OPINION OF ADVOCATE GENERAL ALBER

delivered on 24 September 2002 [1]

I — Introduction

1. In these proceedings the Hoge Raad der Nederlanden (Supreme Court of the Netherlands) has referred two questions concerning the interpretation of Article 43 EC in conjunction with Article 48 EC and 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 [2] (hereinafter: Parent-Subsidiary Directive) for a preliminary ruling. The referring court seeks to ascertain whether those provisions preclude an arrangement, laid down in the Netherlands Law on Corporation Tax, under which the costs incurred by a parent company on account of its holdings in subsidiaries (which, in the instant case, have their seat in a Member State) may be deducted when tax is levied on that parent company provided that those costs are indirectly instrumental in making profit which is taxable in the Netherlands. Under the Parent-Subsidiary Directive, Member States retain the option of providing that any charges relating to the holding owned in a subsidiary may not (in principle) be deducted from the profit of the parent company.

1 — Original language: German.

2 — OJ 1990 L 225, p. 6.

II — Relevant legislation

A — *Community law*

2. The Parent-Subsidiary Directive was adopted with a view to ensuring that the grouping together of companies of different Member States is not hampered by restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States, in order to secure the establishment and effective functioning of the common market. Those objectives are intended to be achieved by means of tax rules which are neutral from the point of view of competition with respect to such grouping together of companies of different Member States and, ultimately, by the introduction of a common tax system. [3]

3. The third recital in the preamble to the directive reads:

'Whereas the existing tax provisions which govern the relations between parent com-

3 — Cf. both the first and the third recitals in the preamble to the directive.

panies 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'.

4. Article 4 of the Parent-Subsidiary 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'.

B — *National law*

5. In Article 13(1) of the Netherlands Wet op de Vennootschapsbelasting (Law on Corporation Tax) 1969 (1993 version) the Netherlands rules governing the determination of profit in the case of holding companies provide:

'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'.

III — Facts and main proceedings

6. Bosal Holding BV, appellant in the main action (hereinafter: Bosal), is a limited company established in the Netherlands and owner of holdings in various Netherlands and foreign companies, the latter being established both inside and outside the European Union. Those holdings range from 50 to 100 per cent of the capital share. Bosal's business consists in holding, financing and licensing activities.

7. In 1993 Bosal incurred interest charges of NLG 3 969 339 in connection with the financing of its holdings in companies established outside the Netherlands but inside the European Union. By an application to the competent Netherlands tax authority, Bosal sought a deduction of that amount from its taxable profit on the ground that, inasmuch as only those costs relating to such holdings which are indirectly instrumental in making profit that is taxable in the Netherlands were deductible, Article 13 of the Netherlands Law on Corporation Tax was not applicable because it was contrary to Article 52 of the EC Treaty (now, after amendment, Article 43 EC).

8. Refusal to grant such a deduction was notified by a corporation tax assessment for 1993. The objection filed by Bosal against that assessment and the action it subsequently brought challenging the decision to reject that objection were both unsuccessful. Bosal then lodged an appeal in cassation.

IV — Reference for a preliminary ruling

9. The Hoge Raad, before which the appeal in cassation has been brought, has referred 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 (now, after amendment, Article 43 EC, read in conjunction with Article 48 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?'

10. Bosal (the appellant), the Netherlands, the Commission and the United Kingdom have submitted observations on those questions to the Court.

V — Legal assessment

A — *The first question referred*

(1) Submissions of the parties

11. With the exception of Bosal, all the parties take the view that Article 13(1) of the Netherlands Wet op de Vennootschapsbelasting does not infringe Community law, either because the provision contains absolutely no restriction on freedom of establishment or because any such restriction is justified.

12. *Bosal* considers that the Netherlands Law unduly restricts freedom of establishment exercised through the acquisition of subsidiaries. In its view, non-deductibility of costs leads in law to double taxation. It observes that that situation does not arise on account of the lack of harmonisation, since the resultant unfavourable tax treatment would continue to exist even if all the States were to introduce a set of rules like that in force in the Netherlands.

13. It also maintains that Member States are permitted to exercise the option granted by the directive of declaring that holding costs may not be deducted only inasmuch as that option applies to all types of holding costs, not just to foreign holdings. By analogy, the predecessor law, the Besluit Vennootschapsbelasting (Decree on Corporation Tax) 1942, which afforded no right of deduction, had not been discriminatory. It was clear from the relevant preparatory documents that the amendment was made in the 1969 Law in order to avoid any undesirable repercussions on the Netherlands' budget resulting from the international prohibition on double taxation.

14. Bosal maintains that the Netherlands adopted the rules in question simply for fear of diminution of tax revenue and abuse. For justification on the basis of the principle of cohesion there must be a direct link between deductibility of the holding costs accruing to the parent company and the taxable profit of the subsidiary, which did not exist in this case because a parent company and a subsidiary do not form one fiscal entity. Furthermore, the cohesion principle was not applied in a uniform manner within the Netherlands system.

15. The *Netherlands Government* considers that the rules in question impose absolutely no restriction on freedom of establishment. This was apparent from the very fact that they were in conformity with Article 4(2) of the Parent-Subsidiary Directive as the Member States were even granted the option in that provision of declaring that absolutely no holding-related charges may be deducted.

16. There was, incidentally, no discrimination on grounds of legal form or registered office. The rules did not focus on the legal system under which subsidiaries had been established and they even benefited parent companies with non-resident subsidiaries, except where the profits of those subsidiaries were not subject to tax in the Netherlands. The sole criterion which had to be satisfied for the holding costs to be deductible was the existence of a link between the costs incurred by the parent company in acquiring a holding and the taxable profit of the subsidiary so acquired. Subsidiaries which made profits in the Netherlands and those which did not could not be compared.

17. Double taxation was prevented both nationally and internationally by virtue of the exemption relating to holdings. That exemption was in conformity with the fiscal principle of territoriality. The aim of the rules was to approximate the tax arrangements governing subsidiaries to those which govern branches.

18. The Netherlands Government further maintains that freedom of establishment is not restricted by the Netherlands tax system but, rather, by the fact that the State in which the subsidiary is established does not allow deduction of the holding costs incurred by the parent company. Differences in the national legal systems did not, however, constitute a restriction on freedom of establishment.

19. Assuming none the less that freedom of establishment was restricted, that restriction would, according to the Netherlands Government, be justified by the principle of cohesion within the tax system, a principle recognised by the Court. The fact that deductibility of costs was conditional on profits being subject to tax in the Netherlands meant that the essential direct link between tax advantage and fiscal levy was established. The two taxable companies, independent of one another in themselves, were to be regarded in that context as a consolidated entity.

20. The purported infringements in the system, for example, the independence of the net profit made by the subsidiary and the non-deductibility of costs in the case of the gross profit made by the subsidiary, did not diminish the fundamental cohesion of the mechanism. The method best corresponding to the principle of proportionality was chosen in order to secure such cohesion. This could indeed be seen in the Netherlands' decision to refrain from taxing those profits which had been made within a group outside the Netherlands.

21. In addition, revenue from taxation in the Netherlands had been significantly reduced as a result of permitting deductibility in general of holding costs, hence the reason for no other Member State introducing such rules without imposing a fiscal levy elsewhere.

22. The *United Kingdom Government* takes the view that the Netherlands rules are justified by the principles of cohesion and territoriality. It maintains that the provision in question establishes a clear link between the deductibility of costs and the levying of tax on profits in the Netherlands. This was a classic case of the principle of cohesion developed by the Court in its judgment in *Bachmann.*[4] Dispensing with the exemption relating to holdings would result in substantial double taxation. The Netherlands rules were in conformity with the Parent-Subsidiary Directive, which was merely permissive in that it permitted Member States to provide that charges relating to a holding may not be deducted but did not preclude their deductibility, albeit only in certain circumstances.

23. The *Commission* adopts a different approach, proceeding from the premise that the Netherlands rules on the taxation of parent companies are, in principle, compatible with freedom of establishment. Technically, there was no discrimination because costs relating to holdings in either resident or non-resident subsidiaries were always deductible provided that the taxable profits concerned were generated in the Netherlands. In practical terms however, foreign subsidiaries as a rule did not generate profit in the Netherlands, and that condition could as a result operate as a restriction. Nevertheless, deduction of charges relating to holdings in respect of foreign subsidiaries was not entirely precluded under the Netherlands rules because costs could, for example, be deducted where the subsidiary for its part operated a permanent establishment in the Netherlands. The Commission takes the overall view that freedom of establishment has been restricted.

24. However, interest expenses of any kind incurred in connection with financing activities had to be deductible for the purpose of determining the correct basis

4 — Case C-204/90 *Bachmann* [1992] ECR I-249.

of assessment in accordance with the deductibility principle. The problem lay in the fact that there was often no opportunity whatsoever to deduct costs inasmuch as the subsidiary did not incur them and the parent company could not deduct them from the profits remitted to it by the subsidiary because most States refrained from levying tax a second time on those profits in order to prevent double taxation.

25. The Commission adds that if, in levying tax on the parent company, account were taken of the holding costs by reason of the fact that that company was liable under civil law to settle the debt in respect of those costs, two problems would arise: The State in which the subsidiary had its seat would be calculating the tax liability on the basis of an excessive sum since it would be taxing the profit of the subsidiary without taking into account the holding costs that led to such profit. Conversely, the Member State of the parent company would collect less tax. The Commission maintains that this may not be established as a rule under Community law.

26. Against that background, the Netherlands model was permissible in the Commission's view. It was consistent with the principle of territoriality and formed the logical conclusion to the 'profit country' approach. It therefore corresponded to the first option, laid down in the Parent-Subsidiary Directive, of providing that charges relating to holdings categorically may not be deducted, and, as a result, such charges had to be deducted in the State in which the subsidiary has its seat. The established shortcomings in the otherwise coherent system were irrelevant inasmuch as they occurred indiscriminately.

27. There was, however, an infringement of Article 43 EC in that, where, conversely, a subsidiary generated profit in the Netherlands, it was not entitled under Netherlands tax law to deduct the holding costs incurred by its foreign parent company. However, this was not the subject-matter of the proceedings.

(2) Assessment

28. With the exception of Bosal, all the parties concur that Article 13(1) of the Netherlands Wet op de Vennootschapsbelasting 1969 contains no restriction whatsoever on freedom of establishment but that, if it did, that restriction would in any event be justified.

29. It will be examined below whether that view is in conformity with freedom of establishment and with the previous decisions of the Court in that regard. Although direct taxation is a matter for the Member States, they must nevertheless exercise their direct taxation powers consistently with Community law and must therefore refrain from applying any form of overt or covert discrimination by reason of

nationality or location of the corporate seat. [5]

30. Article 43 EC constitutes one of the fundamental provisions of Community law and has been directly applicable in the Member States since the end of the transitional period. Under that provision, freedom of establishment includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings under the conditions laid down for its own nationals by the law of the country where such establishment is effected. The abolition of restrictions on freedom of establishment also applies to restrictions on the setting-up of agencies, branches or subsidiaries. [6]

31. Under the second paragraph of Article 43 EC, freedom of establishment is subject to the exercise of freedom of movement for capital. It is evident from the wording of the second paragraph of Article 43 EC that the right to manage undertakings is the determining criterion. When assessing whether or not management of the undertaking concerned is connected with a holding, one particular consideration is the size of the holding concerned. Control can in any event be implied in the case of a substantial holding. [7] Since Bosal owns holdings ranging from 50 to 100 per cent in the capital of companies, it exercises a proportionate influence on such companies. Freedom of establishment is consequently created.

32. Freedom of establishment operates in two directions, first in respect of the host Member State and, secondly, in respect of the State of origin, which, in this case, is the Netherlands. The Court has in this regard held on a number of occasions that even though, according to their wording, the provisions concerning freedom of establishment are mainly aimed at ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of its nationals or of companies incorporated under its legislation and caught by the definition contained in Article 48 EC. [8]

33. The principle of freedom of establishment laid down in Article 43 EC above all precludes all direct and indirect discrimination on grounds of nationality. 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 are, in accordance with Article 48 EC, treated in the same way as natural persons who are nationals of Member States.

5 — Case C-55/00 *Gottardo* [2002] ECR I-413, paragraph 32, Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 19, and Case C-279/93 *Schumacker* [1995] ECR I-225, paragraph 21.

6 — Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Hoechst* [2001] ECR I-1727, paragraph 41.

7 — Case C-251/98 *Baars* [2000] ECR I-2787, paragraphs 20 to 22.

8 — *Baars* (cited in footnote 7, at paragraph 28), Case C-200/98 *X AB and Y AB* [1999] ECR I-8261, paragraph 26, and Case 81/87 *Daily Mail and General Trust* [1988] ECR 5483, paragraph 16.

34. With regard to companies, it is their corporate seat that serves as the connecting factor with the legal system of a particular State, like nationality in the case of natural persons. [9] Accordingly, any restrictions on freedom of establishment may not discriminate on the basis of a given company's seat. This is true not only of overt discrimination by reason of seat but also of all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result. [10]

35. The national tax rules contained in Article 13(1) of the Wet op de Vennootschapsbelasting make no distinction, whether direct or indirect, on the basis of the seat of the parent company since only parent companies having their seat in the Netherlands can be affected by that provision. After all, under the territoriality principle a State is entitled to levy tax only in respect of persons liable to tax in its own territory. As regards the matter of discrimination by reason of a company's seat, this specific case focuses solely on the seat of the parent company and not on that of the subsidiary because here only the parent company, as taxpayer, could be affected by a set of rules that may be discriminatory.

36. Nevertheless, discrimination on grounds of nationality or seat does not arise here because the Netherlands rules apply to all parent companies resident in the Netherlands.

37. However, those national rules could otherwise hinder the exercise of freedom of establishment since, as the Court has consistently held, Article 43 EC precludes any national measure where that measure, even though it is applicable without discrimination on grounds of nationality, is liable to prevent, hamper or render less attractive the exercise by Community nationals, including those of the Member State which enacted the measure, of fundamental freedoms guaranteed by the Treaty. [11]

38. Any difference in treatment created by national provisions is also caught by that prohibition on imposing restrictions because such treatment is liable to render less attractive the exercise of a fundamental freedom for any person who is consequently placed at a disadvantage.

39. A terminology issue arises at this point on account of the Court's case-law, an issue which has implications in practice too. Many judgments delivered by the Court with regard to taxation contain the following formula: 'It is settled law that discrimination arises through the application of different rules to comparable situations or

9 — Case C-307/97 *Compagnie de Saint-Gobain* [1999] ECR I-6161, paragraph 36, Case C-264/96 *ICI* (cited in footnote 5, at paragraph 20), and Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 18.

10 — Case C-279/93 *Schumacker* (cited in footnote 5, at paragraph 26), Case C-330/91 *Commerzbank* [1993] ECR I-4017, paragraph 14, and Case 152/73 *Sotgiu* [1974] ECR 153, paragraph 11.

11 — Case C-55/94 *Gebhard* [1995] ECR I-4165, paragraph 37, and Case C-19/92 *Kraus* [1993] ECR I-1663, paragraph 32.

the application of the same rule to different situations.' [12]

40. The above wording gives the impression that absolutely every instance of different treatment, and by extension every restriction, on the basis of any criteria whatsoever is (inherently) discriminatory. However, according to case-law, restrictions can indeed be justified by imperative requirements in the general interest but only if they are applied in a non-discriminatory manner. [13] On that basis, difference in treatment could never be justified by imperative requirements in the general interest, which is a contradiction in itself because justification on such grounds is expressly permitted.

41. That contradiction may be resolved only in the manner described below: The formula set out in point 37 is intended to cover more than just inherent discrimination by reason of nationality; it may also refer to other cases of different treatment which constitute an obstacle to freedom of establishment. Inherent discrimination, meaning that it can be justified only on the basis of the express derogations laid down by the Treaty in such provisions as Articles 45 EC and 46 EC in respect of freedom of establishment, [14] can arise only where there is a distinction on the basis of nationality or seat. Different treatment on other grounds may, like other obstacles, be justified by imperative requirements in the general interest.

42. To prevent any misunderstanding, in the following assessment of a further restriction on freedom of establishment imposed by the national rules, I shall refrain from using the word 'discrimination' and shall refer only to 'different treatment'.

43. In addition to providing for the non-taxation of gains acquired from subsidiaries pursuant to the first indent of Article 4(1) of the Parent-Subsidiary Directive, Article 13(1) of the Netherlands Wet op de Vennootschapsbelasting provides in general that, in determining the basis of assessment, the costs relating to a holding may not be deducted from the taxable profit. That fundamental rule is neutral and does not involve any difference in treatment since the unfavourable tax treatment associated with non-deductibility is equally detrimental to all parent companies that acquire holdings. Furthermore, under Article 4(2) of the Parent-Subsidiary Directive Member States are expressly permitted to adopt such rules.

44. The provision acquires a different meaning, however, as a result of the derogation provided therein in that, under that derogating provision, the unfavourable tax treatment in the form of non-deductibility does not affect parent companies whose costs incurred in relation to a holding are indirectly instrumental in making

12 — Case C-391/97 *Gschwind* [1999] ECR I-5451, paragraph 21, Case C-107/94 *Asscher* [1996] ECR I-3089, paragraph 40 and Case C-80/94 *Wielockx* [1995] ECR I-2493, paragraph 17.

13 — *Gebhard* (cited in footnote 11, at paragraph 37).

14 — Case C-288/89 *Collectieve Antennevoorziening Gouda and Others* [1991] ECR I-4007, paragraph 11.

profit that is taxable in the Netherlands. In positive terms, parent companies covered by the above derogation obtain a tax benefit by having their basis of assessment reduced as a result of their being permitted to deduct holding costs. However, the granting of that tax advantage renders less attractive the exercise of freedom of establishment through the acquisition of subsidiaries which make their profit exclusively abroad, and consequently parent companies may be deterred from such acquisition in favour of acquiring holdings in the Netherlands.

45. The Court held in *Asscher* [15] and *Baars* [16] that a refusal to grant a single tax advantage may also constitute a restriction on freedom of establishment.

46. The Netherlands Government none the less insists that the national rules are not discriminatory because, rather than making a distinction on the basis of the subsidiary's seat, they make a distinction based on the criterion that the profit generated is taxable in the Netherlands. Moreover, the rules in question were in conformity with the principle of territoriality, under which the right enjoyed by any State to levy taxes applied only to the profits generated in the relevant State's own territory.

47. Considered together, those two points of view do, however, suggest that a subsidiary can generate profit that is taxable in the Netherlands only if it has its seat or at least a permanent establishment in the Netherlands. Under the principle of territoriality, profits are taxed only in the State where the company has its seat. Furthermore, profits which have already been taxed in other Member States as they accrued there to resident subsidiaries and are then transferred to the parent company in the Netherlands on the basis of the relevant agreement are exempt from further taxation in the Netherlands pursuant to the first indent of Article 4(1) of the Parent-Subsidiary Directive. The costs involved in owning holdings in subsidiaries resident in other Member States therefore cannot, in principle, be indirectly instrumental in making profits that are taxable in the Netherlands.

48. Such a situation is conceivable only where the non-resident subsidiary for its part operates permanent establishments in the Netherlands. Even in that case, however, residence in the Netherlands at least of part of a subsidiary is the decisive criterion in establishing that the parent company is subject to different treatment.

49. Moreover, determining specifically whether the rules make a distinction on the basis of the subsidiary's seat or, rather, on the basis of the place where the profit is made is of no great significance because here, unlike in cases of inherent discrimination, the seat is not the decisive factor. Other restrictions on the carrying on of a business activity across borders can also arise in the form of different treatment on the basis of other criteria.

15 — Cited in footnote 12, at paragraph 42.

16 — Cited in footnote 7, at paragraphs 30 and 31.

50. In support of the difference in treatment, the Netherlands Government argues that the respective situations of resident and non-resident subsidiaries cannot be compared in practical terms. However, as already established above, the location of subsidiaries is irrelevant in this case because it is parent companies, not subsidiaries, that are subject to the Netherlands tax legislation at issue. The respective situations of parent companies can be compared in practical terms in that they are subject to tax in the Netherlands upon acquisition of a holding, irrespective of whether the company acquired has its seat in the Netherlands or in another Member State.

51. In *Metallgesellschaft and Hoechst*, [17] taking as its basis circumstances which are the very opposite of those arising in this case, where the subsidiary is subject to tax in the United Kingdom and its parent company is resident either in the United Kingdom or elsewhere, the Court in those circumstances ruled that the place of residence of the parent company may not lead to a difference in tax treatment for the subsidiary.

52. In *X AB and Y AB* [18] the Court had to rule on a set of circumstances comparable with that existing in this instance. There it expressly held that, in the granting of a tax advantage, the distinction made on the basis of the subsidiary's seat constitutes a difference in treatment which is prohibited within the context of freedom of establishment:

'The legislation in question in the main proceedings does not allow Swedish companies which have used their right to free establishment to form subsidiaries in other Member States to receive certain tax concessions upon a type C intra-group transfer. Thus, such legislation entails a difference of treatment between various types of intra-group transfers on the basis of the criterion of the subsidiaries' seat. In the absence of justification, that difference of treatment is contrary to the provisions of the Treaty concerning freedom of establishment...'.

53. In the light of that ruling, it must now be assessed whether different treatment is justified under the Treaty. The parties have essentially raised two grounds of justification, first, the requirements of the Parent-Subsidiary Directive itself and, secondly, the cohesion of the Netherlands tax system as an imperative requirement in the general interest. Three additional grounds have been raised in connection with fiscal cohesion: the principle of territoriality, prevention of double taxation and protection of the integrity of the basis of assessment.

17 — Cited in footnote 6, at paragraph 60.

18 — Cited in footnote 8, at paragraphs 27 and 28.

54. Since Member States are entitled under the Parent-Subsidiary Directive categorically to disallow deduction of holding costs, some of the parties take the view that that provision in itself justifies the Netherlands rules. Cases where Member States disallow deductibility only to a certain degree are considered by those parties to be somewhat of a disadvantage. It is necessary to examine whether that view is in conformity with the substance, spirit and purpose of the Parent-Subsidiary Directive.

55. According to its preamble, the directive is designed, in the interest of the internal market, which covers freedom of establishment, to promote the grouping together of companies of different Member States. However, the directive takes into account the individual interests of the Member States in maintaining their tax revenue, which is apparent from the derogations applying to individual States laid down in the fifth recital in the preamble and from the third recital in the preamble, cited earlier at point 3, in which the Community legislature notes that national provisions governing the grouping together of companies of the same State, laid down in the interest of maintaining the level of tax revenue available to the individual State, in general prove more advantageous than those governing the grouping together of companies of different States. The provisions of the directive can therefore be regarded as the outcome of the Community legislature's careful consideration of the Member States' interest in maintaining their tax revenue on the one hand against common market and internal market concerns on the other.

56. A central issue in the directive is the non-taxation of profits distributed from subsidiaries to parent companies. This is clear from the fact that that measure is not only contained in the first indent of Article 4(1) but is also mentioned as early as in the fourth recital in the preamble to the directive. To compensate somewhat for the requirement imposed by that provision that Member States forgo the revenue from taxation, in Article 4(2) the Community legislature conferred on the Member States the right in general to disallow deduction of holding costs for tax purposes, which constitutes unfavourable tax treatment for companies.

57. It follows from the first recital in the preamble to the directive, under which the grouping together of companies may not, in principle, be hampered by restrictions, disadvantages or distortions arising from the tax provisions of the Member States, that, apart from that specified restriction, Member States are not to be granted any scope for imposing further restrictions. Indeed, the provisions of the directive are to be interpreted narrowly, again on account of the fact that the directive is itself the outcome of a balancing of interests.

58. Although the directive permits Member States generally to disallow deduction of holding costs, it does not, however, provide for derogations. It cannot therefore provide any justification for the derogation under which part of the costs incurred in one State may be deducted provided that the related profit is made in the same State.

However, if it did lay down a derogation to that effect, it would then be necessary to examine whether or not the directive itself offended against the principle of freedom of establishment, a principle enshrined in primary legislation within the Treaty.

59. The Netherlands rules are therefore inconsistent with Article 4(2) of the directive.

60. The principle of cohesion of the tax system was raised as a further essential ground to justify the difference in tax treatment. In its judgments in *Bachmann*[19] and *Commission* v *Belgium*[20] and in its more recent decisions the Court has consistently held that such cohesion presupposes a direct link between the grant of a tax advantage and the offsetting of that advantage by a fiscal levy, both of which relate to the same tax.

61. At paragraph 57 of its judgment in *Verkooijen*[21] the Court in that regard held:

'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...'.

62. Also in *Baars*[22], the Court pointed out that there was no direct link or purpose of safeguarding cohesion where 'different taxpayers' were concerned.

63. The Netherlands rules establish a link between a tax advantage benefiting the parent company, in the form of deductibility of holding costs, and the option of levying tax on the subsidiary. As far as the Netherlands Government and the United Kingdom Government are concerned, that link creates the cohesion of the system.

64. However, there is at this point a failure to take account of the fact that parent companies and subsidiaries, unlike branches and permanent establishments, are separate legal entities, each having its own legal personality. They are taxed separately. Contrary to the submissions of the Commission and the Netherlands, they are not automatically to be regarded as a single consolidated entity for tax purposes. The distinction made here between parent companies having subsidiaries on the one hand and companies having permanent establishments on the other is justified by the very fact that a company is additionally

19 — Cited in footnote 4.

20 — Case C-300/90 *Commission* v *Belgium* [1992] ECR I-305.

21 — Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraphs 56 to 58. In this judgment the overriding public interest requirements for cohesion of the tax system were assessed against the background of a possible infringement of the freedom of movement for capital.

22 — Cited in footnote 7, at paragraph 40.

liable for its permanent establishment, whereas a parent company is not required in the same way to assume liability for the losses incurred by its subsidiary.

65. Thus, the criterion, required by the Court, that there should be a direct link where the same tax is concerned, is not met. The linking of costs incurred by one taxpayer with the fiscal levy imposed on a different taxpayer cannot create a cohesive system.

66. Furthermore, the fiscal principle of territoriality, to which the Court referred in *Futura Participations and Singer*,[23] cannot be relied on in this case to substantiate cohesion of the system. The facts forming the basis of that judgment cannot be compared with the facts of this case. *Futura Participations and Singer* involved a permanent establishment of a foreign company which was located in Luxembourg and subject to tax there. Under the Luxembourg rules, the carrying forward of losses upon taxation in Luxembourg was subject to the condition that those losses should be related to the profit made by the permanent establishment *itself*.

67. That condition is consistent with the principle of territoriality under which, on levying tax on a taxpayer who carries on an economic activity within a State, account is (can be) taken only of the profits and losses it has made in that State. However, under the Netherlands system, deductibility of holding costs in the levying of tax on one person is subject to *another* person, that is to say the subsidiary which is to be distinguished from the parent company, making profit in the Netherlands. It is none the less impossible to deduce from the territoriality principle that the profits and losses accruing to different taxpayers can be offset against each other.

68. The cohesion of the system is, in actual fact, safeguarded by the provisions of the Parent-Subsidiary Directive. Article 4(1) of the directive, under which the levying of tax a second time on profits transferred from subsidiaries may be dispensed with, establishes a tax advantage for parent companies. To offset that measure, Article 4(2) of the directive introduces, in the form of a tax burden on parent companies, the option of non-deductibility in respect of holding costs which have led to such profits.

69. As a result of the measure contained in Article 4 of the directive, double taxation is prevented and, unlike under the Netherlands arrangement, parent companies which have subsidiaries abroad are not placed at a disadvantage in terms of deductibility of costs. In Article 13 of the Wet op de Vennootschapsbelasting the Netherlands legislature prevents double taxation by introducing exemptions for holdings, a measure consistent with the fundamental objective of Article 4 of the directive. Under that exemption, neither the profits nor the costs of a holding are taken into account in determining the profit of the parent company. However, the other

23 — Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, paragraph 22.

provisions, which grant preferential treatment exclusively to parent companies that have resident subsidiaries, have no bearing on prevention of double taxation.

70. Moreover, the Netherlands Government argues that the rules are justified by their objective to maintain the level of tax revenue. On the one hand, the Court has on a number of occasions already held in this regard that diminution of tax revenue is not one of the grounds of justification listed in Article 46 EC and cannot be regarded as a matter of overriding general interest that may be relied upon in order to justify unequal treatment which is, in principle, incompatible with Article 43 EC. [24]

71. On the other hand, however, this case specifically concerns a provision that introduces a disadvantage in that it reduces the tax burden only for certain individuals, and this cannot be justified by the objective of maintaining tax revenue. The Netherlands retain the right to disallow in all cases the deduction of holding costs from taxable profits pursuant to Article 4(2) of the Parent-Subsidiary Directive. In those circumstances tax revenue is increased rather than diminished. As the Commission explained in its written answer of 14 June 2002 to the question raised by the Court, Austria for example applies such an arrangement.

72. It is consequently established that equal treatment as between undertakings of the same State and undertakings of different States is the prerequisite for a set of rules laid down by the Netherlands legislature that is consistent with Community law. Whether the legislature in that respect specifies whether or not the holding charges can be deducted, in a uniform manner, from the profit of the parent company is a matter that Article 4(2) of the Parent-Subsidiary Directive fails to address.

73. I should like to emphasise once more that the Community legislature in this respect deals with situations where holding costs are not taken into consideration when it comes to taxing either the parent company or the subsidiary. This is apparent from the fact that the directive expressly permits the Member States to preclude deduction from the profits of parent companies but does not provide that the costs accruing can in that event be charged to the subsidiary.

74. The answer to the first question referred should therefore be that, on a proper construction, Article 43 EC, in conjunction with Article 48 EC, precludes national rules which provide that a Member State may grant a parent company subject to tax in that Member State a deduction on costs relating to a holding owned by it provided that the relevant subsidiary makes profits that are subject to tax in the Member State in which the parent company is established.

24 — *Metallgesellschaft and Hoechst* (cited in footnote 6, at paragraph 59), *Compagnie de Saint-Gobain* (cited in footnote 9, at paragraph 51) and *ICI* (cited in footnote 5, at paragraph 28).

B — *The second question referred*

(1) Submissions of the parties

75. *Bosal* takes the view that the internal cohesion of the national tax system would in any event be enhanced if, where the subsidiary but not the parent company is subject to tax on its profit in the Netherlands, that State were to take into account the costs incurred by the parent company in respect of its holding.

76. The *Netherlands Government* considers that the second question is irrelevant because in this case it is a parent company, not a subsidiary, that is seeking deduction of costs from its profit. It claims that the first and second questions referred should be answered separately because the circumstances forming the basis of each question are not comparable. The Netherlands could not, in its view, be held responsible for preventing every case of double taxation as, in the situation described in question 2, it is for the State in which the foreign parent company is established to ensure such prevention. The problem arose out of the disparity between the tax systems and the fact that harmonisation, albeit desirable, had not as yet been achieved.

77. The *United Kingdom Government* considers that the answer to the second question makes no difference to the fact that the Netherlands rules are justified by the principle of cohesion.

78. Although the *Commission* takes the view that the Netherlands should also allow holding costs incurred by a foreign parent company to be deducted from the taxable income of a subsidiary established in the Netherlands, which it does not under the existing rules, this matter is in any case irrelevant as regards answering the first question. Moreover, Bosal has not contested that part of the rules in this case.

(2) Assessment

79. It has been established with regard to the first question that the situation underlying the Netherlands rules, namely the refusal in general to allow deduction of holding costs, constitutes a coherent set of rules which is also compatible with the Parent-Subsidiary Directive. The derogation laid down in the provision, that a tax advantage is to be granted to parent companies having subsidiaries that make profits in the Netherlands, is the only measure that undermines the cohesion of the system by placing parent companies that have foreign subsidiaries at a disadvantage.

80. That disadvantage could be offset by the grant of a tax advantage to subsidiaries of foreign parent companies only if there were a direct link between that tax advantage and the levy imposed on disadvantaged parent companies. As stated previously, absolutely no such link exists between the levying of tax on a parent company and the levying of tax on its own subsidiary because these are separate legal entities. In that case, then it truly is impossible to establish the essential link between a resident parent company and subsidiaries of a different, foreign parent company.

81. Irrespective of that matter, the Court has already held on several occasions that unfavourable tax treatment contrary to a fundamental freedom cannot be justified by the existence of other tax advantages, even supposing that such advantages exist.[25]

82. Where it is considered necessary for the holding costs to be deductible at all, rules under which such costs must be deducted from the profits of subsidiaries could be no more than a supplement to the system under the Parent-Subsidiary Directive. In that case, however, it would be necessary, for the purpose of equal treatment, to facilitate the uniform application of that measure across the Community. According to the information provided by Bosal during the proceedings, that is not the case at least in the Member States where it has subsidiaries, that is to say in Belgium, France, the United Kingdom, Ireland, the Netherlands, Germany, Denmark, Spain and Italy.

83. However, even such rules applicable across the Community could have no impact on the established different treatment under the Netherlands rules of parent companies which have foreign subsidiaries. On the contrary, should the Netherlands rules be retained, groups entirely composed of resident undertakings would, in theory, be in a position to claim holding costs twice. In the absence of appropriate offsetting procedures, they could proceed with such claims first, when the parent company is taxed, on the basis of the Netherlands rules and secondly, when the subsidiary is taxed, on the basis of the Community requirement that costs must be taken into account in the case of subsidiaries.

84. The answer to the second question referred should therefore be that it makes no 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.

25 — *Verkooijen* (cited in footnote 21, at paragraph 61), *Compagnie de Saint-Gobain* (cited in footnote 9, at paragraph 54), *Commission* v *France* (cited in footnote 9, at paragraph 21).

VI — Conclusion

85. In the light of the foregoing considerations, I propose that the Court should answer the questions referred by the national court as follows:

(1) On a proper construction, Article 43 EC, in conjunction with Article 48 EC, precludes national rules which provide that a Member State may grant a parent company subject to tax in that Member State a deduction on costs relating to a holding owned by it provided that the relevant subsidiary makes profits which are subject to tax in the Member State in which the parent company is established.

(2) It makes no 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.