Case C-231/05

Proceedings brought by

Oy AA

(Reference for a preliminary ruling from the Korkein hallinto-oikeus)

(Freedom of establishment – Corporate tax legislation – Ability of a company to deduct sums paid by way of intra-group transfer – Obligation on the transferee company also to have its establishment in the Member State concerned)

Opinion of Advocate General Kokott delivered on 12 September 2006

Judgment of the Court (Grand Chamber), 18 July 2007

Summary of the Judgment

1. *Freedom of movement for persons – Freedom of establishment – Provisions of the Treaty – Scope*

(Arts 43 EC and 56 EC)

2. *Freedom of movement for persons – Freedom of establishment – Tax legislation – Corporation tax*

(Art. 43 EC)

1. Legislation which concerns only relations within a group of companies primarily affects the freedom of establishment and must therefore be examined in the light of Article 43 EC. Should that legislation have restrictive effects on the free movement of capital, those effects would be the unavoidable consequence of such an obstacle to freedom of establishment as there might be, and do not therefore justify an independent examination of that legislation from the point of view of Article 56 EC.

(see paras 23-24)

2. Article 43 EC does not preclude a system instituted by legislation of a Member State whereby a subsidiary resident in that Member State may not deduct an intra-group financial transfer which it makes in favour of its parent company from its taxable income unless that parent company has its establishment in that same Member State.

It is true that the difference in treatment to which resident subsidiary companies are subjected according to the seat of their parent company constitutes an obstacle to the freedom of establishment if it makes it less attractive for companies established in other Member States to exercise that freedom and they may, in consequence, refrain from acquiring, creating or maintaining a subsidiary in the State which adopts that measure.

However, having regard to the need to safeguard the balanced allocation of the power to tax between the Member States and the need to prevent tax avoidance, taken together, such a system pursues legitimate objectives compatible with the Treaty and justified by overriding reasons in the public interest.

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

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

(see paras 39, 43, 56, 58, 60, 67, operative part)

JUDGMENT OF THE COURT (Grand Chamber)

18 July 2007 (*)

(Freedom of establishment – Corporate tax legislation – Ability of a company to deduct sums paid by way of intra-group transfer – Obligation on the transferee company also to have its establishment in the Member State concerned)

In Case C-231/05,

REFERENCE for a preliminary ruling under Article 234 EC by the Korkein hallinto-oikeus (Finland), made by decision of 23 May 2005, received at the Court on 25 May 2005, in the proceedings brought by

Oy AA,

THE COURT (Grand Chamber),

composed of V. Skouris, President, P. Jann, C.W.A. Timmermans, A. Rosas, R. Schintgen, P. K?ris, E. Juhász, Presidents of Chambers, K. Schiemann, G. Arestis, U. Lõhmus, E. Levits (Rapporteur), A. Ó Caoimh and L. Bay Larsen, Judges,

Advocate General: J. Kokott,

Registrar: B. Fülöp, Administrator,

having regard to the written procedure and further to the hearing on 16 May 2006,

after considering the observations submitted on behalf of:

– Oy AA, by T. Torkkel and J. Järvinen, asiamiehet,

– the Finnish Government, by T. Pynnä and E. Bygglin, acting as Agents,

– the German Government, by M. Lumma and U. Forsthoff, acting as Agents,

– the Netherlands Government, by H.G. Sevenster and M. de Grave, acting as Agents,

– the Swedish Government, by K. Wistrand and A. Falk, acting as Agents,

– the United Kingdom Government, by S. Nwaokolo and E. O'Neill, acting as Agents, and R. Hill, Barrister,

– the Commission of the European Communities, by R. Lyal and I. Koskinen, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 12 September 2006,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Articles 43 EC, 56 EC and 58 EC, and of Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ 1990 L 225, p. 6), as amended by Council Directive 2003/123/EC of 22 December 2003 (OJ 2004 L 7, p. 41; 'Directive 90/435').

2 The reference was made in proceedings brought before the Korkein hallinto-oikeus (Supreme Administrative Court) by Oy AA, a Finnish company, concerning the deductibility from its taxable income of a financial transfer in favour of its parent company established in another Member State, and raising the question of the compatibility with Community law of Finnish legislation on intra-group financial transfers.

Legal context

Community legislation

3 According to the second recital of Directive 2003/123, the objective of Directive 90/435 is 'to exempt dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and to eliminate double taxation of such income at the level of the parent company'.

4 Article 4 of Directive 90/435 provides that where a parent company, by virtue of its association with its subsidiary, receives distributed profits, the State of the parent company shall, except when the latter is liquidated, either refrain from taxing such profits, or tax them while authorising the parent company to deduct from the amount of tax due that fraction of the corporation tax paid by the subsidiary which relates to those profits.

5 According to Article 5 of Directive 90/435, 'profits which a subsidiary distributes to its parent company shall be exempt from withholding tax', and, under Article 6 of that directive, 'the Member

State of a parent company may not charge withholding tax on the profits which such a company receives from a subsidiary'.

National legislation

6 Article 1 of the Law on Intra-group Financial Transfers (Laki konserniavustuksesta verotuksessa (825/1986)) of 21 November 1986 ('the KonsAvL') reads:

'This law governs the deduction of an intra-group financial transfer from the taxable income of the transferor and the assimilation of that transfer to income in the hands of the transferee.'

7 Article 2 of the KonsAvL provides:

'The expression "intra-group financial transfer" means any transfer made by a company limited by shares, or by a cooperative company which carries on a business, for the purposes of the business of another company limited by shares or cooperative company, which is not an investment of capital, not deductible from income pursuant to the Law on Taxation of Business Income [elinkeinotulon verottamisesta annettu laki (360/1968)].'

8 Article 3 of the KonsAvL provides:

'If a national company limited by shares or a cooperative company (the parent company) holds at least nine tenths of the capital of another national company limited by shares, or of the shares of another national cooperative company (the subsidiary), the parent company may deduct the intra-group financial transfer made in favour of its subsidiary from its taxable business income. The amount of the intra-group transfer made is assimilated to income arising from a taxable business activity of the subsidiary.

The term "subsidiary" also covers companies limited by shares or cooperative companies whose parent company holds at least nine tenths of the capital or shares together with one or more other subsidiaries.

The provisions of the first paragraph above also apply to an intra-group financial transfer by the subsidiary in favour of the parent company or of another subsidiary of the parent company.'

9 According to Article 4 of the KonsAvL:

'An intra-group financial transfer is treated for tax purposes as an expense of the transferor and income of the transferee for the tax year in which the transfer is made.'

10 Article 5 of the KonsAvL provides:

'Taxable persons are entitled to deduct intra-group transfers which they have made as expenses only if the corresponding expense and income are entered in the accounts of the transferor and transferee concerned.'

The dispute in the main proceedings and the question referred

11 AA Ltd, a company established in the United Kingdom, indirectly holds, through two other companies, 100% of the shares in Oy AA.

12 Unlike the business of Oy AA, the business of AA Ltd ran at a loss in 2003 and, according to Oy AA, it could be expected that it would continue to do so in 2004 and 2005. Since the business of AA Ltd was also important for Oy AA, the latter envisaged making an intra-group financial

transfer in favour of AA Ltd in order to secure its financial position.

13 On that occasion, Oy AA applied to the Keskusverolautakunta (Central Tax Commission) for a preliminary decision as to whether the transfer envisaged constituted an intra-group financial transfer for the purposes of Article 3 of the KonsAvL and could therefore be regarded as a tax-deductible expense of Oy AA for the 2004 and 2005 tax years.

14 Taking the view that a deductible intra-group financial transfer and the corresponding taxable income had to fall under the Finnish taxation system, the Keskusverolautakunta held that a transfer by Oy AA in favour of AA Ltd did not constitute an intra-group financial transfer for the purposes of Article 3 of the KonsAvL, and could not therefore be regarded as a tax-deductible expense of the transferor.

15 Oy AA challenged the preliminary decision by the Keskusverolautakunta before the referring court, which held that all the conditions laid down by Finnish law for the tax deductibility of an intra-group financial transfer by Oy AA in favour of AA Ltd were fulfilled, save for the nationality requirement imposed on the transferee company.

16 In those circumstances, the Korkein hallinto-oikeus decided to stay the proceedings and refer the following question to the Court of Justice for a preliminary ruling:

‘Do Articles 43 EC and 56 EC, having regard to Article 58 EC and Directive 90/435/EEC …, preclude the system established by the Finnish Law on Intra-Group Financial Transfers, which makes the deductibility of intra-group financial transfers subject to the condition that the transferor and the transferee be national companies?’

The question referred

17 By its question, the national court asks in essence whether Articles 43 EC and 56 EC, having regard to Article 58 EC and Directive 90/435, preclude a system established by the legislation of a Member State, such as that at issue here, whereby a subsidiary, established in that Member State, may deduct from its taxable income an intra-group financial transfer which it makes in favour of its parent company only if the latter is established in that same Member State.

18 It should be noted as a preliminary observation that, according to consistent case-law, whilst direct taxation falls within the competence of Member States, the latter must nevertheless exercise that competence in a manner consistent with Community law (see, in particular, Case C-446/03 *Marks & Spencer* [2005] ECR I?10837, paragraph 29; Case, C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, paragraph 40; and Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, paragraph 36).

19 Since the referring court is putting a question to the Court as to the interpretation of both Article 43 EC on the freedom of establishment and Article 56 EC on the free movement of capital, the Court must determine whether, and to what extent, legislation such as that at issue in the main proceedings is capable of affecting those freedoms.

20 According to consistent case-law, in a case concerning a shareholding which gives its holder definite influence over the company's decisions and allows that holder to determine the company's activities, it is the provisions of the EC Treaty on the freedom of establishment that are to be applied (Case C-251/98 *Baars* [2000] ECR I-2787, paragraphs 21 and 22; Case C-436/00 *X and Y* [2002] ECR I-10829, paragraphs 37 and 66 to 68; *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 31; and *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 39).

21 According to Article 3 of the KonsAvL, the possibility of making an intra-group financial transfer, deductible for the purposes of that law, is subject to the condition that the parent company hold at least 90% of the capital or shares of the subsidiary.

22 As the order for reference and the observations of the Finnish Government show, the purpose of the system of intra-group financial transfers in force in Finland is to remove tax disadvantages inherent in the structure of a group of companies by allowing a balancing out within a group that comprises both profit-making and loss-making companies. The intra-group financial transfer is thus designed to promote the interests of a group of companies.

23 Since legislation such as that at issue in the main proceedings concerns only relations within a group of companies, it primarily affects the freedom of establishment and must therefore be examined in the light of Article 43 EC (see, to that effect, *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 32; Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, paragraph 118; and Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-0000, paragraph 33).

24 Should that legislation have restrictive effects on the free movement of capital, those effects would be the unavoidable consequence of such an obstacle to freedom of establishment as there might be, and do not therefore justify an independent examination of that legislation from the point of view of Article 56 EC (see, to that effect, Case C?36/02 *Omega* [2004] ECR I?9609, paragraph 27; *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 33; and *Test Claimants in the Thin Cap Group Litigation*, paragraph 34).

25 Concerning Directive 90/435, it should be noted that the situation at issue in the main proceedings concerns the first taxation of the income arising from a subsidiary's business and the possibility for that subsidiary of deducting from its taxable income the intra-group financial transfer which it makes in favour of its foreign parent company.

26 Directive 90/435 governs the tax treatment of dividends and other benefits distributed by a subsidiary to its parent company, first by providing in Article 4 that, where a parent company receives profits, the Member State of the parent company shall either refrain from taxing the profits distributed by the subsidiary, or shall tax them while authorising the parent company to deduct from the amount of its tax that fraction of the corporation tax paid by the subsidiary which relates to those profits, and secondly by providing, in Articles 5 and 6, that withholding tax on those profits may not be charged.

27 Since Directive 90/435 does not constitute the first taxation of income arising from a business activity of a subsidiary and does not govern the financial consequences, for the subsidiary, of an intra-group financial transfer such as that at issue in the main proceedings, it cannot constitute a basis for supplying an answer to the referring court.

28 The question referred must therefore be answered in the light of Article 43 EC alone.

The existence of a restriction on the freedom of establishment

29 Freedom of establishment, which Article 43 EC grants to Community nationals and which includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected, entails, in accordance with Article 48 EC, for companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the European Community, the right to exercise their activity in the Member State concerned through a subsidiary, a branch or an agency (see, in particular, Case C-307/97 *Saint-Gobain ZN* [1999] ECR I-6161, paragraph 35; *Marks & Spencer*, paragraph 30; *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 41; and *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 42).

30 With regard to companies, it should be noted that it is their registered office, central administration or principal place of business, within the meaning of Article 48 EC, that serves as the connecting factor with the legal system of a particular Member State, like nationality in the case of natural persons. To accept that the Member State of establishment may freely apply different treatment solely because the registered office, central administration or principal place of business of a company is situated in another Member State would deprive Article 43 EC of its substance (see, to that effect, Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 18; Case C-330/91 *Commerzbank* [1993] ECR I-4017, paragraph 13; Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, paragraph 42; *Marks & Spencer*, paragraph 37; and *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 43). Freedom of establishment is thus designed to guarantee the benefit of national treatment in the host Member State, by prohibiting all discrimination based on the place where the registered office, central administration or principal place of business of a company is situated (*Commission* v *France*, paragraph 14; *Saint-Gobain ZN*, paragraph 35; and *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 43).

31 In this case, it should be noted that, in relation to the possibility of deducting as expenses a transfer made in favour of the parent company, the legislation at issue in the main proceedings introduces a difference in treatment between subsidiaries established in Finland according to whether or not their parent company has its corporate seat in that same Member State.

32 A transfer made by a subsidiary in favour of a parent company with its corporate seat in Finland and which fulfils the other conditions laid down by the KonsAvL is regarded as an intra-group financial transfer within the meaning of that law, deductible from the taxable income of the subsidiary. By contrast, a transfer by a subsidiary in favour of a parent company not established in Finland will not be regarded as such and will therefore not be deductible from the taxable income of the subsidiary. The subsidiaries of foreign parent companies thus receive less favourable tax treatment than that enjoyed by the subsidiaries of Finnish parent companies.

33 In that regard, the German, Netherlands, Swedish and United Kingdom Governments argue that the position of resident subsidiaries whose parent companies have their establishments in the same Member State is not comparable to that of companies whose parents are established in another Member State, since the latter are not subject to tax in the Member State where the subsidiary is established. They argue that a distinction should be drawn between the position of subsidiaries whose parents are principally or partially taxed in Finland and the position, as in the case in the main proceedings, where the parent company is not subject to tax in that Member State.

34 According to the German and Swedish Governments, where the transferee is not subject to tax in the Member State of the transferor, the latter Member State, which by reason of the limits on its territorial competence cannot influence the tax treatment of the transfer by the Member State of the transferee, is not able, for example, to ensure that the deduction allowed corresponds to the taxable income of the transferee in its State of residence and to prevent a situation in which the transfer made is not taxed at all. The United Kingdom Government also argues that, because the Republic of Finland does not tax the income of non-resident parent companies, it is not required to allow the Finnish subsidiary the set-off arising from the parent company's losses.

35 As stated in paragraph 22 of this judgment, the purpose of the Finnish system of intra-group financial transfers is to remove tax disadvantages inherent in the structure of a group of companies by allowing a balancing out within a group that comprises both profit-making and loss-making companies. As is apparent from Articles 4 and 5 of the KonsAvL, an intra-group financial transfer is regarded as an expense of the transferor and is deducted from that person's taxable income only if it is recorded as income of the transferee.

36 In a cross-border situation, where the transferee is not subject to tax in the Member State of the transferor, that latter Member State cannot guarantee that the transfer will be treated as taxable income of the transferee. The fact that the Member State of the transferor allows deduction of the transfer from the taxable income of the transferor does not guarantee that the aim pursued by the system applicable to transfers will be attained.

37 However, even if the Member State in which the subsidiary is established does not have competence over the parent company, which is established in another Member State and is not subject to tax in the first Member State, it may nevertheless make deductibility of the intra-group financial transfer from the transferor's taxable income subject to conditions concerning the treatment to be applied to the transfer by that other Member State.

38 Therefore, in relation to the aim pursued by the Finnish system of intra-group financial transfers, the mere fact that parent companies which have their corporate establishment in another Member State are not subject to tax in Finland does not differentiate the subsidiaries of those parent companies from the subsidiaries of parent companies which have their establishment in Finland, and does not render the positions of those two categories of subsidiary incomparable.

39 A difference in treatment between resident subsidiary companies according to the seat of their parent company constitutes an obstacle to the freedom of establishment if it makes it less attractive for companies established in other Member States to exercise that freedom and they may, in consequence, refrain from acquiring, creating or maintaining a subsidiary in the State which adopts that measure (Case C?324/00 *Lankhorst-Hohorst* [2002] ECR I?11779, paragraph 32, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 61).

40 That conclusion cannot be called into question by the argument of the United Kingdom Government that the parent company could have attained the objective pursued by creating a branch in Finland rather than a subsidiary. The second sentence of the first paragraph of Article 43 EC expressly leaves traders free to choose the appropriate legal form in which to pursue their activities in another Member State and that freedom of choice must not be limited by discriminatory tax provisions (*Commission* v *France*, paragraph 22, and Case C?253/03 *CLT-UFA* [2006] ECR I?1831, paragraph 14).

41 The United Kingdom Government further argues that, since the intra-group financial transfer was not taxed in the United Kingdom, which Oy AA, however, denies, and since the losses of AA Ltd could be carried forward to other financial years so as to be set off against profits subsequently

made, the delay which that parent company suffered before being able to equalise profits and losses had only an indirect and uncertain effect on its decision whether to establish a subsidiary in Finland.

42 However, for legislation to be regarded as a restriction on the freedom of establishment, it is sufficient that it be capable of restricting the exercise of that freedom in a Member State by companies established in another Member State, without there being any need to establish that the legislation in question has actually had the effect of leading some of those companies to refrain from acquiring, creating or maintaining a subsidiary in the first Member State (*Test Claimants in the Thin Cap Group Litigation*, paragraph 62).

43 It follows that the difference in treatment to which resident subsidiaries are subjected, under a system such as that at issue in the main proceedings, by reason of the place of the corporate seat of their parent company constitutes a restriction on the freedom of establishment.

Justification for the restriction on freedom of establishment

44 A restriction on the freedom of establishment is permissible only if it is justified by overriding reasons in the public interest. It is further necessary, in such a case, that its application be appropriate to ensuring the attainment of the objective in question and not go beyond what is necessary to attain it (*Marks & Spencer*, paragraph 35; *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 47; and *Test Claimants in the Thin Cap Group Litigation*, paragraph 64).

45 In their written observations, the Finnish, German, Netherlands and United Kingdom Governments, and also the Commission of the European Communities, argue that the Finnish system of intra-group financial transfers is justified by the need to ensure the coherence of the tax system concerned, and by the allocation of taxation powers between the Member States, the fear of tax avoidance and the principle of territoriality.

46 At the hearing, which took place after delivery of the judgment in *Marks & Spencer*, the governments making oral submissions maintained that the justifications upheld by the Court of Justice in that case, namely the safeguarding of a balanced allocation of the power to tax between the various Member States and the risks of the double use of losses and of tax avoidance, were also present in this case Those arguments should therefore be examined.

47 The Finnish Government, supported by the Swedish and United Kingdom Governments, argues that, in basing itself on the principle of territoriality, whereby Member States are entitled to tax income generated on their territory, the system at issue in the main proceedings reflects the consensus in the matter of the international allocation of the competence to tax.

48 According to those governments, the Netherlands Government and the Commission, to allow the possibility of deducting a transfer made in favour of a company with its establishment in another Member State would amount to allowing taxpayers to choose the Member State of taxation and would thereby limit the taxation powers of the Member States by undermining a balanced allocation of those powers.

49 Concerning the need to prevent a double use of losses, the Finnish, German, Netherlands, Swedish and United Kingdom Governments argue that that need is analogous to the need to prevent a double advantage being unduly granted. According to those governments, a situation in which an intra-group financial transfer is taken into account when determining the taxable income of the transferor, but is not regarded as taxable income in the hands of the transferee, involves a risk that the profits of the subsidiary making the transfer may escape taxation altogether.

According to the United Kingdom Government, contradicted on this point by Oy AA, that is the situation in the case at issue in the main proceedings.

50 Finally, the Finnish, German, Netherlands, Swedish and United Kingdom Governments and the Commission are agreed in arguing that there is a risk, within a group, that business activities might be organised in such a way that profits taxable in Finland were transferred to companies, created for that purpose, whose corporate seat was in Member States where they would be taxed at a lower rate than in Finland or exempt from taxation.

51 As is apparent from paragraph 51 of the judgment in *Marks & Spencer*, the need to safeguard the balanced allocation of the power to impose taxes between the Member States was accepted by the Court in conjunction with two other grounds of justification, based on the risks of the double use of losses and of tax avoidance (see also Case C?347/04 *Rewe Zentralfinanz* [2007] ECR I-0000, paragraph 41).

52 It should also be remembered that, in the absence of any unifying or harmonising Community measures, Member States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation (Case C?336/96 *Gilly* [1998] ECR I?2793, paragraphs 24 and 30; Case C?470/04 *N* [2006] ECR I-7409, paragraph 44; Case C?513/04 *Kerkhaert and Morres* [2006] ECR I-10967, paragraphs 22 and 23; and *Test Claimants in the Thin Cap Group Litigation*, paragraph 49).

53 Concerning, first, the need to safeguard a balanced allocation of the power to tax between Member States, it should be pointed out that that need cannot justify a Member State systematically refusing to grant a tax advantage to a resident subsidiary, on the ground that the income of the parent company, having its establishment in another Member State, is not capable of being taxed in the first Member State (see, to that effect, *Rewe Zentralfinanz*, paragraph 43).

54 That element of justification may be allowed, however, where the system in question is designed to prevent conduct capable of jeopardising the right of the Member States to exercise their taxing powers in relation to activities carried on in their territory (*Rewe Zentralfinanz*, paragraph 42).

55 The Court has thus held that to give companies the right to elect to have their losses taken into account in the Member State in which they are established or in another Member State would seriously undermine a balanced allocation of the power to impose taxes between the Member States (*Marks & Spencer*, paragraph 46, and *Rewe Zentralfinanz*, paragraph 42).

56 Similarly, to accept that an intra-group cross-border transfer, such as that at issue in the main proceedings, may be deducted from the taxable income of the transferor would result in allowing groups of companies to choose freely the Member State in which the profits of the subsidiary are to be taxed, by removing them from the basis of assessment of the latter and, where that transfer is regarded as taxable income in the Member State of the parent company transferee, incorporating them in the basis of assessment of the parent company. That would undermine the system of the allocation of the power to tax between Member States because, according to the choice made by the group of companies, the Member State of the subsidiary would be forced to renounce its right, in its capacity as the State of residence of that subsidiary, to tax the profits of that subsidiary in favour, possibly, of the Member State in which the parent company has its establishment (see also *Test Claimants in Class IV of the ACT Group Litigation*, paragraph 59).

57 Concerning, secondly, the risk that losses might be used twice, it is sufficient to point out that the Finnish system of intra-group financial transfers does not concern the deductibility of losses.

58 Concerning, finally, the prevention of tax avoidance, it must be acknowledged that the possibility of transferring the taxable income of a subsidiary to a parent company with its establishment in another Member State carries the risk that, by means of purely artificial arrangements, income transfers may be organised within a group of companies towards companies established in Member States applying the lowest rates of taxation or in Member States in which such income is not taxed. That possibility is reinforced by the fact that the Finnish system of intra-group financial transfers does not require the transferee to have suffered losses.

59 By granting a subsidiary the right to deduct an intra-group financial transfer in favour of its parent company from its taxable income only in cases where the latter has its principal establishment in the same Member State, the Finnish system of intra-group financial transfers is able to prevent such practices, likely to be encouraged by the finding of significant disparities between the bases of assessment or rates of tax applied in the various Member States and designed only to avoid the tax normally due in the Member State of the subsidiary on its profits.

60 Having regard to the combination of those two factors, concerning the need to safeguard the balanced allocation of the power to tax between the Member States and the need to prevent tax avoidance, this Court therefore finds that a system, such as that at issue in the main proceedings, which grants a subsidiary the right to deduct a financial transfer in favour of its parent from its taxable income only where the parent and the subsidiary both have their principal establishment in the same Member State, pursues legitimate objectives compatible with the Treaty and justified by overriding reasons in the public interest, and is appropriate to ensuring the attainment of those objectives.

61 It must, however, be examined whether or not such a system goes beyond what is necessary to attain all of the objectives pursued.

62 It should be noted at the outset that the objectives of safeguarding the balanced allocation of the power to impose taxes between Member States and the prevention of tax avoidance are linked. Conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory is such as to undermine the right of the Member States to exercise their tax jurisdiction in relation to those activities and jeopardise a balanced allocation between Member States of the power to impose taxes (*Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraphs 55 and 56, and *Test Claimants in the Thin Cap Group Litigation*, paragraphs 74 and 75).

63 Even if the legislation at issue in the main proceedings is not specifically designed to exclude from the tax advantage it confers purely artificial arrangements, devoid of economic reality, created with the aim of escaping the tax normally due on the profits generated by activities carried out on national territory, such legislation may nevertheless be regarded as proportionate to the objectives pursued, taken as a whole.

64 In a situation in which the advantage in question consists in the possibility of making a transfer of income, thereby excluding such income from the taxable income of the transferor and including it in the taxable income of the transferee, any extension of that advantage to cross-border situations would, as indicated in paragraph 56 of this judgment, have the effect of allowing groups of companies to choose freely the Member State in which their profits will be taxed, to the detriment of the right of the Member State of the subsidiary to tax profits generated by activities

carried out on its territory.

65 That detriment cannot be prevented by imposing conditions concerning the treatment of the income arising from the intra-group financial transfer in the Member State of the transferee, or concerning the existence of losses made by the transferee. To allow deduction of the intra-group financial transfer where it constitutes taxable income of the transferee company, or where the opportunities for the transferee company to transfer its losses to another company are limited, or to allow deduction of an intra-group financial transfer in favour of a company whose establishment is in a Member State applying a lower rate of tax than that applied by the Member State of the transferor only where that intra-group financial transfer is specifically justified by the economic situation of the transferee, as Oy AA has proposed, would nevertheless mean that, in the final analysis, the choice of the Member State of taxation would be a matter for the group of companies, which would have a wide discretion in that regard.

66 In the light of the above considerations, there is no need to examine the other justifications raised by the Finnish, German, Netherlands, Swedish and United Kingdom Governments and by the Commission.

67 The answer to the question referred must therefore be that Article 43 EC does not preclude a system instituted by legislation of a Member State, such as that at issue in the main proceedings, whereby a subsidiary resident in that Member State may not deduct an intra-group financial transfer which it makes in favour of its parent company from its taxable income unless that parent company has its establishment in that same Member State.

Costs

68 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 (Grand Chamber) hereby rules:

Article 43 EC does not preclude a system instituted by legislation of a Member State, such as that at issue in the main proceedings, whereby a subsidiary resident in that Member State may not deduct an intra-group financial transfer which it makes in favour of its parent company from its taxable income unless that parent company has its establishment in that same Member State.

[Signatures]

* Language of the case: Finnish.