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The *Bosal Holding* Case: Analysis and Critique

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1. Introduction

On 18 September 2003, the European Court of Justice (hereafter: ECJ) delivered the *Bosal Holding* judgment.[1] This case concerned the question of whether a Dutch limitation of the deductibility of interest costs in relation to the financing of a holding in companies established in other Member States was in accordance with the Parent-Subsidiary Directive and the freedom of establishment (Article 52 of the EC Treaty; now, after amendment, Article 43 EC). This case is dealt with further in this article. First, in paragraph 2, the facts and the Netherlands regulation are set out, and the questions referred and the answer of the ECJ are reflected. In paragraph 3, the judgment is analysed and an appreciation is given. Subsequently in paragraph 4, a brief account is given of the consequences of the judgment for the special group regimes within the EU. Finally in paragraph 5, a number of closing remarks are made.

2. Background

2.1. The facts and the Netherlands regulation

Bosal Holding BV (hereafter: Bosal) is a limited liability company (*besloten vennootschap*) established in the Netherlands which carries on holding, financing and licensing/royalty related activities and which, in the Netherlands, is subject to corporation tax (*vennootschapsbelasting*). Bosal is holder of 50 to 100% shareholdings in, among others, a number of companies established within the European Community. In 1993, it wanted to deduct from its taxable profits almost 4 million Dutch guilders (1.82 million Euro) of interest costs made in relation to the financing of its holdings in companies in other EC Member States. The tax inspector, however, refused this deduction because Article 13 of the Dutch Corporation Tax Act 1969 (hereafter: CTA 1969), which regulates the Dutch participation exemption, did not allow such deduction for that year.

If a parent company established in the Netherlands is a 5% shareholder of a company, the participation exemption is applicable. This exemption applies to holdings both in companies established in the Netherlands and in companies established in other Member States. Under the participation exemption provisions, exemption is granted for dividends received and for generated capital gains obtained from the sale of shares in the subsidiary. Article 13(1) CTA 1969 reads: ‘in determining profit no account shall be taken of gains acquired from a holding or of the costs relating to a holding’. Thus on balance, in the determination of the taxable profit of the parent company, both the positive and the negative results (losses[2]) acquired from a holding and the costs relating to a holding (particularly interest costs for the financing of a holding) remain outside consideration.

The essence in the subject case is that the costs relating to a holding are not deductible (hereafter: holding costs). There is an exemption to this non-deductibility: holding costs *are* deductible if it should appear that such costs are indirectly instrumental in making profits [of the subsidiary] that are taxable in the Netherlands (the Member State where the parent company is established).[3]

Thus in brief, holding costs that are indirectly instrumental in taxable profits being made in the *Netherlands* are deductible and holding costs which are indirectly instrumental in taxable profits being made *abroad* are not deductible.

2.2. The questions referred and the answer of the ECJ

In the Netherlands, the question of whether the non-deductibility of holding costs is in accordance with European law has considerably occupied the minds both in practice and in the doctrine.[4] The question has

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1 Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financiën*.

2 For example, a loss that is made at the sale of the shares of the subsidiary.

3 See: Article 13(1) CTA 1969.

4 See for example: F.C. de Hosson, De kosten van de deelneming, WFR 1994/6111, pp. 996-1008, C.W. van Noordenne, Enige recente arresten op het gebied van non-discriminatie en hun weerslag op artikel 13 van de Wet op de vennootschapsbelasting, MBB 1995/5, pp. 142-146, P.G.H. Albert, De kostenaftrekbeperking van artikel 13, eerste lid, Wet Vpb. 1969: protectionisme, maar geen discriminatie, Weekblad Fiscaal Recht 1995/6173, pp. 1697-1702, W. Bruins Slot, Naar een bespreking van de niet-aftrekbaarheid van financieringskosten in verband met buitenlandse deelnemingen, Weekblad Fiscaal Recht 1993/6046, p. 315 ff; R.A. van der Jagt, Bosman zet Nederlandse fiscus

been put to various Dutch Courts of Appeal, but none of these Courts had ruled that there was a conflict with EC law or had put the question to the EC Court of Justice. The *Bosal Holding* case is the first to have been brought before the Dutch Supreme Court (*Hoge Raad der Nederlanden*). Another similar case is pending before the *Hoge Raad* in which the compatibility of the deduction limitation of holding costs in relation to a holding established in Norway (thus, not the EC) with the EEA Treaty is at issue.

In a judgment of 11 April 2001,[5] the *Hoge Raad* requested the ECJ for a preliminary ruling on the following questions:

1. Does Article 52 of the EC Treaty, read in conjunction with Article 58 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 above-mentioned costs in levying tax on the subsidiary?

In his Opinion of 24 September 2002, Advocate General Alber deemed that there was a conflict with the right of establishment. The ECJ examined the two questions together and reformulated them into one question that reads:

> 'the referring court effectively asks whether Community law precludes a national provision which, when determining the tax on the profits of a parent company established in one Member State, makes the deductibility of costs in connection with that company's holding in the capital of a subsidiary established in another Member State subject to the condition that such costs are indirectly instrumental in making profits which are taxable in the Member State where the parent company is established'.

The ECJ's answer to this question was:

> '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, interpreted in the light of Article 52 of the EC Treaty (now, after amendment, Article 43 EC) precludes a national provision which, when determining the tax on the profits of a parent company established in one Member State, makes the deductibility of costs in connection with that company's holding in the capital of a subsidiary established in another Member State subject to the condition that such costs be indirectly instrumental in making profits which are taxable in the Member State where the parent company is established'.

3. Analysis of the ruling

3.1. The parent-subsidiary directive

The ECJ first approached the issues from the perspective of the Parent-Subsidiary Directive,[6] the specific tax rules that are applicable to this situation. If a distribution of profits takes place between a subsidiary and a company established within the EC, first, this Directive (Article 5) forbids, under certain conditions, the Member State of the subsidiary from levying a withholding tax on this distribution of profits. Second, the Directive imposes the obligation (Article 4) on the Member State of the parent company to exempt the received distribution of profits (exemption method), or to deduct the amount of tax due from that fraction of the corporation tax paid by the subsidiary which relates to those profits (credit method).

The ECJ first brings back to mind the object of this Directive which is basically that the Directive endeavours to eliminate the difference between profit distributions made in domestic situations compared with profit distributions in foreign situations.[7] The ECJ then deals further with the tax treatment of the holding costs under this Directive. The ECJ first observes that Article 4(2) of the Directive leaves each Member State the option of providing that any charges relating to that holding may not be deducted from the taxable profits of the parent company. It then observes that the deduction refusal 'is not accompanied by any condition or special rule concerning the destination or purpose of the profits obtained by the parent company or its subsidiary, or concerning the applicability in time of Article 4(2)'. There besides it observes, and I can find no reason for this, that the deduction refusal of Article 4(2) always remains applicable, even after the effective entry into force of a common system of company taxation, and that this does not apply to the obligation under Article 4(1) to grant a participation exemption or participation credit, given that pursuant to Article 4(3), after the entry into force of a common

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buitenspel, Weekblad Fiscaal Recht 1996/414; J.P. Linders and B. Wagenaar, De EU-mythe rond non-discriminatie, een veredelde Pavlov-reactie, Weekblad Fiscaal Recht 1996/6222, pp. 1705–1718; R.H. Boon and M.J. Pelinck, De ICI-zaak en artikel 15 en 13, eerste lid, Wet Vpb. 1969, Weekblad Fiscaal Recht 1998/6321, pp. 1823–1833, H.T.P.M. van den Hurk, Reikt het gemeenschapsrecht het volkenrecht de hand?, TFO 1998/39, D.M. Weber, Enige opmerkingen naar aanleiding van de discussie inzake de (on)verenigbaarheid van de kostenaftrekbeperking van artikel 13, eerste lid, Wet Vpb. 1969 met het recht van vestiging, FED 1999/261, pp. 1075–1082; J.J. van den Broek, Bosal Holding: een rechtvaardiging voor de kostenaftrek bij buitenlandse deelnemingen? TFB, no. 10, pp. 5–10 and H. van den Broek, Bosal Holding and the confusion surrounding the territoriality principle, International Transfer Pricing Journal, May/June, 2003, pp. 116–123.

5 Hoge Raad 11 April 2001, no. 35729, BNB 2001/257, with note van der Geld; FED 2001/341, with note Weber.

6 Directive of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, 90/435/EEC.

7 See paragraph 22 of the judgment; see also Joined Cases C-283/94, C-291/94 and C-292/94 *Denkavit International and Others v Bundesamt für Finanzen* [1996] ECR I-5063, paragraph 22; Case C-375/98, *Ministério Público, Fazenda Pública and Epson Europe BV*, [2000] ECR I-4243, paragraph 20; Case C-294/99 *Athinaïki Zythopoiïa* [2001] ECR I-6797, paragraph 25.

system of company taxation, the first paragraph will no longer be applicable.

The ECJ then ruled: 'It follows that, in so far as Article 13(1) of the 1969 Law merely implements the possibility offered by Article 4(2) of the Directive to refuse the deduction of costs incurred by parent companies in connection with holdings in the capital of their subsidiaries, it is compatible with the Directive' (see paragraph 25 of the judgment). The ECJ thus rules that, in principle, Article 4(2) of the Parent-Subsidiary Directive allows the deduction limitation of holding costs, although it immediately adds to this in paragraph 26: 'However, that possibility may be exercised only in compliance with the fundamental provisions of the Treaty, in this case Article 52 thereof. It is therefore in relation to that provision that it is necessary to examine the question whether the Directive authorises a Member State only partially to allow, as does Article 13(1) of the 1969 Law, the deductibility of costs in relation to holdings'. Because Article 4(2) of the Directive is not clear as to the question of whether in the event a subsidiary in the Netherlands makes profit the holding costs may be allowed to be deducted (which is logical given that the Directive only covers cross border EC distribution of profits and not domestic situations), the ECJ examines whether this option is allowed by the EC Treaty freedoms. Accordingly, the Directive is explained in conformity with the Treaty. The ECJ has followed this method of interpretation before. In this sense, it considered in *Commission v. Germany*,[8] 'when the wording of secondary Community law is open to more than one interpretation, preference should be given to the interpretation which renders the provision consistent with the Treaty rather than the interpretation which leads to its being incompatible with the Treaty. Consequently, the Directive should not be construed in isolation and it is necessary to consider whether or not the requirements in question are contrary to the abovementioned provisions of the Treaty and to interpret the Directive in the light of the conclusions reached in that respect'.

3.2. Applicability of the right of establishment

The ECJ and the *Hoge Raad* assume, without further substantiation, that there is an establishment in another Member State by means of a subsidiary and thus, the right of establishment is applicable. This assumption is correct, given that the Netherlands parent company only held majority interests in holdings established in other Member States such that, on the basis of the *Baars* and the *Überseering* cases, only the right of establishment is of importance.[9] In light of the convergence concerning the explanation of the EC Treaty freedoms it can be assumed in principle that the judgment will also apply to situations in which the free movement of capital is applicable (thus by minority holdings).

3.3. Restriction of the right of establishment

At the beginning of the judgment (paragraph 13), the ECJ correctly established that the question of whether holding costs are deductible is not dependent on the place of establishment of the subsidiary but on the question of whether the subsidiary has Dutch or foreign profit. Holding costs can, for example, be deducted by the parent company established in the Netherlands from its profit if a subsidiary established in another Member State makes profit by means of a permanent establishment in the Netherlands. Thus, no distinction is made according to the place of establishment but according to the place where the profit is made, in other words, on the basis of a 'profit jurisdiction criterion'.

The *Hoge Raad* had already ruled that 'this difference in tax treatment – by the same Member State – of the costs made by a Dutch parent company (. . .) has a restraining influence on the decision of the parent company to establish a subsidiary outside the Netherlands'. Referring to *ICI*[10] and *Baars*[11] the *Hoge Raad* ruled that there is a hindrance of the free movement of establishment. In these judgments there was also, just as there is in the subject case, a matter of hindrance by the Member State of origin, thus from the Member State from which (in this case, the Netherlands) a national of a Member State make their establishment in another Member State. The ECJ follows the *Hoge Raad* in this and adds that 'a parent company might be dissuaded from carrying on its activities through the intermediary of a subsidiary established in another Member State since, normally, such subsidiaries do not generate profits that are taxable in the Netherlands'. It then goes on to refer to the objective set forth by the Directive that endeavours to eliminate the difference between domestic and foreign situaties.[12]

We see here that the ECJ does not consider the holding costs deduction limitation an (in)direct disrimination against nationality but as a measure that draws a distinction between domestic and foreign situaties (by differentiating between profit generated in the Netherlands and that generated abroad) which hinders the free movement.

This approach to the issue would seem to be the only correct one. The Dutch deduction limitation namely makes no (indirect) distinction according to nationality. As is remarked above, the questions of whether holding costs of a parent company estab-

[8] See Case 218/82, *Commission v. Council* ECR [1983] 4063 and Case 205/84, *Commission v. Germany* ECR [1986] 3755, paragraph 62.

[9] Cf. Case C-251/98, *Baars* [2000] ECR I-2787, paragraph 22 and Case 208/00, *Überseering BV and NCC* [2002] ECR I-9919, paragraph 77. For that matter, there is more nuance in the criterion for the distinction between establishment and capital movement, but as a rule establishment is with a majority interest and capital movement is with minority interests.

[10] Case C-294/96, *ICI* [1998] ECR I-4695.

[11] Case C-251/98, *Baars* [2000] ECR I-2787.

[12] More specifically: tries to eliminate 'the disadvantage due to the application of tax provisions governing relations between parent companies and subsidiaries of different Member States which are less advantageous than those applicable to parent companies and subsidiaries of the same Member State'.

lished in the Netherlands are deductible is dependent on the question of whether the subsidiary has Dutch or foreign profit (profit jurisdiction criterion). This distinction does not, in principle, differentiate between nationalities. There is no *direct* discrimination against nationality: the law does not determine that only companies formed under *Dutch* law may enjoy cost deductions.[13] There is also no question of *indirect* discrimination against nationality. By putting companies resident outside the Netherlands at a disadvantage there could be a question of indirect discrimination against nationality given that companies established outside the Netherlands are usually companies that were formed under the laws of another Member State.[14] Given that Article 13(1), CTA 1969, does not determine that only companies *resident* abroad may fall under the holding costs deduction limitation, there is no question of indirect discrimination against nationality.[15]

Under the EC Treaty freedoms, however, measures are also forbidden that although they do not discriminate between nationalities, they do hinder the exercising of fundamental freedoms. From a European law point of view, such dissuading measures are divided into *discriminatory measures* (or measures with distinction) and *equally applicable measures* (or measures without distinction).[16] A discriminatory measure is a measure that differentiates between domestic situations and situations in which use is made of the free movement whereby it is liable to hinder or make less attractive the exercise of fundamental freedoms.[17] In this case, we are dealing with a discriminatory measure (the difference between Netherlands or foreign profit) that hinders the free movement (to wit, the establishment of subsidiaries in other Member States).

Although the Dutch deduction limitation is equally applicable to each parent company resident in the Netherlands, there is no question of an equally applicable measure. In this case, a distinction is made by the profit jurisdiction criterion. Equally applicable measures are domestic provisions that do not (also not indirectly) discriminate between domestic and foreign situations.[18] A forbidden non-discriminatory measure was examined in, for example, the *Bosman* judgment.[19] In this judgment, transfer rules for football clubs were at issue that applied both to transfers of players between various football clubs within the same Member State, and to transfers between a domestic and a foreign football club.[20] In direct taxation equally applicable measures were examined in the *Futura Participation* case[21] and in the more recent *De Coster* case.[22]

3.4. Justifications

3.4.1. Discriminatory measures and overriding reasons based on the general interest

According to the case law of the ECJ, equally applicable measures can only be justified by overriding reasons based on the general interest. These are the grounds for justification that are permitted by the ECJ, such as the need to preserve the coherence of the tax system, the prevention against tax avoidance and the effectiveness of fiscal supervision. Discriminatory measures cannot be justified by such unwritten reasons based on the general interest. This is apparent from the landmark *Gebhard case*, in which the ECJ summed up four conditions which a hindering national measure must meet if it is to be justified. The first condition was that 'they must be applied in a non-discriminatory manner'.[23] Discriminatory measures can only be invoked by the exceptions listed in the EC Treaty concerning public policy, public security or public health (see: Article 30 EC, Article 39(3) EC, Article 45 EC and Article 46 EC).

Problematic, and a thorn in the flesh for many writers in the doctrine and of advocates General,[24] is that the ECJ itself does not adhere to its case law. In many tax judgments where indirect discrimination of nationality was clearly at issue, the ECJ still examined the justification grounds raised when it could have sufficed by pronouncing that because of the discrimination the measure cannot be justified. In his Opinion in the *Bosal Holding* case, Advocate General Alber tries to resolve these issues by stating that only 'inherent discrimination' cannot be justified by reasons based on the general interest. He understands 'inherent discrimination' as the situation where there is a

13 With companies, the ECJ puts 'the seat' of a company on equal foot with the 'nationality' of the company. See Case 270/83, *Avoir fiscal*, [1986] ECR 273, paragraph 18.

14 See for a first applicability of indirect discrimination against nationality of companies: Case C-330/91, *Commerzbank* [1993] ECR I-4017, paragraph 15.

15 In the Dutch literature, it is noted that there is an inferred indirect discrimination against nationality (in the second degree): foreign profit, is *usually* made by subsidiaries established abroad. A subsidiary established abroad is *usually* incorporated under foreign law, thus there is an (indirect) discrimination against nationality (see: J.A.G van der Geld, Verslag van het EFS-seminar van 23 november 2000, WFR 2001/6424, pp. 291-297 (at p. 294). The above stance is defendable, but in my view a far-reaching reasoning to arrive at indirect discrimination against nationality. Furthermore it is unnecessary, given that discriminatory measures that have a negative influence on the free movement are forbidden anyway under the Treaty freedoms.

16 See also: Kapteyn - VerLoren van Themaat, Introduction to the law of the European Communities, third edition, Kluwer Law International, London, 1998, pp. 584-586.

17 See case C-55/94, *Gebhard*, [1995] ECR I-4165, paragraph 37.

18 See for such measures in the area of taxes: P. Farmer, The Court's case law on taxation: a castle built on shifting sands?, EC Tax Review 2003/2, pp. 75-81, at 78-80.

19 Case C-415/93, *Bosman* [1995] ECR I-4921.

20 See explicitly paragraph 98-100 of the *Bosman* case.

21 Case C-250/95, *Futura Participations*, [1997] ECR I-2471, in this case an accounting obligation for a permanent establishment in Luxembourg was considered a hindrance, because there was a double burden (accounting records in the Member State of the headquarters and in the Member State of the permanent establishment must be kept up to date).

22 Case C-17/00, *De Coster*, [2001] ECR I-9445. In this case, there was a satellite dish tax that according to the ECJ 'applies without distinction to national providers of services and to those of other Member States', but which does constitute a hindrance of the free movement.

23 See: case C-55/94, *Gebhard*, [1995] ECR I-4165, paragraph 37.

24 See e.g. Advocate General Tesauro, in case C-118/96, *Safir*, [1998] ECR I-1897, point 27-34.

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', according to the Advocate General. He also suggested only using the word 'discrimination' for inherent discrimination and in all the other cases, such as the subject one, to use 'different treatment'.

The ECJ did not follow Alber's suggestions. For that matter, I can read nothing in the suggestion of the Advocate General. First, his suggestion is wordplay which gives rise to great lack of clarity. In a grammatical sense there is no distinction between the terms 'discrimination' and 'different treatment'. Both terms indicate that there is a measure with met distinction (to use another word with the same meaning). In addition, his suggestion does not solve the problem. He suggests that only inherent discrimination, that is discrimination on the basis of nationality or seat, can be justified by overriding reasons based on the general interest. Apparently with this, he refers to direct and indirect discrimination of nationality. The problem in fact is that the ECJ always examines the justification grounds for *indirect* discrimination against nationality and has even applied this itself.[25] I am of the view that it follows from the case law that, for the free movement of persons, a domestic measure on *direct* discrimination against nationality (for companies under the right of establishment) can no longer be justified on the basis of reasons based on the general interest, but only on the exceptions listed in the EC Treaty. See for a recent example, the *Überseering* case.[26] In my view, the ECJ would do well to rule that in the event of *direct* discrimination against *nationality,* a Member State may no longer apply the reasons based on the general interest, it may only resort to the exceptions listed in the EC Treaty. Such an opinion would render the ECJ case law more consistent. Furthermore, I empathise with the suggestion of Advocate General Jacobs in the *Danner* case,[27] who proposes to declare the overriding reasons based on the general interest applicable to each restriction thus, to both (i) a discriminatory (direct or indirect) restriction no matter what criteria (also in discrimination against nationality), and (ii) non-discriminatory restrictions. I am of the view that this is not in conflict with the Treaty text and moreover, as the Advocate General noted, there are serious justifications nowadays (protection of the environment, consumer protection, coherence of the tax system) that must be protected.

3.4.2. Coherence of the tax system

In its judgment, the *Hoge Raad* first examined whether the holding costs deduction limitation could be justified by the need to preserve the coherence of the tax system known from the *Bachmann* judgment[28] (hereafter also called 'coherence-justification'). This justification can be invoked, such as the ECJ repeated in this judgment, if there is 'a direct link, 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 [are] related to the same tax' (paragraph 29 of the judgment).

In order to examine whether the coherence-justification could be invoked, the *Hoge Raad* elucidated extensively on the scope of the Dutch participation exemption and the holding costs deduction limitation. Of special note is that the *Hoge Raad* examines where the costs should belong under Dutch law. Should that be the Member State of the parent company, thus the law follows a 'legal cost allocation' that links to the debtor. Or is it so that the law follows a 'territorial cost allocation' that is linked to the place where the profit is made with which the costs are economically coherent.

According to the *Hoge Raad,* the scope of the participation exemption is that in the matter of the profit generated by the subsidiary, corporation tax is not levied twice, to wit, first from the subsidiary and then after the profit distribution of the parent company. The *Hoge Raad* then draws a distinction between the effect of the participation exemption in a domestic and a foreign situation:

a) in domestic relationships, there is prevention of double taxation in one and the same Member State. The *Hoge Raad* compares the effect of the participation exemption with a taxation levy as if the subsidiary were consolidated with the parent company (extension concept);
b) in foreign relationships, there is prevention of double taxation levied by various Member States. Although the *Hoge Raad* does not consider this explicitly, it appears that the *Hoge Raad* also carries through the comparison with the extension concept to foreign relationships.[29]

Furthermore, the *Hoge Raad* indicates that with the holding costs deduction, account has been taken in the law with the words 'indirectly instrumental', whereby, a link is made between the holding costs made by the parent company and the taxable profit made by the subsidiary. The *Hoge Raad* again emphasises that there is thus an economic connection between the holdings costs of the *parent company* and the profit of the *subsidiary* and that, although the holdings costs are taken into consideration at parent company level, there is no connection between the holdings costs of the *parent company* and taxable profit of the *parent company.*[30] Clearly here, for *domestic* situations, the *Hoge Raad* makes a connection between two different taxpayers. Further in the judgment, the *Hoge Raad* carries through this connection (and the extension concept) to the applicability of the participation exemption in *foreign* situations. The *Hoge Raad* acknowledges namely, that also in the event where it concerns a foreign subsidiary, 'an economic coherence

[25] See Case 204/90, *Bachmann,* [1992] ECR I-249.
[26] Case 208/00, *Überseering BV and NCC*, [2002] ECR I-9919, paragraph 93.
[27] Opinion of Advocate General Jacobs in Case C-136/00, *Danner*, [2002] ECR I-8147, point 40.
[28] Case C-204/90, *Bachmann* [1992] ECR I-249; Case C-300/90 *Commission v Belgium* [1992] ECR I-305.
[29] See paragraph 3.4.3 of the judgment of the *Hoge Raad.*
[30] See paragraph 3.4.2 of the judgment of the *Hoge Raad.*

exists between the holdings costs and the profit of the subsidiary'. It then considers that although there is such an economic coherence, in foreign situations coherence of costs and taxable profit within one taxation system is lacking.

This is the crux of the issues. The *Hoge Raad* first indicates that the deduction of the holding costs is correct on principle (flowing from the extension concept). Subsequently, that there is an (economic) coherence (connection) between the holding costs at parent company level and profit of the subsidiary, and finally, that this coherence is breached in foreign relationships given that the profit of the subsidiary is outside the jurisdiction of the Netherlands. It flows from this consideration that the Netherlands system rests on two concepts: on the one hand, the Netherlands follows the territorial cost allocation on the basis of the extension concept given that for the question of *whether* the costs are deductible, the costs are allocated to the territory where the subsidiary makes profit. On the other, the extension concept is not carried through to the extent that the parent company and the subsidiary are actually consolidated for tax purposes. The costs, namely, can ultimately be brought for deduction by the parent company which, from a legal point of view, is the debtor. The *Hoge Raad* does not doubt the fact that the Dutch *concept* behind the rule is a coherent system. The approach of Dutch law resting on two concepts did cause the *Hoge Raad* doubt, however, on which basis the Supreme Court was not certain if the coherence-justification could successfully be invoked and therefore decided to ask preliminary questions. Before dealing with these points of doubt of the *Hoge Raad*, attention must first be devoted to the fact that other to the *Hoge Raad*, the ECJ sees no direct link whatsoever whereby the coherence is safeguarded:

Having first brought to mind that the direct link can be lacking, for example, because 'one is dealing with different taxes or the tax treatment of different taxpayers', the ECJ gives four reasons for the lack of the direct link:

i) *No link between granting tax advantage to parent companies and the tax system relating to subsidiaries*

> 'Nor is there any direct link between, on the one hand, the granting of a tax advantage (the right to deduct costs connected with holdings in the capital of their subsidiaries from their taxable profit) to parent companies established in the Netherlands and, on the other, the tax system relating to the subsidiaries of parent companies where the latter are established in that Member State' (paragraph 31 of the judgment).

I sincerely do not understand this consideration. I am unclear as to what the ECJ uses as comparison and why. It would almost seem that the ECJ does not see a direct link between granting of a *tax advantage* to parent companies and the *tax system* relating to subsidiaries. Frankly, I do not see this direct link either, but this is mainly because it does not concern such coherence. Of note is that it can be derived from the Report for the Hearing[31] that the Netherlands and the United Kingdom have very poorly indicated what precise coherence they mean. The *Hoge Raad* however, has reflected precisely and to great extent (see above) that an economic coherence exists between the holdings costs of the parent company and the profit of the subsidiary, but that when it concerns a subsidiary with foreign profit, the coherence of costs and taxable profit is lacking within one taxation system. These considerations of the *Hoge Raad* are not contained in the Report for the Hearing, but it would appear to follow from paragraph 19 of the judgment that the ECJ has finally understood what coherence was being invoked. In that framework, paragraph 31 quoted above is surprising. It would appear to concern an entirely different coherence, to me, incomprehensible. However, assume that the ECJ was considering the same coherence as that referred to by the *Hoge Raad*. Then it is remarkable that the ECJ rejects the direct link without substantiation (the ECJ *states* namely only that there is no coherence), there where the *Hoge Raad* came to a well-substantiated conclusion that there was a direct link. All in all, I am not entirely impressed with the rejection of the direct link.

ii) *Parent companies and subsidiaries are distinct legal persons (different taxpayers)*

> 'Unlike operating branches or establishments, parent companies and their subsidiaries are distinct legal persons, each being subject to a tax liability of its own, so that a direct link in the context of the same liability to tax is lacking and the coherence of the tax system cannot be relied upon' (paragraph 32 of the judgment).

With this consideration, the ECJ continues the stringent case law that there can only a direct link if there is a link for the same taxpayer and for the same tax. The ECJ considers that there is no question of a direct link in the context of the same liability to tax, given that there are distinct legal persons, *each being subject to a tax liability of its own*. Again here, we see that the ECJ holds no appreciation of the considerations of the *Hoge Raad* that form the basis of the preliminary referral. In its judgment, the *Hoge Raad* compares the effect of the participation exemption with a tax levy *as if* the subsidiary were *consolidated* with the parent company (extension concept). The *Hoge Raad* thus indicates that the system in the Netherlands starts from the assumption of territorial cost allocation, whereby for the question of whether the costs are deductible, it makes no difference that there are legally different taxpayers. The ECJ ignores this entirely, which in fact implies that this consideration is not based on that which the *Hoge Raad* had established on the Netherlands system. In fact, the judgment has a shortcoming and on this basis, the conclusion cannot be arrived at that, in this case, there is no direct link.

[31] In this Report, the facts, the national provisions the relevant Community law and the written remarks of the parties are described and are used by the ECJ as basis of the judgment.

Accordingly, this consideration gives rise to the question of whether paragraph 32 of the judgment could have been different in a situation in which the ECJ is expressly aware that we have distinct legal persons, each being subject to a tax liability of its own, but where the tax provision for the territorial division of costs and profits *starts from the assumption* of one taxpayer (such as in *Bosal Holding*). This will be presumably not the case and we can expect that the ECJ will uphold its starting point that the tax treatment of a taxpayer can only be made dependent on its own proceeds and costs and not on those of another taxpayer.[32]

No matter, with this consideration the ECJ has clearly restricted the sovereignty of the Member States. Namely, there are multiple national tax provisions on which the tax position of a taxpayer is dependent on that of another taxpayer. This is particularly the case in various special group provisions known in the various Member States (see further on this subject in paragraph 4).

iii) Limitation of deductibility of costs not compensated for by corresponding tax advantage

> 'Moreover, the limitation of the deductibility of costs incurred by a parent company established in the Netherlands in connection with its holdings in the capital of subsidiaries established in other Member States is not compensated for by a corresponding advantage' (paragraph 33, first sentence).

This consideration is somewhat curious because it looks as if the ECJ has reversed the applicable conditions of the coherence-justification. Instead of requiring that there be an advantage that is compensated by a disadvantage, the ECJ questions whether there is a disadvantage that is compensated by an advantage.

If the coherence-justification is to be invoked there must be, as the ECJ itself remarks, a direct link in the case of one and the same taxpayer, between the granting of a tax advantage and the offsetting of that advantage by a tax levy. For example, pension premiums are tax deductible (= the 'tax advantage') and this tax deduction is later compensated by the tax levy on these pension benefits (= the 'fiscal levy'). Subsequently, there must be a situation in which if use is made in the case of free movement, the coherence is breached because no tax is levied on, using our example, the pension benefits. If there is a breach of the coherence, this may be repaired by refusing the tax deduction. According to the *Hoge Raad,* in the case in question there was economic coherence between the deductibility of the holdings costs (= the 'tax advantage') and the profit of the subsidiary (= the 'fiscal levy'). This coherence is breached, however, if use is made of the free movement given that for a foreign subsidiary with foreign profit, the coherence between the holdings costs and the taxable profit within one taxation system is lacking, according to the *Hoge Raad*. In such situation, the Netherlands may no longer impose a levy on the profit of the foreign subsidiary. In the case in question, the ECJ wonders whether the measure with which the coherence is repaired (the holding costs deduction limitation) is compensated because there is an advantage that can be set off against it. In fact here, the ECJ thus questions whether the coherence in the event that use is made of the free movement has indeed been breached (breaching of the coherence gives namely a tax advantage given that no compensating levy can be imposed). According to the ECJ, this is not the case, although why is not made clear. This is remarkable given that the *Hoge Raad* had ruled that the coherence had indeed been breached, because the Netherlands cannot levy tax in the case of a foreign subsidiary that has foreign profit. That thus is the 'advantage' the ECJ was seeking. Here also it becomes clear that the ECJ entirely disregards the considerations of the *Hoge Raad*.

iv) Holding costs should normally be deductible

> The effect of implementing that limitation appears to be that costs which should normally be deductible are not taken into consideration when calculating the amount of the tax liability. Such over taxation cannot be justified by reference to the need to preserve the coherence of the tax system (paragraph 33, last sentence and 34 of the judgment).

Of note here is the remark of the ECJ that the holding costs, 'appear to be costs which should normally be deductible are not taken into consideration when calculating the amount of the tax liability'.

True, the ECJ carefully uses 'appears to be' but here, it assumes without substantiation that the holding costs should always be deductible at parent company level. This is amazing given that the *Hoge Raad* had established that in light of the extension concept, economic coherence exists between the holdings costs and the profit of the *subsidiary*. For the question of whether there is a right of deduction, based on a territorial costs allocation, it must be examined to which territory the profit of the subsidiary should be allocated. The holding costs can only be deducted by the parent company but they are not costs that cohere to the profit of the parent company. The *Hoge Raad* had made the following explicit remark: 'Although the holdings costs of the parent company are taken into consideration the consideration is *not* [based on] the ground that the deduction could find justification in the existence of any connection between the holdings costs and the profit generated by the *parent company*' (italics, DMW).

The ECJ was probably confused because the Dutch system rests on two concepts: The system follows the territorial costs allocation for the question of whether the costs are deductible; however, the ultimate deduction takes place at the level of the legal debtor (the parent company). Nevertheless, it appears that

[32] Furthermore, the consideration gives rise to the question, although not relevant in this case, of whether in the event two distinct legal persons are *in fact* deemed one taxpayer (such as in the Netherlands under the fiscal unity of prior to 2003), there can be a question of a direct link in certain cases.

again here, the ECJ has given an incorrect reflection of the Dutch system.

It could also be that the ECJ in fact meant to say that the holdings costs *must* be deductible at the level of the *parent* company. In that case, the ECJ would follow a legal costs allocation. If so, I feel the ECJ would be going too far. It is not the task of the ECJ to rule that the costs *should* be deductible and in *what* Member State the costs are deductible (thus to elect the legal or the territorial costs allocation). By doing so, the ECJ would be acting in an area that belongs to the sovereignty of the Member States.[33] As the ECJ itself considered in *Futura Participations*: 'As yet, no provision has been made for harmonizing domestic rules relating to determination of the basis of assessment to direct taxes. Consequently, each Member State draws up its own rules governing the determination of profits, income, expenditure, deductions and exemptions as well as the amounts in respect of each of them which may be included in the calculation of taxable income or of losses which may be carried forward'. The ECJ must have implicitly reversed this decision in *Bosal Holding* and in my view, that could never have been the intention.

Or does the ECJ mean that on the basis of *Community law* the holdings costs belong to the parent company and thus a legal costs allocation must be followed. This because Article 4(2) of the Parent-Subsidiary Directive lays down that a Member State is allowed not to deduct the costs from the profit of the *parent* company and thus they belong to this legal entity. That would be startling and cannot be expressly derived from the judgment. In addition, precise the contrary can be derived from Article 4(2) of the Directive: because this Article allows that the holding costs are not deductible at parent company level, this Article assumes that in such case, the costs belong to the jurisdiction of the Member State of the subsidiary and thus the territorial costs allocation must be followed. It must therefore be observed that the Directive simply allows the Member States to elect the legal or territorial costs allocation.

What should be noted for that matter, but did not come up in these proceedings, is that if the deduction of the holdings costs at the level of the parent company is not allowed on the basis of Article 4(2) of the Parent-Subsidiary Directive, the Directive does not solve the problem of the holding costs actually then being deductible by the subsidiary in the other Member State. This leaves the chance open (which will virtually always be so in practice) that the holdings costs are not be deductible anywhere, they will end up in no man's land. By not providing a solution for this, it can be defended that the Parent-Subsidiary Directive creates a disparity. This would imply that Article 4(2) of the Directive could be in conflict with Community law. This follows from an analogous application of the *Pinna* case[34] (ruled for Article 51 EEC Treaty, the present Article 42 EC) in which the ECJ considered that Community rules 'must refrain from adding to the disparities which already stem from the absence of harmonization of national legislative rules'.

The ECJ could have, for that matter, partly resolved these issues by deciding that Member States that do not allow the costs deduction from the parent company must be consistent and in the reverse situation (parent company established abroad: subsidiary with profit in the Netherlands) allow this deduction at subsidiary level.

3.4.3. The points of doubt of the Hoge Raad about the coherence-justification

After the considerations set out above, the ECJ deals with the points of doubt the *Hoge Raad* had with application of the coherence-justification.[35]

The first point of doubt lies in the fact that the coherence between deduction of the holdings costs from the parent company and the taxable profit from the subsidiary is not based on a pure application of the principle that proceeds and costs attributable thereto should be treated coherently from a tax point of view. According to the *Hoge Raad*, the tax treatment lacks 'systematic coherence', because first, the holdings costs can be deducted from the profit of the parent company irrespective of how much profit the subsidiary has made (even if the subsidiary did not make any profit in that year[36]), and second, in the reverse case, in which the subsidiary does make a profit and the parent company does not, if viewed as consolidated the holdings costs have no influence on the tax on the profit of the subsidiary. In brief: with the system now in force, deductibility of the holdings costs in domestic situations is sometimes earlier and sometimes later than should be the case based on a pure allocation of proceeds and costs. There is thus a difference in *timing* in the system. In light of the foregoing considerations, it could have been expected that the ECJ would seize on the lack of systematic coherence so to deem that there was no question of a direct link. The ECJ does not add why there is no question of a direct link. Apparently it deems that self-explanatory and requires that there can only be a question of a direct link if the proceeds and costs are directly related.

The second point of doubt of the *Hoge Raad* was the fact that the Netherlands inconsistently applied the coherence referred to. The concept that the costs deduction limitation is justified because the coherence of the national tax system is secured implies in fact that in situations where these costs are not deductible, the holdings costs must then be considered by the Member State of the *subsidiary*, thus abroad. In the reverse case, however (parent company established in another Member State and subsidiary with profit in the Netherlands), the Netherlands does not apply this

[33] See also in that sense the article worth reading of: R.A.V. Boxem, HvJ EG, quo vadis met het paard achter de wagen? (het recht op nationale behandeling, dispariteiten en intern inconsistente wetgeving), Weekblad Fiscaal Recht, 2003/6540, pp. 1231–1238, at p. 1236 and p. 1237.

[34] Case 41/84, *Pinna/Caisse d'allocations familiales de la Savoie* [1986] ECR 1.

[35] See paragraphs 3.4.4. and 3.4.5. of the judgment of the *Hoge Raad* and paragraph 15 of the judgment of the ECJ.

[36] See Hoge Raad, 26 January 2000, BNB 2000/160.

principle. Even if at parent company level the deduction of the holding costs are refused by a similar deduction limitation abroad, the Netherlands still does not allow deductibility of these costs at subsidiary level. The *Hoge Raad* had explicitly asked the ECJ whether this reversed inconsistent treatment was relevant (the second question; see above), but as has been remarked, the ECJ treated these two questions as one. Advocate General Alber dealt explicitly with the second question and arrived at the conclusion that the inconsistent treatment was not relevant, however, it appears from his Opinion that he did not recognise the issues that were at hand. In paragraph 36, the ECJ deals with the issue and considers that on the basis of this inconsistency 'one is entitled to *question* the coherence of a system of taxation' (italics, DMW). The ECJ thus gives no answer to the question of whether the inconsistency that had been outlined was relevant, it only states that one can *question* the coherence of a system of taxation. A very peculiar consideration, certainly in light of the fact that the *Hoge Raad* had put a question on this issue explicitly before the ECJ.

I share the view of Advocate General Wattel of the *Hoge Raad*[37] and of the European Commission that in itself, this inconsistency does not prejudice the applicability of the justification ground concerning the tax coherence. Complaints can be made about this inconsistency, but only in those situations where a subsidiary is established by a foreign parent company in the Netherlands that wishes to deduct the holdings costs it has made.

3.4.4. *Principle of territoriality*

The Netherlands Government had also invoked the principle of territoriality, as recognised by the ECJ in *Futura Participations*.[38] That the ECJ dealt with this principle after the coherence-justification is striking and, in the first instance, gives the impression that this concerns a justification ground. In my view, the application of the principle of territoriality concerns the question of whether there are similar situations, thus, whether or not there is a matter of discrimination. Apart from this, by rejecting the Netherlands stance, it would appear that the ECJ is of the opinion that there is a matter of comparative cases and in the end (rightfully) treats the principal of territoriality as a discrimination issue.

In *Futura Participations,* the ECJ accepts that for a right to the carrying forward of losses, requested by a non-resident with a permanent establishment in another Member State, the permanent establishment state may set the condition that the losses must be economically related to the income earned by the taxpayer in that State, provided that resident taxpayers do not receive more favourable treatment. According to the ECJ 'such a system, which is in conformity with the fiscal principle of territoriality, cannot be regarded as entailing any discrimination, overt or covert, prohibited by the Treaty.'

On the basis of the principle of territoriality, the Netherlands argue that the costs in connection with activities abroad, including financing costs and costs in relation to holdings, should be set off against the profits generated by those activities and the deduction of those costs is linked solely to the making or non-making of profits outside the Netherlands. This argument is in line with the opinion of the *Hoge Raad*: we have remarked before that according to the *Hoge Raad,* on the basis of the objective of the rule, there is a connection between the holding costs made by the *parent* and the profit of the *subsidiary*. An economic coherence does exist between the holding costs and the profit of the subsidiary.

According to the Netherlands Government, that is why there is no question of discrimination because there is no comparison between subsidiaries with taxable profit in the Netherlands and subsidiaries with taxable profit abroad. In my view, the Netherlands was holding a trump card. This was the crux of the matter. This can be seen from the fact that both Advocate General Wattel of the *Hoge Raad* and the European Commission supported this point of view. The ECJ, however, would hear nothing of this point of view. It rejects this, notably for two reasons:

- Application of the principle of territoriality in the *Futura Participations* case related to one taxpayer (paragraph 38);
- The argument that there is no comparison between subsidiaries with domestic and foreign profit is irrelevant; this case concerns the tax treatment of the parent company; it is established that the profits of the subsidiaries are not taxable in the hands of the parent company (paragraph 39).

On balance, the ECJ thus rejects the invoking of the principle of territoriality because this can only be applied to one taxpayer, and it concerns the domestic profit of the parent company and not the domestic or foreign profit of the subsidiary. Again, it is clear that just as with the coherence-justification, the ECJ does not deal further with the judgment of the *Hoge Raad* that on the basis of the extension concept, economic coherence does exist between the holdings costs made by the parent company and the profit of the subsidiary, whereby for the question of whether the costs are deductible, the fact that there are two independent taxpayers is not relevant. Basically the ECJ argues that the principle of territoriality should always be applied to each individual taxpayer and that for the question of whether these costs are deductible, costs that are legally made by a taxpayer should not be allocated to another taxpayer. In other words: this in itself may be done, but a disadvantageous distinction may not be drawn if the costs are to be allocated to a foreign territory. We see that the ECJ holds a view on the principle of territoriality other to that which we see in tax law. Levying tax on the basis of the principle of territoriality entails that income and costs are taken into consideration by a state for the determining of the taxable income if these income and costs can be

[37] See point 7.12. of his Opinion.
[38] Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, paragraph 22.

imputed to the territory of that state. The principle of territoriality does not resist that costs being taken into consideration at a taxpayer other than the one who actually made these costs. The ECJ however, attaches a restricted substance of this principle within the EC. Again the question arises as to whether the ECJ is not encroaching on the sovereignty of the Member States. In my view, Community law contains no mention of the territorial principle and, in principle, leaves the substance to the practice of the Member States. What the ECJ could have said but did not is that the Netherlands must be consistent in its application of the territoriality principle. The Netherlands should thus not only address the question of whether the costs are deductible on the basis of the territorial costs allocation, they should also deduct the costs at subsidiary level. What the ECJ does in this case is far more stringent. It would seem that on no account will the ECJ allow the costs that are (legally) made by a legal entity, in this case the parent company, to be allocated to another legal entity, in this case the subsidiary. That this approach is too stringent, also from a Community law point of view, is apparent from the following example:

> Assume that Dutch legislation should determine that the holding costs are deductible by the subsidiary in the event it has taxable profit in the Netherlands (for the reason that the costs are economically connected with the profit of the subsidiary). Assume that the Netherlands determines this for holding costs made both by a parent company resident abroad and by a parent company resident in the Netherlands. The legislator would then in fact and consistently apply a territorial costs allocation. Would the ECJ still hold that in the event of a parent company resident in the Netherlands with a subsidiary that makes foreign profit, the holding costs must be deducted from the profits of the parent company resident in the Netherlands? This because on the basis of the territoriality principle the Netherlands may not allocate the costs made by the parent company to the profit of the subsidiary. It is difficult to imagine but strict application of the *Bosal Holding* judgment does entail this. Presumably, the ECJ would still deny the deduction at the Dutch parent company level and slightly modify the stringent approach that follows from *Bosal Holding* referring to a difference in situation. If not, the Member State would refer to article 4(2) of the Parent-Subsidiary Directive that allows the refusal of the holding costs deduction at parent company level in such case.

The conclusion is that in testing the territoriality principle, the ECJ (again) fails to take account of the extension concept and besides, stringently applies this principle.

4. The influence of Bosal Holding on Special Group provisions in the EU

The judgment of the ECJ that the parent companies and subsidiaries are distinct legal entities whereby the coherence-justification cannot be applied and the judgment that the principle of territoriality can only be applied per taxpayer can be of significant influence to the application of Group provisions in the EU.

Currently most relevant in this framework, is the heated debate in the United Kingdom on the issue of whether the Group relief for losses is in conformity with the right of establishment. On this issue, on 23 May 2003, a Group Litigation Order ('GLO') was filed with the UK High Court.[39] In addition, the *Marks & Spencer* case is pending. In this case, the Special Commissioners have rejected conflict with the right of establishment,[40] but the case is now pending before the UK High Court that has announced that questions are to be put to the ECJ for a preliminary ruling. In the *Marks & Spencer* case, the issue at hand is whether there is conflict with the free movement because under the UK ruling for Group relief for losses the losses of a subsidiary established in another Member State cannot be set off from the profit of the parent company established in the United Kingdom.

In the *Marks & Spencer* case, the interested parties have taken the point of view that in the event of a company resident in the UK establishing itself in another Member State, there is discrimination between establishments by means of a permanent establishment in comparison with an establishment by means of a subsidiary in another Member State. For a permanent establishment, the losses of this establishment are deducted at the headquarters established in the United Kingdom whereas the losses of a subsidiary established in another Member State cannot be deducted from the profit of a parent company. This could be held to be a hindering of the right to choose the form of establishment.

The Special Commissioners ruled that there was no question of prohibited discrimination. It would seem that this is supported by the judgment in the *Bosal Holding* case in the sense that in paragraph 32, the ECJ accepts that branches or establishments form part of the headquarters and thus they are one (and the same) taxpayer, whereas parent companies and their subsidiaries are distinct legal entities and thus are different taxpayers. Furthermore, the ECJ can refer to the territoriality principle that, as is clear from *Bosal Holding*, must be applied *per* taxpayer. It is clear from

[39] See on this and other GLO's, the EU Tax Alert, no 17 (September 2003); www.eutaxalert.com. On 23 May 2003, a Group Litigation Order ('GLO') on group loss relief rules was filed with the UK High Court. Under a GLO, claims with a common issue are grouped, test cases are selected and costs are shared amongst the claimants. This GLO covers claims that the UK group relief provisions are in breach of Article 43 (the freedom of establishment) of the EC Treaty and/or the non-discrimination Article of various double tax treaties. The claims relate to the following: i) surrender of loss of EU subsidiary to UK parent and/or UK subsidiary; ii) surrender of loss of EU parent and/or EU subsidiary to UK subsidiary; iii) surrender of loss of EU subsidiary to UK subsidiary if the parent is a non-EU company; iv) surrender of loss between UK subsidiaries or UK subsidiaries and UK branches if the parent is a non-EU company; v) surrender of loss between UK branch and UK subsidiary if the parent is an EU company.

[40] The Special Commissioners, 24 and 25 November 2002, *Marks & Spencer and Halsey HM Inspector of Taxes*; see also: L Hinnekens, The Marks & Spencer Case: UK Special Commissioners Find UK Group Relief Rules Compatible with the freedom of Establishment, European Taxation 2003, pp. 175–182.

Futura Participations that a domestic taxpayer can be taxed on its worldwide income, whereas for the setting off of losses of non-residents, such as a subsidiary established in another Member State of a parent company established in the United Kingdom, the requirement can be made that the losses must be economically related to the income earned by the taxpayer in the United Kingdom.[41] The (foreign) losses of the subsidiary established abroad do not meet this requirement.

The second position taken by Marks & Spencer is that there is discrimination between a subsidiary resident in the UK (that can carry over the losses to the parent company resident in the UK[42]) and a subsidiary resident in another Member State (that does not have this option). Because the UK subsidiary falls within the scope of UK tax in respect of its worldwide activities and a foreign subsidiary falls outside the scope of UK tax, the Special Commissioners have ruled that there is no question of a discriminatory restriction because a different rule is applied to situations that are not objectively comparable.[43] The question is whether this ruling can be upheld after *Bosal Holding*. It follows from *Bosal Holding* namely that, in principle, the ECJ accepts that the parent company and its subsidiary are distinct legal entities, both of which are liable separately for tax. A ruling such as the Group relief for losses, however, breaks through this system of independence between the parent company and its subsidiary. The problem is that this system has only been breached for companies resident in the United Kingdom. It could well be that the ECJ requires that this must also be done for companies resident abroad, given that the only difference is the place of residence of the company. This would entail that through a provision such as Group relief for losses, the United Kingdom will have no option other than to set off foreign losses.

5. Closing remarks

It will be clear to the reader that I have mixed feelings about the *Bosal Holding* judgment. On the one hand, the ECJ gives a pointed explanation, with a proper understanding of the Netherlands system, as to why there is a hindrance of the right of establishment, but goes off target or cut corners too quickly in the treatment of the coherence-justification and the principle of territoriality.

The ECJ namely seeks i) a coherence that does not even exist; puts ii) the emphasis on the existence of different taxpayers there where, for the question of whether a right of deduction exists, the domestic law assumes that the being of another taxpayer is not relevant; fails iii) to see that the coherence is breached, whereas the *Hoge Raad* had clearly indicated that this was the case; would appear to rule iv) that the costs according to the Dutch participation exemption belong to the parent company (legal costs allocation), whereas the *Hoge Raad* had indicated that the costs cohere economically with the profit of the subsidiary (territorial costs allocation). Furthermore, the ECJ should not make a choice between legal or territorial costs allocation given that this choice belongs to the sovereignty of the Member States, and for that matter, Community law (the Parent-Subsidiary Directive) does not make a choice between legal or territorial costs allocation. Finally, v) when testing the territoriality principle, the ECJ fails to take the extension concept into account and stringently applies the territoriality principle.

It is clear from the treatment of the coherence-justification and the territoriality principle that the ruling is not based on a proper understanding of the Dutch tax system. The lack of understanding would seem to flow from, among others, the fact that only a severely summarised version of the judgment of the *Hoge Raad* is reflected in the Report of the Hearing, whereby probably the ECJ was unable to examine the considerations of the *Hoge Raad*.

Whatever the reason, it is of course highly detrimental where in preliminary proceedings that according to the case-law of the ECJ, 'is a means of cooperation between the Court of Justice and national courts',[44] no attention whatsoever is devoted to the explanation of the *Hoge Raad* in the matter of the operation of the Dutch system. This namely because these explanations were important for a proper assessment of the Dutch holding costs deduction limitation.

What will the *Hoge Raad* do? Send the case straight back to Luxembourg and see to it that the ECJ is fully and properly informed about the Dutch system? Such that upon having been properly informed, the ECJ can take another decision, but then, one that is based on a proper understanding of the Dutch system. From a legal point of view, that would have the most integrity. However, from a practical point of view, what use would that be? The judgment of the ECJ might be based on an incorrect understanding of the Dutch system but the message is clear: the ECJ will not accept that there be a coherence between different taxpayers, or that there be a system that on the basis of the extension concept makes a connection between the holdings costs of the parent company and the profit of another legal entity (the subsidiary). Furthermore, in the eyes of the ECJ, the principle of territoriality may only be applied per separate, individual taxpayer. In the end, the deduction limitation on holdings costs will always go to the wall.

41 Cf. paragraph 43 of the Futura Participation judgment.

42 Cf. Article 402 and 403 of UK the Income and Corporation Taxes Act 1988.

43 The Special Commissioners, 24 and 25 November 2002, *Marks & Spencer and Halsey HM Inspector of Taxes*, paragraph 116(2).

44 Cf. for a tax judgement, for example: Case C-28/95, *Leur-Bloem* ECR [1997] I-4161, paragraph 24.