JUDGMENT OF THE COURT (Second Chamber)

29 March 2007 *

In Case C-347/04,

REFERENCE for a preliminary ruling under Article 234 EC from the Finanzgericht Köln (Germany), made by decision of 15 July 2004, received at the Court on 13 August 2004, in the proceedings

Rewe Zentralfinanz eG, as universal legal successor of ITS Reisen GmbH

v

Finanzamt Köln-Mitte,

THE COURT (Second Chamber),

composed of C.W.A. Timmermans, President of the Chamber, J. Klučka, R. Silva de Lapuerta, J. Makarczyk and L. Bay Larsen (Rapporteur), Judges,

* Language of the case: German.

Advocate General: M. Poiares Maduro,
Registrar: B. Fülöp, Administrator,

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

after considering the observations submitted on behalf of:

— Rewe Zentralfinanz eG, by M. Lausterer, Rechtsanwalt,

— the Finanzamt Köln-Mitte, by B. Redmann, acting as Agent,

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

— the Commission of the European Communities, by R. Lyal and D. Triantafyllou, acting as Agents, after hearing the Opinion of the Advocate General at the sitting on 31 May 2006,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Article 52 of the EC Treaty (now, after amendment, Article 43 EC), Article 58 of the EC Treaty (now Article 48 EC), Articles 67 to 73 of the EC Treaty (repealed by the Treaty of Amsterdam), Articles 73b to 73d of the EC Treaty (now Articles 56 EC to 58 EC), Article 73e of the EC Treaty (repealed by the Treaty of Amsterdam) and Articles 73f and 73g of the EC Treaty (now Articles 59 EC and 60 EC).

2 That reference was made in proceedings between Rewe Zentralfinanz eG ('Rewe'), established in Germany and acting as universal successor of ITS Reisen GmbH ('ITS'), and the Finanzamt Köln-Mitte concerning the refusal to allow, as operating expenses deductible in determining the taxable profits for the 1993 and 1994 tax years, losses stemming from partial write-downs to the book value of shareholdings in subsidiaries established in other Member States.

National legislation

3 By virtue of Paragraph 1 of the Law of 1991 on corporation tax (Körperschaftsteuergesetz 1991) ('the KStG 1991'), which is applicable in the main proceedings, resident companies are liable to corporation tax in Germany on their worldwide profits. The latter include profits made by branches or agencies through which those resident companies carry on their activities outside that State. Conversely, a resident company is not liable to tax on the profits of its subsidiaries at the time when they are made.

4 According to Paragraph 8(1) of the KStG 1991, it is the provisions of the Law of 1990 on income tax (Einkommensteuergesetz 1990) ('the EStG 1990') and the KStG 1991 which define what is to be treated as 'income' and how the latter is to be calculated.

5 The second sentence of Paragraph 6(1)(2) of the EStG 1990 provides that partial write-downs to the book value of shareholdings constitute operating expenses which are deductible in calculating profits. Under Paragraph 6, the book value is deemed to be the amount which a purchaser of the whole of the undertaking would attribute to the asset in question in the overall purchase price. While, in calculating profits, fixed assets capable of being written down are, in principle, to be entered in the balance

sheet at their acquisition value or their cost of manufacture, reduced by depreciation for wear and tear, taxpayers may also declare a lower book value (a partial write-down) where, for example, the actual value of the asset has fallen beneath the acquisition value or cost of manufacture, as reduced by depreciation for wear and tear.

6 Paragraph 2(3) of the EStG 1990 provides that a taxpayer's net income for a tax year is to comprise the aggregate of positive and negative income. Should losses remain as a result of that calculation, Paragraph 10d of the EStG 1990 provides that they may be deducted in other years, when taxable income is calculated, and carried forward or carried back as tax losses.

7 Under the EStG 1990, as amended by the Law of 1992 on tax reform (Steueränderungsgesetz 1992) of 25 February 1992 (BGBl. 1992 I, p. 297), the offsetting for tax purposes of partial write-downs to the value of shares in a company was, at the time of the facts in the main proceedings, treated differently, according to whether the company concerned was established within, or outside, Germany.

8 Pursuant to Paragraph 2(3) of the EStG 1990, where shares were held in a company established in Germany, negative income, including losses stemming from partial write-downs, in a period of assessment could be offset by all the positive income generated by the taxpayer.

9 Under Paragraph 2a(1) and (2) of the EStG 1990, entitled 'Negative income having a foreign connection', certain foreign-sourced negative income was allowed to be taken into account for tax purposes only to a limited extent:

'(1) Negative income

...

2. from a permanent industrial or commercial establishment in a foreign country,

3. (a) from the adoption in the accounts of a lower book value in respect of a shareholding, forming part of operating assets, in an entity that does not have its place of management or its registered office in Germany (foreign entity), ...

...

may be offset only against positive income of the same kind from the same State ...; nor may it be deducted under Paragraph 10d. Reductions in profits shall be treated in the same way as negative income. To the extent that negative income cannot be offset under the first sentence, it shall reduce the positive income of the same kind which the taxpayer may generate in subsequent periods of assessment in the same State ...

(2) Point 2 of the first sentence of subparagraph (1) shall not apply where the taxpayer establishes that the negative income stems from an industrial or commercial establishment abroad whose object is exclusively or almost exclusively ... the provision of services of a commercial nature, to the extent that these do not consist in the creation or operation of facilities used for the purposes of tourism or in the letting or leasing of economic assets ...; the direct holding of an interest of at least one quarter of the nominal capital of a company whose object is exclusively or almost exclusively the abovementioned activities, and the financing connected with the holding of such an interest, shall be regarded as the provision of services of a commercial nature where the company does not have its place of management or its registered office in Germany. Points 3 and 4 of the first sentence of subparagraph (1) shall not apply where the taxpayer establishes that the conditions set out in the first sentence were satisfied by the entity either since its formation or during the last five years before the period of assessment in which the negative income arose and during that period.

...'

10 It follows from Paragraph 2a of the EStG 1990 that the offsetting of negative income stemming from a partial write-down is possible only where the company generates

income, within the meaning of Paragraph 2a(2), abroad ('active' income) or if it itself holds an interest of at least one quarter in another foreign company which, for its part, generates active income for the purposes of Paragraph 2a(2). The carrying on of activities connected with tourism abroad automatically excludes the offsetting of losses.

11 Pursuant to Paragraph 8b(2) of the KStG 1991, as amended by the Law to secure Germany as a place of establishment (Standortsicherungsgesetz) of 13 September 1993 (BGBl. 1993 I, p. 1569), capital gains realised on the disposal of shares were exempted from tax for the first time in the 1994 tax year.

12 Lastly, the Law on the reduction of taxes (Steuersenkungsgesetz) of 23 October 2000 (BGBl. 2000 I, p. 1433) amended Paragraph 8b(3) of the KStG 1991. That provision states, in its amended version, that no regard is to be had to reductions in income arising from the taking into account of the lower book value of a shareholding, irrespective of whether those shares are owned by a company established outside Germany or within that State.

The main proceedings and the question referred for a preliminary ruling

13 By a contract entered into on 6 March 1995, ITS, a member of the Kaufhof Holding AG group, whose object is tourism-related activities, was sold by that group to Rewe.

By a merger agreement of 3 November 1995, Rewe became the universal legal successor of ITS.

14 In 1989, ITS had incorporated a wholly-owned subsidiary in the Netherlands, Kaufhof-Tourism Holdings BV ('KTH'). KTH established, in the same Member State, a holding company, International Tourism Investment Holdings BV, which was wholly owned by it. The latter company also acquired inter alia the whole of the shares in German Tourist Facilities Ltd, established in the United Kingdom, together with 36% of the share capital of Travelplan SA, established in Spain.

15 In its annual accounts for 1993 and 1994, ITS made partial write-downs to the value of its holding in its Netherlands subsidiary KTH and to the value of book debts owed by the two subsidiaries of its second-tier subsidiary, established in the United Kingdom and in Spain. The aggregate of those exceptional charges was in excess of DEM 46 million for the 1993 and 1994 tax years.

16 However, as the Finanzamt Köln-Mitte considered that Paragraph 2a of the EStG 1990 precluded those charges stemming from the shareholding in KTH being taken into account, it refused to allow those charges as operating expenses for tax purposes and to treat them as negative income in determining Rewe's taxable profits for the 1993 and 1994 tax years. Accordingly, it issued amended notices of assessment regarding, in particular, the corporation tax for which Rewe was liable in respect of those tax years.

17 Since it considered that it was entitled to have the whole of the charges stemming from the holding companies established in the Netherlands, in the United Kingdom and in Spain, taken into account for tax purposes, Rewe brought an appeal for that purpose before the Finanzgericht Köln (Cologne Finance Court), arguing that the application of Paragraph 2a of the EStG 1990 constitutes discrimination contrary to Community law.

18 According to that court, the effect of the law which was applicable at the time of the facts in the main proceedings is that, whereas write-downs to the book value of shareholdings in a subsidiary established in Germany could, in principle, be taken into account for tax purposes without restriction as operating expenses of the parent company in calculating its taxable profits, write-downs to the book value of shareholdings in a subsidiary established in another Member State could be taken into account for tax purposes only in limited cases, that is to say, where the negative income stemming from those write-downs was offset by positive income from that other Member State or where the conditions of the scheme governing exemptions set out in Paragraph 2a(2) of the EStG 1990 were satisfied. It therefore takes the view that it is likely that such a difference in treatment, stemming from Paragraph 2a(1)(3)(a) and (2) of the EStG 1990, is contrary to Community law and does not consider that it can put forward reasons to justify that difference.

19 In those circumstances the Finanzgericht Köln decided to stay the proceedings and to refer the following question to the Court for a preliminary ruling:

'Are Article 52, ... in conjunction with Article 58 ... and Articles 67 to 73 and 73b et seq., ... [of the Treaty] to be interpreted as precluding a rule which — like the rule laid down in Paragraph 2a(1)(3)(a) and Paragraph 2a(2) of the [EStG] which is at issue in the main proceedings — restricts the immediate deduction for tax purposes of losses stemming from write-downs to the book value of shareholdings in subsidiaries in other countries in the Community, where those subsidiaries pursue passive activities within the meaning of the national provision and/or where the subsidiaries pursue active activities within the meaning of the national provision only through their own second-tier subsidiaries, whereas write-downs to the book value of domestic subsidiaries are possible without these restrictions?'

The question referred for a preliminary ruling

20 By its question, the national court essentially asks whether, in circumstances such as those which arise in the main proceedings, the provisions of the EC Treaty relating to freedom of establishment and the free movement of capital preclude legislation of a Member State which restricts the right of a parent company which is resident in that State to deduct for tax purposes losses incurred by that company in respect of write-downs to the book value of its shareholdings in subsidiaries established in other Member States.

The interpretation of the provisions of the Treaty relating to freedom of establishment

21 It should be noted at the outset that, according to well-established case-law, although direct taxation falls within their competence, the Member States must none the less exercise that competence consistently with Community law (see, inter alia, Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR

I-1727, paragraph 37; 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-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paragraph 25).

22 In accordance with settled case-law, national provisions which apply to holdings by nationals of the Member State concerned in the capital of a company established in another Member State, giving them definite influence on the company's decisions and allowing them to determine its activities, come within the substantive scope of the provisions of the Treaty on freedom of establishment (see, to that effect, Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 22; Case C-436/00 *X and Y* [2002] ECR I-10829, paragraph 37; *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 31; and *Test Claimants in the Thin Cap Group Litigation*, paragraph 27).

23 That is the case where, as in the main proceedings, a resident company such as ITS owns 100% of the shares in a company established in another Member State. A 100% holding by a taxpayer in the capital of a company having its seat in another Member State undoubtedly brings such a taxpayer within the scope of application of the provisions of the Treaty relating to the right of establishment (*Baars*, paragraph 21).

24 It is therefore necessary to examine whether Articles 52 and 58 of the Treaty preclude the application of legislation such as that at issue in the main proceedings.

25 Freedom of establishment, which Article 52 of the Treaty 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 58 of the Treaty, 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, branch or agency (see, inter alia, Case C-307/97 *Saint-Gobain ZN* [1999] ECR I-6161, paragraph 35; *Marks & Spencer*, paragraph 30; and Case C-471/04 *Keller Holding* [2006] ECR I-2107, paragraph 29).

26 Furthermore, even though, according to their wording, the provisions of the Treaty concerning freedom of establishment are directed to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation (Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 21, and *Marks & Spencer*, paragraph 31).

27 The legislation at issue in the main proceedings provides that asset losses stemming from write-downs to the book value of shareholdings in subsidiaries in Germany are to be taken into account immediately and without restriction in calculating the taxable profits of parent companies which are subject to unlimited liability to tax in Germany.

28 By contrast, as is clear from Paragraph 2a(1) and (2) of the EStG 1990, losses of the same kind stemming from shareholdings in a subsidiary established in another Member State are deductible in the case of a parent company which is subject to unlimited liability to tax in Germany only under certain conditions linked to the income of that company or to the carrying on by its subsidiary of so-called 'active' activities.

29 It is true that, for a parent company resident in Germany, losses stemming from shareholdings in subsidiaries established in other Member States could be taken into account in Germany where those subsidiaries subsequently generated positive income. However, it remains the case that, even where sufficient positive income was established, such a parent company is not, unlike a parent company having subsidiaries established in Germany, entitled to have its losses taken into account immediately and is thus deprived of a cash-flow advantage (see, to that effect, *Marks & Spencer*, paragraph 32).

30 It follows that the tax situation of a parent company which is resident in Germany and has, like Rewe, a subsidiary and a second-tier subsidiary in another Member State is less favourable than its situation would be if such a subsidiary and such a second-tier subsidiary were established in Germany.

31 Such a difference in treatment gives rise to a tax disadvantage for a parent company which is established in Germany and has a subsidiary in another Member State. In the light of that difference, a parent company might be dissuaded from carrying on its activities through the intermediary of subsidiaries or indirect subsidiaries established in other Member States (see, to that effect, Case C-168/01 *Bosal* [2003] ECR I-9409, paragraph 27).

32 However, the German Government argues that such a difference in treatment does not constitute a restriction on freedom of establishment, inasmuch as the situation of a subsidiary established in Germany is not comparable to the situation of a subsidiary established in another Member State. That Government contends that subsidiaries are autonomous legal entities in relation to their parent company, which are liable to tax in the State in which they are established. It is likely that the KTH subsidiary will have claimed losses when it declared its taxable profits in the Netherlands. That Government takes the view that the Federal Republic of Germany is not required, as the State in which the parent company is established, to accord foreign subsidiaries a legal status comparable to that enjoyed by a resident parent company.

33 It must be held in that regard, as the Advocate General stated at point 21 of his Opinion, that the different tax treatment at issue in the main proceedings does not concern the situation of subsidiaries, according to whether or not they are established in Germany, but that of parent companies which are resident in Germany, according to whether or not they have subsidiaries established in other Member States.

34 Those companies are in a comparable situation as regards losses incurred by such resident parent companies in respect of write-downs made to the book value of their shareholdings in subsidiaries, whether the shares are held in subsidiaries established in Germany or in other Member States. In each case, first, the losses which it is sought to deduct are borne by the parent companies and, secondly, 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.

35 Accordingly, a restriction on the deductibility of such losses by a resident parent company which affects only losses incurred in respect of write-downs to the book

value of foreign shareholdings does not reflect an objective difference in the situation of parent companies according to whether their subsidiaries have their seat in Germany or in other Member States.

36 It follows that the difference in tax treatment arising under the legislation at issue in the main proceedings and the disadvantageous tax situation which stems from it for German-resident parent companies having a subsidiary which is established in another Member State are capable of constituting an obstacle to freedom of establishment by such companies, by discouraging them from creating, acquiring or maintaining a subsidiary in another Member State. They accordingly constitute a restriction on freedom of establishment for the purposes of Articles 52 and 58 of the Treaty.

37 Such a restriction on freedom of establishment can be accepted only if it pursues a legitimate aim compatible with the Treaty or is justified by overriding reasons of public interest. But even if that were so, application of that measure would still have to be such as to ensure achievement of the aim in question and not go beyond what is necessary for that purpose (see, inter alia, *Marks & Spencer*, paragraph 35 and the case-law cited there, and *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 47).

38 According to the German Government, it is justified, on any basis, in limiting, as regards a German-resident parent company, the right of that company to deduct for tax purposes losses incurred by it in respect of write-downs to the book value of its shareholdings in subsidiaries established in other Member States, by allowing

foreign-sourced losses to be taken into account for tax purposes only where such losses are connected to positive income of the same kind arising in the same State. The German Government puts forward a number of arguments in that regard, which, as the Advocate General states at point 24 of his Opinion, may essentially be summarised in terms of the reasoning set out below.

39 In the first place, by reference in particular to the judgment in *Marks & Spencer*, in which the Court took into account the principle of the balanced allocation of the power to impose taxes between the Member States, the German Government puts forward its first ground, based on a rule of symmetry between the right to tax the profits of a company and the obligation to take into account the losses incurred by that company. It contends that the German tax authorities should not have to take account, in the context of the tax treatment of a German-resident parent company, of losses stemming from the activity of a subsidiary which is established in another Member State, since they have no right to tax the profits of that subsidiary.

40 Such an argument cannot be upheld.

41 As the Advocate General stated at point 32 of his Opinion, it is necessary to define the scope to be accorded to the legitimate requirement of the balanced allocation of the power to impose taxes between the Member States. In particular, it must be noted that such a justification was accepted by the Court in the judgment in *Marks & Spencer* only in conjunction with two other grounds, based on the taking into account of tax losses twice and on tax avoidance (see, to that effect, *Marks & Spencer*, paragraphs 43 and 51).

42 It must be acknowledged in that regard that there are courses of action which are capable of jeopardising the right of the Member States to exercise their taxing powers in relation to activities carried on in their territory and thus of undermining a balanced allocation of the power to impose taxes between the Member States (see *Marks & Spencer*, paragraph 46) and which may justify a restriction on freedom of establishment (see *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraphs 55 and 56). The Court has thus held that the fact of giving 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, since the tax base would be increased in the first State, and reduced in the second, by the amount of the losses surrendered.

43 However, a difference in tax treatment between resident parent companies according to whether or not they have subsidiaries abroad cannot be justified merely by the fact that they have decided to carry on economic activities in another Member State, in which the State concerned cannot exercise its taxing powers. Accordingly, an argument based on the balanced allocation of the power to impose taxes between the Member States cannot in itself justify a Member State systematically refusing to grant a tax advantage to a resident parent company, on the ground that that company has developed a cross-border economic activity which does not have the immediate result of generating tax revenues for that State.

44 It must also be pointed out that losses incurred by a parent company in respect of write-downs to the book value of its shareholdings in subsidiaries established in Germany may be offset by its positive income, even where those subsidiaries have not made taxable profits during the tax year in question.

45 In the second place, the German Government contends that the legislation at issue in the main proceedings is necessary in order to prevent parent companies from being able to benefit from multiple tax advantages in the form of losses incurred abroad being taken into account twice.

46 Such an argument is irrelevant in the circumstances of the main proceedings.

47 While it must be accepted that the Member States must be able to prevent the danger of tax losses being used twice (see *Marks & Spencer*, paragraph 47), it must be pointed out that the losses at issue in the main proceedings are not, as the Advocate General stated at points 37 and 38 of his Opinion, comparable to losses incurred by subsidiaries abroad which the resident parent company requires them to surrender to it in order to reduce its taxable profits, which was the position in *Marks & Spencer*.

48 The losses at issue in the main proceedings are incurred by the parent company because of the reduction in the book value of its shareholdings in foreign subsidiaries. Those losses related to the writing down of the book value of the shareholdings are taken into account only as regards the parent company and are subject, for tax purposes, to a different treatment from that which applies to losses incurred by the subsidiaries themselves. Such a separate treatment of, first, the losses suffered by the subsidiaries themselves and, secondly, the losses incurred by the parent company cannot, on any basis, amount to using the same losses twice.

49 Furthermore, it must be pointed out that, as the Commission of the European Communities, in particular, argued at the hearing, a parent company which is

established in Germany and has subsidiaries in that State is permitted to deduct write-downs to the book value of its shareholdings in its resident subsidiaries from its taxable income, without those subsidiaries being prevented from using their own losses when they are taxed in Germany.

50 In the third place, the German Government contends that the legislation at issue in the main proceedings is targeted at a particular form of tax avoidance, which consists, for German-resident parent companies, in particular those carrying on business in the tourism sector, in transferring habitually loss-making activities to other Member States by forming subsidiaries there, solely in order to reduce their taxable profits in Germany. At the hearing, that Government added that it was of the view that the case-law of the Court in the field should be relaxed, since it considered the requirement of the specific objective of the counteraction of purely artificial arrangements to be unduly restrictive. According to the German Government, it is essential to allow the Member States to enact general measures of principle, designed to counteract tax avoidance and to adopt abstract and general regulations targeted at specific avoidance schemes.

51 It is sufficient to hold in that regard that the mere fact that in a particular economic sector, such as tourism, the tax authorities of a Member State may establish cases of significant and continuing losses incurred by foreign subsidiaries of parent companies which are resident in that State cannot suffice to establish the existence of purely artificial arrangements designed to create losses in respect of write-downs to the book value of shareholdings in subsidiaries established in other Member States (see, with respect to the requirement of the specific objective of counteracting purely artificial arrangements, *ICI*, paragraph 26; *Marks & Spencer*, paragraph 57; and *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 51).

52 In the present case, a provision such as Paragraph 2a(1)(3)(a) of the EStG 1990, which covers generally any adoption in the accounts of a lower book value in respect of a shareholding when subsidiaries owned by a parent company which is established in Germany are established, for any reason, in other Member States, cannot, without going beyond what is necessary to attain the objective which it allegedly seeks to achieve, be regarded as justified by the danger of tax avoidance. Such a provision does not have the specific object of excluding from the benefit of a tax advantage purely artificial arrangements designed to circumvent German tax law, but is targeted, generally, at any situation in which subsidiaries are established, for any reason, outside Germany. The formation of a company outside that Member State does not, of itself, imply the existence of tax avoidance, since the company in question is, in any event, subject to the tax legislation of the State in which it is established.

53 Similarly, Paragraph 2a(2) of the EStG 1990, by excluding the so-called 'active' activities listed in it, in particular those consisting in the creation or operation of facilities used for the purposes of tourism, goes beyond what is necessary in order to counteract abusive arrangements. The counteraction of tax avoidance cannot justify a situation in which negative income from an industrial or commercial operation established abroad, having as its object the provision of services of a commercial nature can, as a general rule, be offset without restriction by positive income, whereas, when facilities used for tourism-related activities are involved, the offsetting of positive income is made subject to a number of conditions.

54 In the fourth place, the German Government also has no basis for invoking the need to facilitate the effectiveness of fiscal supervision of transactions taking place abroad in order to justify the national legislation at issue in the main proceedings.

55 While the effectiveness of fiscal supervision allows a Member State to apply measures which enable the amount of deductible charges in that State in respect of

shareholdings in foreign subsidiaries to be ascertained clearly and precisely (see, to that effect, Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, paragraph 31, and Case C-55/98 *Vestergaard* [1999] ECR I-7641, paragraph 23), it cannot, however, justify that State being permitted to impose different conditions on that deduction, according to whether the shares relate to subsidiaries established in that State or in other Member States.

56 In that regard, it should be pointed out that Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (OJ 1977 L 336, p. 15) may be invoked by a Member State in order to obtain from the competent authorities of another Member State all the information which is necessary to allow it to effect a correct assessment of corporation tax.

57 In addition, as regards the German Government's argument that the monitoring of foreign operations often remains very difficult, even where there is collaboration with the authorities of another Member State, it is sufficient to note that the tax authorities concerned are entitled to demand from the parent company itself such evidence as they consider necessary in order to determine whether or not to grant a deduction applied for in respect of losses stemming from write-downs to the book value of shareholdings in subsidiaries established in other Member States (see, to that effect, *Vestergaard*, paragraph 26).

58 Such a possibility should be especially useful in a situation such as that which arises in the main proceedings, involving a parent company which should be in a position to demand all the necessary documents directly from its foreign subsidiaries.

Moreover, the fact that there may be difficulties in determining the losses stemming from write-downs to the book value of shareholdings in subsidiaries established in other Member States cannot, in any event, justify an obstacle to freedom of establishment (see, to that effect, Case C-334/02 *Commission* v *France* [2004] ECR I-2229, paragraph 29, and Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 54).

59 In the fifth place, in order to justify the tax disadvantage suffered in the present case by parent companies which are established in Germany and hold shares in subsidiaries established in other Member States, the German Government contends that the legislation at issue in the main proceedings is objectively justified by the need to ensure the uniformity of the tax system. Essentially, two arguments put forward by that Government may be used to support that justification, one of which is based on the need to maintain the coherence of the German tax system, and the other of which is based on respect for the principle of territoriality.

60 As regards the need to maintain the coherence of that tax system, the German Government argues, first, that by virtue in particular of a double taxation convention concluded with the Netherlands, the State in which the Rewe subsidiary KTH is established, dividends paid by subsidiaries established in that State are exempt from tax in Germany. The requirement of coherence therefore means that advantages should not be granted to parent companies which are resident in Germany in respect of losses relating to their foreign subsidiaries.

61 The argument based on the need to maintain the coherence of the tax system put forward by the German Government cannot be accepted, inasmuch as losses such as

those at issue in the main proceedings are also taken into account in Germany when a foreign subsidiary carries on a so-called 'active' activity for the purposes of Paragraph 2a(2) of the EStG 1990, whereas, in such a case, dividends paid by such a subsidiary may still be exempted under double taxation conventions.

62 Moreover, as regards the need to maintain the coherence of the national tax system established by the legislation at issue in the main proceedings, which, according to the German Government, those conventions serve to guarantee, it must be pointed out that, in paragraphs 28 and 21 respectively of the judgments in Case C-204/90 *Bachmann* [1992] ECR I-249 and Case C-300/90 *Commission* v *Belgium* [1992] ECR I-305, the Court recognised that the need to maintain the coherence of a tax system can justify a restriction on the exercise of the fundamental freedoms guaranteed by the Treaty. However, for an argument based on such reasoning 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, to that effect, *Keller Holding*, paragraph 40, and *Test Claimants in the Thin Cap Group Litigation*, paragraph 68).

63 Examination of the national legislation at issue in the main proceedings shows that parent companies which are subject to unlimited liability to tax in Germany and which hold shares in subsidiaries established in that Member State are entitled both to immediate deductibility of losses stemming from partial write-downs to the book value of shareholdings in those subsidiaries and to a tax exemption in respect of those dividends. By contrast, even though the dividends which a parent company which is subject to unlimited liability to tax in Germany receives from its subsidiary established in the Netherlands are also exempt from tax under the double taxation convention, the deduction of losses stemming from partial write-downs to the book value of shareholdings in such a subsidiary is subject to restrictions.

64 Since the German Government has not established the existence of a connection between the immediate deductibility, for a resident parent company, of losses stemming from partial write-downs to the book value of shareholdings in subsidiaries and the tax exemption for dividends received from those subsidiaries, the argument that it would be justified by the need to preserve the coherence of the German tax system in not granting advantages to German-resident parent companies in respect of losses relating to their foreign subsidiaries, because the dividends paid by those subsidiaries are exempt from tax in Germany pursuant to double taxation conventions, cannot be accepted.

65 The German Government argues, secondly, that the fiscal coherence of the legislation at issue in the main proceedings was guaranteed by the exemption of capital gains on the disposal of shares granted in Paragraph 8b(2) of the KStG 1991, as amended by the Law to maintain Germany as a place of establishment.

66 In the first place, it must be pointed out, as was noted by the national court, that that exemption was applicable for the first time in respect of the 1994 tax year and accordingly did not apply to the first tax year at issue in the main proceedings.

67 In the second place, it must be held that, in the framework of the calculation of the taxable income of resident parent companies which hold shares in foreign subsidiaries, the prohibition on deducting losses such as those at issue in the main

proceedings produces immediate effects. Accordingly, 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 parent companies which hold shares in foreign subsidiaries.

68 As regards, lastly, the principle of territoriality, as recognised by the Court in paragraph 22 of the judgment in *Futura Participations and Singer*, it must be held that that principle is also not capable of justifying the national legislation at issue in the main proceedings.

69 It is true that, in accordance with that principle, the Member State in which a parent company is established may tax resident companies on the whole of their worldwide profits but may tax non-resident subsidiaries solely on the profits from their activities in that State (see, to that effect, *Marks & Spencer*, paragraph 39). However, such a principle does not in itself justify the Member State of residence of the parent company refusing to grant an advantage to that company on the ground that it does not tax the profits of its non-resident subsidiaries (see, to that effect, *Marks & Spencer*, paragraph 40). As the Advocate General stated at point 49 of his Opinion, the purpose of that principle is to establish, in the application of Community law, the need to take into account the limits on the Member States' powers of taxation. As regards the main proceedings, were the advantage claimed by Rewe to be granted, that would not result in a competing tax jurisdiction becoming involved. It concerns German-resident parent companies which are subject, in that respect, to unlimited liability to tax in that State. Accordingly, the legislation at issue in the main proceedings cannot be considered as an implementation of the principle of territoriality.

70 In the light of all the above considerations, the answer to the national court's question must be that, in circumstances such as those of the main proceedings, in

which a parent company holds shares in a non-resident subsidiary which give it a definite influence over the decisions of that foreign subsidiary and allow it to determine its activities, Articles 52 and 58 of the Treaty preclude legislation of a Member State which restricts the right of a parent company which is resident in that State to deduct for tax purposes losses incurred by that company in respect of write-downs to the book value of its shareholdings in subsidiaries established in other Member States.

The interpretation of the provisions of the Treaty relating to the free movement of capital

71 Since the provisions of the Treaty relating to freedom of establishment thus preclude national legislation such as the legislation at issue in the main proceedings, it is not necessary to consider whether the provisions of the Treaty relating to free movement of capital also preclude that legislation (see, to the same effect, *Keller Holding*, paragraph 51).

Costs

72 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 (Second Chamber) hereby rules:

In circumstances such as those of the main proceedings, in which a parent company holds shares in a non-resident subsidiary which give it a definite influence over the decisions of that foreign subsidiary and allow it to determine its activities, Article 52 of the EC Treaty (now, after amendment, Article 43 EC) and Article 58 of the EC Treaty (now Article 48 EC) preclude legislation of a Member State which restricts the right of a parent company which is resident in that State to deduct for tax purposes losses incurred by that company in respect of write-downs to the book value of its shareholdings in subsidiaries established in other Member States.

[Signatures]