



## Court of Justice of the European Union on the impossibility of deducting a foreign tax loss in the Czech Republic



In its judgment in Case C-405/18 of 27 February 2020, the Court of Justice of the European Union dealt with a question referred by the Supreme Administrative Court concerning the possibility of claiming tax losses incurred abroad against the tax base in the Czech Republic. Specifically, the Supreme Administrative Court asked i) whether transfer of the place of management of a company could be covered under the concept of freedom of establishment and ii) whether a national law which does not allow an entity from another Member State to claim a loss assessed in another Member State following a change in tax residence is contrary to the relevant articles of the Treaty on the Functioning of the European Union.

A Dutch tax resident company declared a tax loss in 2007 in accordance with local tax legislation. Subsequently, in 2008, it established a branch (at the same time a permanent establishment for the purposes of the Income Tax Act) in the Czech Republic. In 2009, the company transferred its place of effective management to the Czech Republic and became a Czech tax resident. However, the company's registered office remained in the Netherlands and the company continued to be incorporated under Dutch law.

In 2012, the company decided to claim the tax loss of 2007 (incurred in the Netherlands) as a deductible item from the (Czech) tax base. The tax authority disallowed this deduction, referring to the fact that the Czech Income Taxes Act does not allow such an option. The question eventually came before the Supreme Administrative Court, which referred it to the Court of Justice of the European Union.

In answering the first question, the CJEU discussed the admissibility of invoking the freedom of establishment in this case under Article 49 of the Treaty on the Functioning of the European Union. The CJEU concluded that the company could indeed invoke this article.

In answering the second question, the CJEU then examined whether this article prevents a State from adopting an arrangement which prevents taxpayers from claiming tax losses incurred in another Member State. The Court concludes that the Treaty on the Functioning of the EU does not guarantee that a relocation of a place of effective management will be tax neutral. In view of the objective of the national legislation, the situation of a company, to which a loss was assessed in the Netherlands, and that of a company that incurred a tax loss in the Czech Republic, cannot be regarded as comparable. The Court therefore concludes that the Czech Republic cannot be required to take into account losses incurred in the Netherlands in 2007, since it had no tax jurisdiction over the company in that year.

This judgment may affect all companies that report tax losses and that, e.g. because of a rapidly changing tax environment, are considering migrating their tax residency to the Czech Republic or other EU countries.



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