Executive summary

On 22 February 2018, the Court of Justice of the European Union (CJEU) issued a long-awaited decision in two cases that may impact taxpayers currently applying the Dutch tax consolidation regime (fiscal unity). The essential question brought before the CJEU was whether certain (beneficial) elements of the Dutch fiscal unity regime currently only available in domestic situations should also be made available (on a stand-alone basis) in a broader EU context. In line with the Opinion of the Advocate-General (AG) of 25 October 2017 (the Opinion),² the CJEU answered this question affirmatively.

In view of the significant (budgetary) impact, the Dutch Government announced legislation on 25 October 2017 to become applicable contingent upon a confirmation of the Opinion by the CJEU ruling, basically canceling various (domestic) benefits of the fiscal unity regime with retroactive effect to 25 October 2017, as outlined in a prior EY Global Tax Alert. Upon the final decision of the CJEU, the Dutch Government immediately sent a letter to the Dutch Parliament, confirming that it will issue this announced legislation in the second quarter of 2018, retaining the retroactive effect to 25 October 2017. Simultaneously, discussions with stakeholders will be started to design an EU-compliant regime that ensures a continuation of its attractiveness for both Dutch and foreign investors.

Given the significant impact of the decision in conjunction with the retroactive nature of the pending legislation, taxpayers that currently have a Dutch fiscal unity in place should evaluate the impact of this legislation on their operations.
Detailed discussion

Fiscal unity regime

A group of Dutch resident companies\(^2\) can file a single tax return and calculate the Dutch corporate income tax on a consolidated basis by forming a fiscal unity. The Dutch fiscal unity regime is not available for companies that are not tax resident in the Netherlands.

Application of the fiscal unity regime can have several benefits. For example, losses of one entity could be offset against the profits of another entity. In addition, transactions within a fiscal unity are typically ignored, as a result of which for example, assets may be transferred between group companies without tax consequences and loans may be disregarded. Administrative simplicity is also an advantage; only a single corporate income tax return has to be filed. There are also disadvantages, such as joint and several liability for corporate income tax payable and exposure to complex anti-abuse rules.

Background on the two cases brought before the CJEU

In the two cases brought before the CJEU, the question was whether the Netherlands must grant certain stand-alone benefits of the fiscal unity regime in a broader EU context based on the so-called per-element approach introduced by the CJEU in its *Groupe Steria* decision of 2 September 2015 (C-386/14).

In the first case, the taxpayer was confronted with Dutch base erosion rules of article 10a of the Dutch Corporate Income Tax Act 1969 (CITA) that, *inter alia*, may deny the deduction of interest for loans used to finance capital investments in a (n) (EU) subsidiary. This rule would not have applied in a Dutch domestic context if the taxpayer had included a domestic subsidiary in a fiscal unity prior to the capital contribution, as such capital contribution would consequently have been disregarded.

The second case dealt with a similar issue regarding a non-deductible currency loss suffered with regard to a participation held in a UK subsidiary. If this subsidiary had been allowed to be included in a fiscal unity, currency exchange losses with respect to its assets would generally have been deductible for Dutch corporate income tax purposes.

In both cases, the question was whether the Netherlands may refuse to grant these tax benefits (interest deduction and deduction of the currency loss) of the fiscal unity regime in cross-border situations.

Decision of the CJEU

In line with the per-element approach developed by the CJEU in its *Groupe Steria* decision, the CJEU ruled that each stand-alone benefit of the Dutch fiscal unity regime should be assessed on a case-by-case basis, thereby thus ignoring the fact that the fiscal unity regime is an overall package of advantages and disadvantages.

Applying this case-by-case approach, the CJEU ruled in the first case that the interest deduction limitation rule of article 10a CITA is a non-justifiable infringement of the freedom of establishment, as such taking into consideration that its application could have been avoided in domestic situations by forming a fiscal unity.

On the basis of its earlier case law (in particular Case X which the CJEU ruled upon on 10 June 2015 (C-686/13)), the CJEU decided in the second case that the freedom of establishment does not require the Netherlands to deduct currency losses suffered from EU-participations.

Response of the Dutch Government

The CJEU’s decision is in line with the Opinion issued by the AG on 25 October 2017. Following the conclusion of the AG, the Dutch Government already announced on that same date that it would issue emergency response legislation if the CJEU were to follow the Opinion. These measures would be implemented into law with retroactive effect to 25 October 2017, 11:00 AM. Following the CJEU’s decision, the Dutch Government has now confirmed the release of such legislation in a letter to the Dutch Parliament. It is expected that the actual legislative proposal will be submitted to Parliament in the second quarter of 2018.

The response measures are basically intended to provide an introduction of the “per-element approach” in certain domestic situations, with the aim to equally restrict certain benefits of the current fiscal unity regime, rather than granting such benefits EU-wide, given the adverse budgetary consequences that would have. As a result, certain tax rules would be applied as if no fiscal unity exists. The Dutch Government specifically mentions the application of the interest deduction limitation rule to prevent base erosion (article 10a CITA), certain specific elements of the participation exemption rules (article 13, paragraph 9 up to and including paragraph 15 CITA, as well as article 13, paragraph 17 CITA), excessive participation debt rules (article 13I CITA), the loss relief rules in the case of a change in ownership (article 20a CITA) and a specific credit mechanism for foreign dividend withholding taxes.
(article 11 of the Dutch Dividend Withholding Tax Act 1965). Other advantages, such as the tax neutral transfer of assets and the transfer of tax losses within the fiscal unity, are not specifically mentioned to be restricted.

The Dutch Government furthermore repeated that the emergency response measures should be replaced by a company tax group regime that is future (EU) proof both from a technical and legal perspective. With regard to the design and timing of the implementation of such a future regime, it was previously announced that consultations will be held with the Dutch business community and other stakeholders, taking into consideration the tax investment climate for (foreign) companies.

Current fiscal unity structures – next steps
The earlier announced and now confirmed emergency response measures may affect current fiscal unity structures, and it is therefore recommended that taxpayers verify what the impact of the announced measures may be for existing structures. For the period prior to 25 October 2017, 11:00 AM, the announced measures would not have an impact. The same is true – both for the future and for the past – for fiscal unity benefits that are not listed in the proposed response measures (e.g., tax-free transfer of assets). Taxpayers should also review whether a tax appeal to apply the per-element approach affirmatively could be beneficial.

Endnotes
2. And in certain cases also Dutch permanent establishments of foreign companies.
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