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Press and Information

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Judgment of the Court of Justice in Case C-347/04

Rewe Zentralfinanz eG, as universal successor of ITS Reisen GmbH v Finanzamt Köln-Mitte

**THE GERMAN LEGISLATION ON THE DEDUCTIBILITY OF LOSSES INCURRED
IN RESPECT OF WRITE-DOWNS TO THE BOOK VALUE OF SHAREHOLDINGS IN
SUBSIDIARIES RESTRICTS FREEDOM OF ESTABLISHMENT**

Since the restriction is not justified, it is not compatible with Community law

The German Law on income tax (Einkommensteuergesetz)¹ provides that a parent company established in Germany may deduct from its taxable profits the losses it has incurred in relation to write-downs to the book value of shareholdings in its subsidiaries established in Germany.

Conversely, losses of the same kind stemming from shareholdings in subsidiaries established in another Member State are deductible only where those subsidiaries subsequently generate positive income of the same kind or if they carry on an activity of a commercial nature.

ITS Reisen, a German company in the tourism sector, owns a subsidiary in the Netherlands. In its annual accounts for 1993 and 1994, ITS Reisen made write-downs to the book value of its shareholding in its Netherlands subsidiary which it wished to take into account as losses in the calculation of its taxable profits in Germany.

Since the Finanzamt Köln-Mitte (German tax authority) refused to allow it to take into account the losses stemming from those write-downs, Rewe Zentralfinanz eG, as successor to ITS Reisen, brought an action before the Finanzgericht Köln. That court referred a question to the Court of Justice of the European Communities for a preliminary ruling on the compatibility with Community law of the German rules, as in force at the relevant time, on the deductibility of losses incurred by German parent companies in relation to write-downs to the book value of shareholdings in subsidiaries.

In its judgment delivered today, the Court holds, first of all, that **the German legislation constitutes a restriction on freedom of establishment**. That legislation applies a different tax treatment to parent companies according to whether their losses stem from write-downs to the value of shareholdings in a resident subsidiary or in a non-resident subsidiary. It therefore discourages them from creating subsidiaries in other Member States.

¹ Law of 1990 on income tax.

Next, the Court considers whether that restriction is justified.

The Court holds, in particular, that **a difference in tax treatment between resident parent companies** according to whether or not they have foreign subsidiaries **cannot be justified merely by the fact that they have decided to carry on economic activities in another Member State, in which the State of residence cannot exercise its taxing powers.**

In addition, the Court rejects the argument of the German Government based on a danger of losses incurred abroad being taken into account twice. It notes that since the losses in question are incurred by the parent company, they are taken into account only in its regard, so that **the separate treatment of those losses incurred by the parent company, on the one hand, and the losses incurred by the foreign subsidiaries, on the other, cannot on any basis amount to use of the same losses twice.**

The Court holds that the German legislation, which covers generally any situation in which subsidiaries are established outside Germany, and which is therefore not targeted at the specific objective of counteracting purely artificial arrangements, **cannot be justified by the risk of tax avoidance.**

Lastly, the Court holds that **there is no link**, in the German legislation, between **the deductibility, for a resident parent company, of losses** stemming from write-downs to the book value of shareholdings in subsidiaries and **tax exemption** in Germany, under double taxation conventions, in respect of dividends received from foreign subsidiaries. In the absence of such a link, the argument of the German Government based on the need to maintain fiscal coherence cannot be accepted to justify the restriction in question.

In the light of all those considerations, the Court holds that **the German restriction on freedom of establishment is not justified.**

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Languages available: ES CS DE EL EN FR IT HU NL PL RO SK

The full text of the judgment may be found on the Court's internet site

<http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=EN&Submit=rechercher&numaff=C-347/04>

It can usually be consulted after midday (CET) on the day judgment is delivered.

For further information, please contact Christopher Fretwell

Tel: (00352) 4303 3355 Fax: (00352) 4303 2731