

Case C-377/07

Finanzamt Speyer-Germersheim

v

STEKO Industriemontage GmbH

(Reference for a preliminary ruling from the Bundesfinanzhof)

(Corporation tax – Transitional provisions – Deduction of the depreciation of holdings in non-resident companies)

Summary of the Judgment

Free movement of capital – Restrictions – Tax legislation – Corporation tax

(Art. 56 EC)

Where a resident capital company has a holding of less than 10% in another capital company, and suffers a reduction in profit resulting from the partial write-down of its holding in that other company, Article 56 EC must be interpreted as precluding a prohibition on the deduction of reductions in profit in connection with such a holding which enters into force earlier with regard to a holding in a non-resident company than with regard to a holding in a resident company.

Such a difference in treatment, depending on where capital was invested, is liable to discourage a shareholder from investing in a company established in another Member State and also to have a restrictive effect in relation to companies established in other States, representing, as far as the latter are concerned, an obstacle to the raising of capital in the Member State concerned. In addition, the knowledge that the possibility of reducing the amount of taxable profit by partial write-downs will expire sooner in respect of a holding in a non-resident company than in respect of a holding in a resident company is liable to discourage the company concerned from maintaining its holdings in a non-resident company and to encourage it to divest itself more quickly than it would otherwise have done of holdings in resident companies. It is insignificant, in that regard, that the difference in treatment existed only for a limited period of time, since that fact alone does not preclude the difference in treatment from having significant effects or, therefore, from giving rise to a genuine restriction on the free movement of capital.

As regards the possibility of a resident company deducting from its taxable revenue reductions in profit resulting from a partial write-down of its holdings, depending on whether they are held in a resident or non-resident company, the difference in treatment is not based on an objective difference in situations.

Such a difference in treatment is not justified by the margin of discretion granted to the Member States for the setting-up of a transitional system in order to bring the national corporation tax system into line with Community law and to remove any possible discrimination. That margin of discretion must always be limited by the respect of the fundamental freedoms including, in particular, the free movement of capital. Even if such a transitional system can be justified by a legitimate concern to ensure a seamless transition from the earlier system to its replacement, and even though there are arguments which explain why the new rules were introduced later for

companies holding shares in resident companies, those arguments cannot justify that difference in treatment to the detriment of companies holding shares in non-resident companies.

Nor is that difference in treatment justified by the need to ensure the coherence of the tax system, since the fact that it is possible, subsequently, to obtain an exemption for capital gains realised on a disposal, assuming that a sufficient level of profit is achieved, does not constitute a consideration based on fiscal coherence which is capable of justifying a refusal to allow an immediate deduction in respect of losses incurred by companies holding shares in non-resident companies.

As regards the need to ensure the effectiveness of fiscal controls, such an overriding reason in the general interest is, in any event, of no relevance where the depreciation in the value of holdings in non-resident companies is the result of a fall in the stock market.

(see paras 27-29, 35, 49-50, 54-56, operative part)

JUDGMENT OF THE COURT (First Chamber)

22 January 2009 (*)

(Corporation tax – Transitional provisions – Deduction of the depreciation of holdings in non-resident companies)

In Case C-377/07,

REFERENCE for a preliminary ruling under Article 234 EC from the Bundesfinanzhof (Germany), made by decision of 4 April 2007, received at the Court on 8 August 2007, in the proceedings

Finanzamt Speyer-Germersheim

v

STEKO Industriemontage GmbH,

THE COURT (First Chamber),

composed of P. Jann, President of the Chamber, M. Ilešić, A. Tizzano, A. Borg Barthet and E. Levits (Rapporteur), Judges,

Advocate General: D. Ruiz-Jarabo Colomer,

Registrar: R. Grass,

having regard to the written procedure,

after considering the observations submitted on behalf of:

– the German Government, by M. Lumma and C. Blaschke, acting as Agents,

– the Commission of the European Communities, by R. Lyal and W. Mölls, acting as Agents, having decided, after hearing the Advocate General, to proceed to judgment without an Opinion, gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Article 56 EC.

2 The reference has been made in the course of proceedings between Finanzamt Speyer-Germersheim ('the Finanzamt') and STEKO Industriemontage GmbH ('STEKO') concerning the determination of the basis of assessment of STEKO's trade tax and corporation tax for 2001 and 2002.

National legal context

3 According to the first sentence of Paragraph 8b(2) of the 1999 Law on Corporation Tax (Körperschaftsteuergesetz 1999), as amended on 14 September 2000 ('KStG (old version)'), profits made by the corporations referred to in that provision which were subject to unlimited taxation from the sale of holdings in non-resident companies formerly held by them were left out of account in the assessment of then taxable revenue. It was apparent from that provision, read in conjunction with Paragraphs 8b(5) or 26(2) and (3) of that law, that this was subject to the condition of a minimum holding requirement of 10%.

4 Subject to the same conditions, the second sentence of Paragraph 8b(2) KStG (old version) prohibited the deduction of losses incurred on the sale of holdings. In that regard, the referring court states that that prohibition did not cover reductions in profit on the basis of an assessment in respect of such holdings containing the lower partial value (partial write-down).

5 Where a resident company held shares in resident companies – irrespective of the level of those holdings – or holdings of less than 10% in non-resident companies, the determination of profits was governed by the combined provisions of Paragraph 8(2) KStG (old version) and Paragraph 4(1) of the Law on Income Tax (Einkommensteuergesetz).

6 The effect of those provisions was that profits arising on the sale of holdings by a resident capital company were taxable, and losses on the sale of such holdings, as well as losses arising as a result of the partial write-down of the value of those holdings, could be taken into account for taxation purposes.

7 In the course of the changeover from the previously applicable set-off procedure to the 'half-income procedure' for corporation tax purposes, the Law on Corporation Tax was amended by the Law on reduction of tax rates and on reform of taxation of undertakings for the period 2001-2002 (Gesetz zur Senkung der Steuersätze und zur Reform der Unternehmensbesteuerung 2001/2002) of 23 October 2000 (BGBl. 2000 I, p. 1433).

8 Thereafter, according to the first sentence of Paragraph 8b(2) of the Law on Corporation Tax, as amended on 23 October 2000 ('KStG (new version)'), profits from the sale of holdings in companies and associations are not to be taken into account, irrespective of whether they are holdings in resident or non-resident companies, and regardless of their size.

9 Paragraph 8b(3) KStG (new version) provides that reductions in profit arising as a result of the lower partial value of those holdings being taken into consideration (partial write-down) or of

their sale are not to be taken into account in determining taxable profits.

10 Point 2 of the first sentence of Paragraph 34(4) KStG (new version) is a transitional provision concerning the application of Paragraph 8b(2) and (3) of that law.

11 According to that provision, if the holding is in a resident company, Paragraph 8b(2) and (3) KStG (new version) is, as a rule, applicable for the first time to the tax assessment period 2002; it may be applicable to the tax assessment period 2001 only if, in the course of 2001, the holding company altered its business year so as no longer to correspond to the calendar year.

12 By contrast, according to the referring court, in the case of holdings in a non-resident company, Paragraph 8b(2) and (3) KStG (new version) applies to the tax assessment period 2001 where the holding company's business year corresponds to the calendar year.

The main proceedings and the question referred for a preliminary ruling

13 STEKO, a limited liability company established in Germany, held shares in non-resident companies as part of its investments in 2001. Those holdings amounted to less than 10%. The referring court states that it is unaware as to whether those holdings were in companies established in other Member States or in non-member countries.

14 STEKO assessed those shares in its final balance sheet on 31 December 2001 at the lower partial value of DEM 139 775.35, owing to a fall in share prices, instead of at their earlier book value of DEM 220 021.09. As a result, there was a reduction in taxable profits of DEM 80 245.74.

15 The Finanzamt accepted the assessment at the lower partial value, as the falling market prices of the shares represented a permanent reduction in value. However, according to the Finanzamt, the reduction in profits could not be taken into account for taxation purposes, since Paragraph 8b(3) KStG (new version) and, consequently, the prohibition on the deduction of such a reduction in value laid down by that provision applied, as from the tax assessment period 2001, to holdings in non-resident companies.

16 By a judgment of 29 September 2005, the Finanzgericht Rheinland-Pfalz (Finance Court, Rhineland-Palatinate) allowed the action brought by STEKO against the notices of assessment issued by the Finanzamt on that basis; the latter therefore lodged an appeal on a point of law against that judgment before the Bundesfinanzhof (Federal Finance Court).

17 The referring court observes that, under Paragraph 8b(3) KStG (new version), STEKO could not, in respect of 2001, deduct an amount equivalent to the reduction in profit on its holdings in non-resident companies. By contrast, as regards holdings in resident companies, that provision was, in principle, applicable from 2002 at the earliest. The partial write-downs undertaken by STEKO could have been taken into account for the purposes of reducing the amount of tax payable if they had related to holdings in resident companies, since the deduction of such write-downs was not prohibited.

18 According to the Bundesfinanzhof, the holdings in non-resident companies – as to which it is foreseeable that the capital loss will be permanent – were subject in 2001 to disadvantageous tax treatment by comparison with similar holdings in resident companies. However, taking into account the particular circumstances of the case, the referring court queries whether that distinction amounts to an infringement of the free movement of capital.

19 In the first place, the Bundesfinanzhof doubts that unequal treatment of relatively short duration could prevent or deter taxpayers from investing in non-resident companies.

20 In the second place, the referring court takes the view that a restriction on the free movement of capital may be acceptable on a transitional basis, inasmuch as the changeover from the previously applicable set-off procedure to the half-income procedure is advantageous with regard to holdings in non-resident companies.

21 In the third place, the referring court queries whether, with regard to holdings in companies established in non-member countries, such a restriction is not justified by the need to ensure fiscal control, while indicating that that factor could be decisive where the reduction in profit in question is based on a mere reduction in the value of shares held in a particular company – such a reduction depending, as a rule, only on the circumstances of the company in which those shares are held – but would probably not be relevant where such a capital loss results from a fall in the market price of the shares.

22 In those circumstances, the Bundesfinanzhof decided to stay the proceedings and to refer the following question to the Court for a preliminary ruling:

‘Does Article 56 EC preclude a provision of a Member State according to which a prohibition on the deduction of reductions in profit in connection with the holding of a capital company in another capital company enters into force earlier with regard to foreign holdings than with regard to domestic (German) holdings?’

The question referred for a preliminary ruling

23 It should be noted that the measures prohibited by Article 56(1) EC, as restrictions on the movement of capital, include those which are likely to discourage non-residents from making investments in a Member State or to discourage that Member State’s residents from doing so in other States (see Case C-513/03 *Van Hilten-van der Heijden* [2006] ECR I-1957, paragraph 44; Case C-370/05 *Festersen* [2007] ECR I-1129, paragraph 24; and Case C-101/05 *A* [2007] ECR I-11531, paragraph 40).

24 National measures which can be regarded as ‘restrictions’ within the meaning of Article 56(1) EC include not only measures liable to prevent or limit the acquisition of shares in companies established in other States (Case C-112/05 *Commission v Germany* [2007] ECR I-8995, paragraph 19 and case-law cited) but also measures liable to discourage the maintenance of such holdings in companies established in other States (see, by analogy, Case C-324/00 *Lankhorst-Hohorst* [2002] ECR I-11779, paragraph 32, and Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paragraph 61).

25 As regards the main action, it is apparent from the order for reference that, in 2001, a resident company could not deduct from its taxable revenue reductions in profit resulting from the partial write-down of holdings in non-resident companies. By contrast, in the same year and, moreover, in identical circumstances, a resident company could deduct such reductions in profit from its taxable revenue where they related to holdings in resident companies.

26 As the referring court found, resident companies holding depreciated shares in non-resident companies were, in 2001, in a less favourable situation than those holding such shares in resident companies.

27 However, such a difference in treatment, depending on where capital was invested, as was

introduced by the KStG (new version) prior to the tax assessment period in which that legislation became applicable was liable to discourage a shareholder from investing in a company established in a State other than the Federal Republic of Germany and also to have a restrictive effect in relation to companies established in other States, representing, as far as the latter are concerned, an obstacle to the raising of capital in Germany.

28 In addition, as the Commission of the European Communities stated, the knowledge that the possibility of reducing the amount of taxable profit by partial write-downs would expire sooner in respect of a holding in a non-resident company than in respect of a holding in a resident company was liable to discourage the company concerned from maintaining its holdings in a non-resident company and to encourage it to divest itself more quickly than it would otherwise have done of holdings in resident companies.

29 It is insignificant, in that regard, that the difference in treatment existed only for a limited period of time (Case C-436/06 *Grønfeldt* [2007] ECR I-12357, paragraph 15). That fact alone does not preclude the difference in treatment from having significant effects – as indeed shown in the facts in the main proceedings – or, therefore, from giving rise to a genuine restriction on the free movement of capital.

30 According to case-law, a national tax provision which distinguishes between taxpayers depending on the place where their capital is invested could be regarded as being compatible with the EC Treaty provisions on the free movement of capital provided that the difference in treatment applies to situations which are not objectively comparable or is justified by overriding reasons in the general interest (see Case C-194/06 *Orange European Smallcap Fund* [2008] ECR I-0000, paragraph 59 and case-law cited).

31 The German Government submits that, during the tax assessment period 2001, there was not just one tax system in force, from which companies holding shares in non-resident companies were excluded, but two different systems of tax relief. Companies holding shares in resident companies were still subject to the old system of tax relief, whereas companies holding shares in non-resident companies were subject to a new system, namely the half-income procedure.

32 Consequently, according to the German Government, the situation of a company holding shares in a resident company and that of a company holding shares in a non-resident company are not objectively comparable.

33 That reasoning cannot be accepted. The application of different taxation systems to a resident company depending on whether it has holdings in resident or non-resident companies cannot be a valid criterion for assessing the objective comparability of their situations and, therefore, for identifying an objective difference between them. It is precisely the application of different taxation systems that is responsible for the difference in treatment, in respect of which it must be assessed whether it is justified or not.

34 Furthermore, it is important to note that the Court has already held, as regards losses incurred by parent companies resident in Germany in respect of write-downs made to the book value of their shareholdings in subsidiaries, that those companies are in a comparable situation whether the shares are held in subsidiaries established in Germany or in other Member States. The Court has stated that, in each case, first, the losses which it is sought to deduct are borne by the parent companies and, second, the profits of those subsidiaries, whether they come from subsidiaries which are taxable in Germany or from those which are taxable in other Member States, are not taxable in the hands of the parent companies (Case C-347/04 *Rewe Zentralfinanz* [2007] ECR I-2647, paragraph 34).

35 The changeover to the half-income procedure in respect of resident companies holding shares in non-resident companies did not alter those characteristics. It is necessary therefore to take the view that – as regards the possibility of a resident company deducting from its taxable revenue reductions in profit resulting from a partial write-down of its holdings, depending on whether they are held in a resident or non-resident company – the difference in treatment is not based on an objective difference in situations.

36 Accordingly, it is necessary to examine whether a difference in treatment such as that at issue in the main proceedings is justified by overriding reasons in the general interest.

37 In the first place, the German Government takes the view, in common with the referring court, that that difference in treatment must be allowed inasmuch as it forms part of a transitional scheme, applicable for a limited period, whereby the staggered entry into force of the new system is linked to the gradual replacement of the full deduction system by that of the half-income procedure, so as to ensure that the system of corporation tax would be compatible with Community law.

38 The German Government explains that, under the full deduction system, a company was, in principle, liable to tax at a rate of 40%. Profits distributed to its shareholders were taxed at only 30%. The shareholder would have to pay tax again on the income from distributed profits, depending on his personal rate of taxation. He could, however, deduct in full from his personal tax liability the corporation tax already paid in Germany by the capital company, thereby avoiding the double taxation of profits.

39 By contrast, as regards the half-income procedure, according to the German Government a capital company is now subject to tax on its profits only at a standard rate of 25%, irrespective of whether or not its profits are distributed to its shareholders. The double taxation of dividends issued is avoided by including only half of the dividends in the amount serving as the basis for assessment of shareholders' income tax, whereas distributions of a company's profits to another company are, as a rule, eligible for the general exemption in respect of dividends. Thus, a company's profits which have already been taxed at the standard corporation tax rate of 25% are safeguarded against incurring a further corporation tax levy in the event of redistribution to another company.

40 Since, according to the German Government, the sale of shares corresponds, in economic terms, to a full distribution, that sale is treated as a distribution of profits. Consequently, just as in the case of the exemption of dividends laid down by Paragraph 8b(1) KStG (new version), the exemption of capital gains on the sale of shares under Paragraph 8b(2) is also intended to avoid double taxation in the case of a series of holdings. By contrast, losses incurred on the sale of holdings and capital losses resulting from depreciation of such holdings cannot be taken into account for taxation purposes under Paragraph 8b(3).

41 The German Government states that the half-income procedure came into force, in principle, with effect from 2001 in regard to companies distributing profits.

42 However, in order to ensure that profits in respect of which a capital company had been taxed in accordance with the deduction procedure are still taxed under the same procedure at shareholder level, and to enable the latter, for the final time, to deduct from his personal tax liability the tax paid by that company, it was decided that that procedure should be maintained for 2001 in respect of shareholders where the dividends were based on the ordinary distributions of a resident company in the year 2000.

43 However, since the deduction procedure was not applicable to dividends distributed by non-resident capital companies, the new half-income procedure could be applied in respect of shareholders from 2001.

44 The German Government further submits that Member States must have a certain margin of discretion when seeking to establish taxation systems compatible with Community law, which means that there is no obligation to structure the transitional scheme differently or, in particular, to extend to holdings in non-resident companies, for their final year of application, the rules applied to holdings in resident companies.

45 In the second place, the German Government takes the view that the provisions in force for the tax assessment period 2001 are justified on grounds relating to the coherence of the tax system as a whole. In the German Government's opinion, the national taxation rules are structured in such a way as to offer complete symmetry in respect of the advantages and disadvantages to capital companies, whether the shares in those companies are held in non-resident or resident companies.

46 According to the German Government, if, during the tax assessment period 2001, a capital company had sold a shareholding in a non-resident capital company, thereby making a profit, it could collect that profit under Paragraph 8b(2) KStG (new version) by being exempted from corporation tax, but, in return, it had to accept that a corresponding loss – either as a direct result of the sale of its holdings, or as a result of those holdings being written down to a lower partial value – would no longer be taken into account for the purposes of that tax. By the same reasoning, if a capital company made a profit when selling holdings in resident companies, that profit was taxable but the taxation was compensated for by the fact that a loss resulting from those holdings could be set off for the purposes of reducing the basis of taxation. That tax system would thus have a coherent structure.

47 In the third place, the German Government takes the view that, if the holdings are in companies established in non-member countries, the difference in treatment can be justified by the need to ensure effective fiscal control.

48 The justification thus relied on by the German Government cannot be accepted.

49 With regard to the argument that a Member State seeking to bring the national corporation tax system into line with Community law and to remove any possible discrimination should be granted a certain margin of discretion for the setting-up of a transitional system, suffice it to reply that the Court has already held that that margin of discretion must always be limited by the respect of the fundamental freedoms including, in particular, the free movement of capital (see *Grønfeldt*, paragraph 32).

50 However, even if a transitional system, such as that at issue in the main proceedings, can be justified by a legitimate concern to ensure a seamless transition from the earlier system to its replacement, and even though the German Government's arguments explain why the new half-income system was introduced only with effect from 2002 for companies holding shares in resident companies, those arguments cannot justify a difference in treatment to the detriment of companies holding shares in non-resident companies, as is the case in the main proceedings.

51 Although, as the German Government asserts, companies with holdings in non-resident companies were not subject to the full deduction system, it nevertheless follows from that government's own observations that, until the tax year 2001, a resident company whose holdings in a non-resident company were less than 10% was subject to the same treatment as a resident

company holding shares in a resident company in respect of the deduction of the partial value of those holdings, which could be taken into account for taxation purposes.

52 As to the argument concerning the need to preserve the coherence of the tax system in its entirety, the Court has held that, for such an argument to succeed, a direct link must be established between the tax advantage concerned and the offsetting of that advantage by a particular tax levy (see Case C-293/06 *Deutsche Shell* [2008] ECR I-1129, paragraph 38 and case-law cited).

53 Furthermore, the direct nature of such a link must be established, in light of the objective pursued by the tax rules concerned, in relation to the relevant tax payers by a strict correlation between the deductible element and the taxable element (*Deutsche Shell*, paragraph 39).

54 However, as regards the determination of the taxable revenue of resident companies holding shares in non-resident companies, the Court has already held that the fact that it is possible, subsequently, to obtain an exemption for capital gains realised on a disposal, assuming that a sufficient level of profit is achieved, does not constitute a consideration based on fiscal coherence which is capable of justifying a refusal to allow an immediate deduction in respect of losses incurred by companies holding shares in non-resident companies (see, by analogy, *Rewe Zentralfinanz*, paragraph 67).

55 Finally, as regards the argument relating to the need to ensure the effectiveness of fiscal controls, assuming that this is an overriding reason in the general interest which may be relied upon to justify the restrictions on the free movement of capital from or to non-member countries, it must be held that such an overriding reason in the general interest is, in any event, of no relevance where the depreciation in the value of holdings in non-resident companies is, as in the main proceedings, the result of a fall in the stock market.

56 In light of all of the foregoing considerations, the answer to the question referred is that, in circumstances such as those of the main proceedings, in which a resident capital company has a holding of less than 10% in another capital company, Article 56 EC must be interpreted as precluding a prohibition on the deduction of reductions in profit in connection with such a holding which enters into force earlier with regard to a holding in a non-resident company than with regard to a holding in a resident company.

Costs

57 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (First Chamber) hereby rules:

In circumstances such as those of the main proceedings, in which a resident capital company has a holding of less than 10% in another capital company, Article 56 EC must be interpreted as precluding a prohibition on the deduction of reductions in profit in connection with such a holding which enters into force earlier with regard to a holding in a non-resident company than with regard to a holding in a resident company.

[Signatures]

* Language of the case: German.