

The ECJ rules that freedom of establishment does not guarantee that the change of a company's tax residence will be tax neutral

The CJEU ruled that the freedom of establishment does not prevent a Member State from excluding the claim of tax losses within its jurisdiction, where those losses were incurred in another Member State before the transfer of a company's place of effective management and that company retains its registered office in that other Member State.



On February 27, 2020, the Court of Justice of the European Union (CJEU) issued its decision in the case of *AURES Holdings a.s. v Odvolací finanční ředitelství* (C-405/18). The case concerned a Dutch company, AURES Holdings, which incurred a substantial loss in 2007. In 2008, AURES Holdings established a branch in the Czech Republic which qualified as a permanent establishment of the company under Czech law. Subsequently, in 2009, Aures Holdings moved its place of effective management, and consequently its tax residence, to the Czech Republic. Nevertheless, AURES Holdings retained its registered office in the Netherlands.

Next, in 2012, AURES Holdings sought to deduct its 2007 Dutch losses from the taxable base in the Czech Republic. However, the Czech tax administration refused this deduction. Under Czech domestic law, although a taxpayer is taxable on its worldwide income, a loss is only deductible if it arises from an economic activity in the Czech Republic. AURES Holdings challenged this decision and finally appealed to the Supreme Administrative Court in the Czech Republic, which in turn referred two preliminary questions to the CJEU.

By the first question, the referring court asks whether the mere transfer of a company's place of effective management falls within the scope of the freedom of establishment (Article 49 TFEU). In only

a few paragraphs, with reference to the *National Grid Indus* (C-371/10) and *Lasteyrie du Saillant* (C-9/02) cases, the CJEU holds that this is the case.

By the second question, the referring court asks whether the freedom of establishment precludes national legislation of a Member State which prevent a company, who has transferred its place of effective management to that Member State, from claiming tax losses which it incurred in another Member State before that transfer and in which it retained its registered office.

For starters, the CJEU holds that the refusal to claim these tax losses constitutes a difference in treatment. Nevertheless, the CJEU considers that such a difference is permissible since it relates to situations which are not objectively comparable in the light of the objectives pursued by the Czech legislature, namely to preserve the allocation of the power to impose taxes between the Member States and to prevent the risk of double deduction of losses.

The CJEU draws a distinction between, on the one hand, the situation where a company incurs losses and then uses them in one and the same Member State and, on the other hand, the situation where a company incurs losses in one Member State and subsequently transfers its place of effective management to another Member State. In the latter situation, the company falls under the tax jurisdiction of two Member States, namely the Member State where the losses arose and the Member State where the company intends to claim those losses. This creates an increased risk of double deduction of losses. Therefore, like Advocate General Kokott, the CJEU ruled that the freedom of establishment does not prevent a Member State from excluding the claim of tax losses within its jurisdiction, where those losses were incurred in another Member State before the transfer of a company's place of effective management and that company retains its

registered office in that other Member State.

Take-away

The CJEU ruled that the freedom of establishment does not impose an obligation on a Member State to take into account tax losses incurred by a company in the Member State of the preceding tax residence, when that company retains its registered office in that Member State.

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Although EU law protects the freedom of establishment, this freedom of establishment does not guarantee that the transfer of a company's effective place of management, and consequently its tax residence, will be tax-neutral as the freedom of establishment does not require Member States to adjust its tax rules to avoid disparities between Member States.

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