for the first time in the Papillon Case, where the CJEU concluded that the French tax consolidation regime was in breach of the freedom of establishment as it did not allow for a French company which participated in another French company through a Dutch intermediate holding, to include the French subsidiary in its tax consolidation group.

Conversely, in the X Case, the Court had the chance to examine the Dutch tax consolidation regime and concluded that a regime which does not allow for consolidation of companies resident in different EU member States is not in breach of EU Law, the argument being that the discrimination is justified to ensure the allocation of taxation powers among the EU member States.

More recently, the CJEU has issued a decision in the Felixstowe Case, in which the UK consortium regime is deemed to be in breach of EU Law because it does not allow the transfer of losses among UK resident companies which have a “link company” which is not tax resident in the UK but is resident in another EU member State. While the UK regime is not similar to the Spanish tax consolidation regime, this is a valuable precedent as it shows the criteria applied by the CJEU in similar discriminatory circumstances.

EU Advocate General’s conclusions
In the conclusions issued on 27 February 2014, the EU Advocate General opined on the EU compatibility of the Dutch tax consolidation regime in two different fact patterns: the indirect holding of Dutch subsidiaries through EU tax resident holding companies (similar to the Papillon Case, although involving lower-tier subsidiaries), and the tax consolidation of sister companies having a common EU shareholder. This is, therefore, the first opportunity for the CJEU to address the so-called “horizontal tax consolidation.”

The Advocate General concludes that the Dutch tax consolidation regime is, in both situations, in breach of EU Law, as it does not allow the Dutch companies involved in the case to participate in the existing tax consolidation group or to create a new one, the only reason being that such Dutch companies are held by other EU tax resident companies.

The Advocate General therefore concludes that the Dutch tax regime should be amended to allow, not only for tax consolidation in a fact pattern similar to that in Papillon, but also in case of sister Dutch companies with a common EU shareholder.

Implications in Spain
Spanish rules defining the companies which may enter into a tax consolidation group are identical to the Dutch regime, as they also require that Spanish companies forming a tax consolidation group have a common Spanish shareholder. Similarly to the Dutch rules being challenged in the referenced cases, the Spanish regime does not allow Spanish sister companies held by a common EU shareholder to create a tax consolidation group, unless the sister companies are held through a Spanish permanent establishment of the common EU shareholder.
A decision from the CJEU in favor of the taxpayers in the pending cases would also render the Spanish tax consolidation regime incompatible with the EU freedom of establishment. Under this approach, multinational groups seeking to form a horizontal tax consolidation group with their Spanish companies (e.g., where there are loss-making and profit-making Spanish subsidiaries held by a common EU shareholder) should assess the possibility of electing this regime, following the formalities required by the Spanish rules. The rules generally require that the election be made in the year prior to that in which the consolidation rules are to be applied, i.e., for groups having a calendar tax year, the election for horizontal tax consolidation would have to be made in 2014. A number of practical issues must be carefully addressed when opting for this scheme.

EY has broad experience in claims based on EU principles and is able to assist clients in electing “horizontal tax consolidation” in Spain.

Endnotes
1. C-418/07, decision dated 27 November 2008 and C-337/08, decision dated 25 February 2010, respectively.
4. C-80/12, decision dated 1 April 2014.
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