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Global Tax Alert

CJEU rules Luxembourg's fiscal unity regime infringes EU law

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Executive summary

On 14 May 2020, the Court of Justice of the European Union (CJEU) concluded that certain features of Luxembourg's fiscal unity regime in both its pre-2015 and post-2014 versions do not comply with the European Union's (EU) freedom of establishment principle.

The case concerns questions surrounding "horizontal fiscal unities," i.e., fiscal unities between sister companies, and relates both to the Luxembourg fiscal unity regime before 1 January 2015 (i.e., at a time when the law only allowed "vertical fiscal unities", i.e., fiscal unities headed by a common Luxembourg parent company or permanent establishment) and after the introduction of the possibility of horizontal fiscal unities in Luxembourg law as from 1 January 2015. The CJEU concluded that it would be an infringement of EU law if Luxembourg did not allow subsidiaries of EU companies to form a horizontal fiscal unity and that the wording of the Luxembourg provisions, which may require the dissolution of an existing vertical fiscal unity before being able to form a horizontal fiscal unity is not in line with EU law. However, the CJEU also acknowledged that the condition of filing the request for fiscal unity regime before the end of the first tax year for which application of that regime is sought remains valid and imperative, thus closing the door on requests for a retroactive application of the fiscal unity regime.

Building a better working world

Based on the decision of the CJEU, the switch from a vertical fiscal unity to a horizontal fiscal unity while maintaining the same Luxembourg company as head of the consolidated group should consequently be possible going forward, without triggering adverse tax consequences as a result of the termination of a pre-existing vertical fiscal unity. Given the primacy of EU law over national law, it is expected that Luxembourg will adapt its current legislation to comply with the CJEU's judgment.

Detailed discussion

Background on Luxembourg fiscal unity rules

The Luxembourg fiscal unity regime, up to and including tax year 2014, only allowed vertical consolidations, i.e., a fiscal unity between one or more Luxembourg resident companies and their Luxembourg resident parent, which could either be a Luxembourg company or a Luxembourg permanent establishment of a nonresident company which is fully liable to a tax corresponding to the Luxembourg corporate income tax.

Following the CJEU ruling of 12 June 2014 on the compatibility of the Dutch fiscal unity regime in light of the freedom of establishment,[1] the Luxembourg legislation was amended so as to allow, as from tax year 2015, a horizontal fiscal unity, i.e., a consolidation between two or more Luxembourg resident companies and permanent establishments (directly or indirectly) owned by the same nonresident parent company, provided the parent company is resident in a State of the European Economic Area (EEA).

Under both the old and the new regime, a written request must be filed before the end of the first tax year for which application of the regime is sought.

Facts underlying the dispute and Luxembourg court proceedings

As from tax year 2008, a Luxembourg company, whose parent company had its seat in France, formed a fiscal unity with its Luxembourg subsidiary (i.e., a vertical fiscal unity). The perimeter of the fiscal unity was progressively enlarged by the inclusion of additional Luxembourg subsidiaries. In December 2014, two requests were filed to include two further Luxembourg companies, in which the Luxembourg head of the existing fiscal unity did not hold a direct participation, but which were both indirectly held by the same French parent company (i.e., a horizontal fiscal unity). The regime was requested as from 1 January 2013 or, alternatively, from 1 January 2014.

The Luxembourg Tax Administration rejected the 2014 request on the grounds that the companies did not fulfill the legal conditions to enter into a fiscal unity, in particular that the head of the fiscal unity must hold directly or indirectly a participation of at least 95% in the capital of the companies to be included in the fiscal unity.

In its judgment of 6 December 2017, the Luxembourg Administrative Tribunal rejected the application of the fiscal unity for the tax year 2013 on the grounds that the request was not filed within the legally foreseen deadline. For tax year 2014, however, it ruled that refusing to allow a nonresident parent company to establish a fiscal unity with its resident subsidiaries is incompatible with the freedom of establishment, given that this possibility is open to a resident parent company by means of a vertical fiscal unity.

An appeal was filed against this judgment, in which the claimants requested the application of the fiscal unity regime also for tax year 2013. The Luxembourg Tax Administration in turn requested the judgment to be upheld as regards tax year 2013, and incidentally appealed against the decision of the Tribunal with respect to tax year 2014.

The Luxembourg Administrative Court decided to request a preliminary ruling, asking the CJEU to rule on the compatibility of the Luxembourg fiscal unity regime in its old but also in its new version, and to analyze how the formal requirement, viz. the requirement to file the request prior to the end of the first tax year for which application of the regime is sought, would interfere with the outcome of the first two questions.

Compatibility of the pre-2015 fiscal unity regime with EU law

By reference to its judgment in *SCA Group Holding BV and others* of 12 June 2014, the CJEU recalled that the freedom of establishment aims to guarantee the benefit of national treatment in the host Member State, by prohibiting any discrimination based on the place in which companies have their seat. The Luxembourg fiscal unity regime constitutes a cash-flow advantage for the companies concerned, as it allows the profits and losses of the companies constituting the fiscal unity to be aggregated at the level of the parent company. Where such tax advantage is granted to resident

companies by means of a vertical fiscal unity, it creates a difference in treatment compared to parent companies that hold Luxembourg subsidiaries but are resident in another Member State and do not have a permanent establishment in Luxembourg, as in such situation the aggregation of the profit and losses of the subsidiaries is possible neither through a vertical nor a horizontal fiscal unity.

Luxembourg argued that there is no discrimination between the Luxembourg companies involved, as a horizontal fiscal unity without including the parent company was also not possible for Luxembourg companies held by a Luxembourg parent company, and Luxembourg companies held by an EU company could form a fiscal unity if they were held by a Luxembourg permanent establishment. This argument was rejected by the CJEU.

Given that such cross-border situations are disadvantaged compared to pure domestic situations, the CJEU ruled that the pre-2015 Luxembourg fiscal unity provisions constitute a restriction prohibited by the provisions of the Treaty on the Functioning of the European Union (TFEU) on the freedom of establishment.

Compatibility of the post-2014 fiscal unity regime with EU law

The second question raised by the Luxembourg Administrative Court relates to the fiscal unity regime as applicable from tax year 2015 onwards.

While extending the fiscal unity regime to also allow horizontal fiscal unities, the fiscal unity provision in its reading as from tax year 2015 states that a member of a fiscal unity cannot at the same time be member of another fiscal unity. This argument was brought up by the representative of the Luxembourg Government in front of the Administrative Court in the context of the debates around the application of the horizontal fiscal unity regime for tax year 2014: in his view, an existing vertical fiscal unity, as in the instant case, cannot coexist with a new horizontal fiscal unity with the same Luxembourg company acting as head of the fiscal unity. In other words, the switch from a vertical fiscal unity to a horizontal fiscal unity implicitly results in the termination of the existing tax group, to give rise in a second step to a new tax group. Given that the domestic provisions require a fiscal unity to be upheld for five years, the early termination of such fiscal unity retroactively annuls the benefits of the regime and triggers rectifying taxation of all the companies concerned on a stand-alone basis as if the regime had never applied.

The Administrative Court thus asked the CJEU if the strict separation between the regimes of vertical and horizontal fiscal unity and the resulting obligation to first end the existing vertical fiscal unity before being able to create a horizontal fiscal unity is compliant with the freedom of establishment.

To answer this question, the CJEU first noted that a Luxembourg parent company can decide to include a resident subsidiary in a pre-existing fiscal unity and to remove it again after a minimum period of five years, with the consequence that said subsidiary will again be taxed on a stand-alone basis, without this change of the composition of the tax group triggering the termination of the previous fiscal unity and the creation of a new fiscal unity. This constitutes in the view of the CJEU a tax advantage for the companies concerned.

On the other hand, the legislation as it stands results in a less favorable treatment for a parent company having its seat in another Member State and without having a permanent establishment in Luxembourg, as it can only establish a fiscal unity of its resident subsidiaries at the cost of the termination of an existing vertical fiscal unity between one of its subsidiaries and some sub-subsidiaries. If in addition the five-year period is not met for all or some of the companies concerned, the termination of the existing fiscal unity triggers a rectifying taxation of these companies.

As a result, the CJEU ruled that articles 49 and 54 TFEU must be interpreted as precluding the legislation of a Member State which obliges a parent company established in another Member State to terminate a pre-existing vertical fiscal unity between one of its subsidiaries and some of its resident sub-subsidiaries in order to allow that subsidiary to form a horizontal fiscal unity with other resident subsidiaries of such parent company, even though the integrating subsidiary (head of the consolidated group) remains the same and the termination of the vertical fiscal unity before the end of the minimum duration of the existence of the fiscal unity, as foreseen by the domestic legislation, implies a rectifying taxation on a stand-alone basis for the companies concerned. As a result, switching from a vertical to a horizontal fiscal unity headed by an EU parent company must be allowed.

Impact of the formal requirement of requesting a fiscal unity on the conclusions

Luxembourg domestic law requires that a request for entering into a fiscal unity regime be filed before the end of the first tax year for which application of the regime

is sought. In the case at hand, requests for applying the horizontal fiscal unity regime for 2013 and 2014 were filed in December 2014. The companies argued that prior to the decision in the case *SCA Group Holding BV and others* of 12 June 2014 Luxembourg administrative practice and case law would have prevented them from requesting a horizontal fiscal unity and that they filed the request shortly after the CJEU decision in that case and within the five-year statute of limitations.

In the CJEU's opinion, this question must be analyzed by reference to the principles of equivalence and effectiveness which apply to requests that aim to ensure the exercise of a right drawn from EU law and to judicial actions that aim to ensure the safeguard of such a right.

The principle of equivalence requires that a national rule be applied without distinction as regards procedures based on EU law and those based on national law. As per the CJEU, there is nothing that would sustain that the deadline for filing the request for fiscal unity does not respect this principle.

According to the principle of effectiveness, domestic requirements shall not render the exercise of rights conferred by EU law impossible in practice or excessively difficult. The CJEU noted that for tax year 2013, the claimants had the possibility to file at any time during that year a request for a horizontal fiscal unity by invoking the incompatibility of the Luxembourg legislation with EU law. Such request was indeed filed on these grounds for tax year 2014, prior to the legislative amendments extending the regime to horizontal fiscal unities. The fact that, given the domestic legislation, administrative practice and domestic jurisprudence, the claimants considered the filing of such request as pointless, cannot be assimilated to an objective impossibility to file such request nor to a situation where such a procedure would cause excessive difficulties or could not reasonably be requested in the sense of existing case law of the CJEU on the principle of effectiveness.

The CJEU therefore ruled that the principles of equivalence and effectiveness do not preclude a requirement that any request for applying the fiscal unity regime must be submitted to the competent authority before the end of the first tax year for which application of that regime is sought.

Next steps

Based on the CJEU ruling, taxpayers that filed a request for horizontal fiscal unity under the pre-2015 legislation or that requested to switch from a vertical to a horizontal fiscal unity under the current legislation should in principle be entitled to retroactive application of this regime, provided the request was filed within the deadline set forth by the law.

Nevertheless, a case-by-case analysis should be made as such retroactive application may give rise to domestic procedural issues, to the extent companies concerned have been assessed for the years under debate.

Companies with a financial year corresponding to calendar years and that wish to switch from a vertical fiscal unity to a horizontal fiscal unity should file their request prior to 31 December 2020.

Endnote

1. *SCA Group Holding BV and others*, Joined cases C-39/13, C-40/13 and C-41/13.

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