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German Tax and Legal News

New case law on cross-border loss relief within groups under EC freedom of establishment

ECJ rules on exclusion of foreign subsidiaries from Dutch fiscal unity
In its decision of 25 February 2010 (C-337/08), the European Court of Justice (ECJ) decided on whether Member States (in this case, the Netherlands) may exclude foreign subsidiaries from participating in a domestic group taxation regime that provides for a pooling of profits and losses within the group for tax purposes. The ECJ concluded that the Netherlands' restriction of the fiscal unity regime to domestic subsidiaries violates the freedom of establishment provision in the EC Treaty, but the restriction can be justified by the need to safeguard the allocation of the power to impose taxes between the Member States. The ECJ held that the Netherlands is not required to allow the offset of current losses of foreign subsidiaries that effectively meet all requirements for inclusion in a fiscal unity (apart from being a domestic entity) and as such can deny cross-border loss compensation. In its decision in the X-Holding case, the ECJ confirmed the principles of its 2005 decision in the Marks & Spencer case, where it stated that a Member State only is obliged to allow the deduction of final losses (i.e. losses that may neither be used by the subsidiary in another assessment period nor transferred to another taxpayer) of a foreign subsidiary at the level of the domestic parent company, provided other requirements for transferring the loss to the parent company are met.

Local tax court of Lower Saxony decides German Marks & Spencer case
In a recently published decision (6 K 406/08), the local tax court of Lower Saxony decided a case involving a German company with EU-based subsidiaries that incurred final losses. The court held that the losses are deductible at the level of the parent company if the parent company entered into a loss assumption agreement with its subsidiary for at least five years. According to the court, a loss transfer does not require a formal profit and loss pooling agreement (PLPA), which is a prerequisite for a German fiscal unity.

The case involved a German company that established two Italian subsidiaries in 2002, both of which incurred substantial losses until they ceased commercial activities in 2006. Under Italian rules, the German parent company was required to ensure adequate capitalization of its subsidiaries. To meet this obligation, on several occasions the German parent injected cash into the subsidiaries via shareholder loans, which were subsequently converted into equity by loan waivers. The parent company sought to deduct the losses incurred by the subsidiaries based on the freedom of establishment principle, arguing that it was legally obliged to assume the losses of its subsidiaries and that the losses became final because the subsidiaries ended their activities. According to the German taxpayer, the principles laid down in the Marks & Spencer decision applied.

The local tax court of Lower Saxony ruled against the taxpayer. While the court acknowledged that the conclusion of a five-year PLPA under the German Stock Corporation Act (which is a prerequisite for a fiscal unity between two domestic entities) with the Italian subsidiaries was impossible, it required at least a five-year contractual obligation of the parent company to offset the losses of the subsidiaries as the economic equivalent to a PLPA. The Court stated that a mere "factual" obligation to assume the losses (i.e. only under the Italian rules) was not sufficient to claim loss compensation for German tax purposes under the Marks & Spencer principles.

The local tax court allowed an appeal to the Federal Tax Court (BFH) against its decision. It is not yet known whether the taxpayer did appeal the decision, although this is likely.

If you have any questions, please contact the authors of this article at gtln@deloitte.de or your regular Deloitte contact.

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