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Judgment of the Court of Justice in Case C-231/05

Oy AA

NATIONAL LEGISLATION NOT ALLOWING A RESIDENT SUBSIDIARY TO DEDUCT AN INTRA-GROUP FINANCIAL TRANSFER IN FAVOUR OF ITS FOREIGN PARENT COMPANY FROM ITS TAXABLE INCOME IS COMPATIBLE WITH COMMUNITY LAW

To allow such deductibility would undermine the objectives of allocating the power to impose taxes among the Member States and of preventing tax avoidance

Finnish legislation[1] makes provision for a company making a financial transfer in favour of another company in the same group to deduct the amount of that transfer from its taxable income. That possibility is, however, subject to conditions, amongst them the requirement that the transferor and transferee companies be national companies.

Oy AA, a Finnish company, is a subsidiary of the parent company AA Ltd, which has its main establishment in another Member State. Oy AA wished to make a cross-border intra-group financial transfer in favour of AA Ltd in order to secure the financial position of the latter.

According to the Keskusverolautakunta (Central Tax Commission), such a transfer may not be regarded as an expense deductible from the taxable income of Oy AA. The Korkein hallinto-oikeus (Supreme Administrative Court), before which that company challenged the decision, asks the Court of Justice of the European Communities as to the compatibility of the Finnish legislation with Community law. [2]

The Court has found that, in relation to the possibility of deducting as expenses a transfer made in favour of the parent company, Finnish law introduces a difference in treatment between subsidiaries established in Finland according to whether or not their parent company has its corporate seat in that same Member State. **The subsidiaries of foreign parent companies thus receive less favourable tax treatment** than that enjoyed by the subsidiaries of Finnish parent companies.

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[1] Laki Konserniavustuksesta verotuksessa (825/1986) of 21 November 1986

[2] Articles 43 EC, 56 EC and 58 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 (OJ 1990 L 225, p. 6), as amended by Council Directive 2003/123/EC of 22 December 2003 (OJ 2004, L 7, p. 41).

The Court has found that such a **difference in treatment constitutes a restriction on the freedom of establishment.**

A restriction on the freedom of establishment is permissible only if it is justified by overriding reasons in the public interest, and if its application is appropriate to ensuring the attainment of the objective in question and does not go beyond what is necessary to attain it.

The Court holds that to accept that an intra-group cross-border transfer may be deducted from the taxable income of the transferor would result in allowing groups of companies to choose freely the Member State in which the profits of the subsidiary are to be taxed, by removing them from the basis of assessment of the latter and, where that transfer is regarded as taxable income in the Member State of the parent company transferee, incorporating them in the basis of assessment of the parent company. **That would undermine the system of the allocation of the power to tax between Member States** because, according to the choice made by the group of companies, the Member State of the subsidiary would be forced to renounce its right, in its capacity as the State of residence of that subsidiary, to tax the profits of that subsidiary in favour, possibly, of the Member State in which the parent company has its establishment.

Moreover, the possibility of transferring the taxable income of a subsidiary to a parent company with its establishment in another Member State **carries the risk that, by means of purely artificial arrangements, income transfers may be organised within a group of companies** towards companies established in Member States applying the lowest rates of taxation or in Member States in which such income is not taxed.

Having regard to the combination of those two factors, the Court considers that the Finnish legislation pursues legitimate objectives compatible with the treaty and justified by overriding reasons in the public interest.

Even if the legislation at issue in the main proceedings is not specifically designed to exclude purely artificial arrangements, devoid of economic reality, created with the aim of escaping the tax normally due on the profits generated by activities carried out on national territory, from the tax advantage it confers, **such legislation may nevertheless be regarded as proportionate to the objectives pursued**, taken as a whole; an extension of the tax advantage to cross-border situations would have the effect of allowing groups of companies to choose freely the Member State in which their profits will be taxed, to the detriment of the right of the Member State of the subsidiary to tax profits generated by activities carried out on its territory.

The Court has therefore held that Community law does not preclude a system instituted by legislation of a Member State whereby a subsidiary resident in that Member State may not deduct an intra-group financial transfer which it makes in favour of its parent company from its taxable income unless that parent company has its establishment in that same Member State.

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Languages available: EN, FI FR

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-231/05
It can usually be consulted after midday (CET) on the day judgment is delivered.

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