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Icelandic Ministry of Finance and Economic Affairs
Arnarhvoli við Lindargötu
101 Reykjavík
Iceland

Dear Sir or Madam,

Subject: Letter of formal notice to Iceland concerning tax consolidations and relief from losses in Iceland

1 Introduction

By a letter dated 7 April 2016,[1] the EFTA Surveillance Authority ("the Authority") informed the Icelandic Government that it had opened an own initiative case regarding tax consolidations and relief from losses in Iceland.

This letter of formal notice addresses the Icelandic rules on tax consolidations and relief from losses in Iceland contained in Article 55 of the Income Tax Act No 90/2003 (lög nr. 90/2003 um tekjuskatt ("the ITA")), which in the Authority's view are not compatible with the EEA Agreement, in the light of recent judgments from the Court of Justice of the European Union ("the CJEU").

Article 55, paragraph 1, ITA effectively excludes branches (permanent establishments) of non-resident companies from joint taxation in Iceland. Furthermore, the provision excludes joint taxation of an Icelandic parent company and its subsidiaries, resident in Iceland, if the subsidiaries are directly owned by a foreign company, even though they are indirectly owned by the Icelandic parent company.

2 Correspondence

By the above mentioned letter of 7 April 2016, the Authority sent Iceland a request for information, inviting the Icelandic authorities to provide certain clarifications concerning the fact that branches of non-resident companies are not eligible to be included in a joint taxation under Article 55 ITA and concerning the requirement that no less than 90% of the shares in subsidiaries are held by the parent company wishing to be jointly taxed, or other subsidiaries included in the joint taxation.

By a letter dated 12 May 2016,[2] Iceland replied to the Authority's request for information. In this letter, the Icelandic Government stated that it was aware of the interpretation of the CJEU concerning the exclusion of branches of non-resident companies from joint taxation and noted that the Government was looking into which amendments needed to be made to the ITA in order to fulfil Iceland's obligations under the EEA Agreement. In the letter, the

[1] Document No 799566.
[2] Document No 804539.

Icelandic Government moreover recognised that the requirement of no less than 90% shareholding in a subsidiary by a parent company as a condition for joint taxation, or such holding by other subsidiaries included in the joint taxation, appeared to transgress the boundaries of permissible restrictions under Article 31 of the EEA Agreement ("EEA"). The Government informed the Authority that the rectification of this shortcoming was one of the objectives of the revision of Article 55 ITA.

The case was discussed at the package meeting in Iceland in June 2017, where representatives of the Icelandic Government informed the Authority that extensive work had taken place in the Ministry evaluating which amendments needed to be made to the ITA in order for the legislation to be in compliance with EEA law.

3 Relevant national law

Article 55, paragraph 1, ITA[3] reads as follows:

> *"The Director of Internal Revenue can allow joint taxation of two or more limited companies, as noted in point 1 in paragraph 1 of Article 2. The joint taxation is conditioned upon that no less than 90% of the shares in the subsidiaries are held by the parent company wishing to be jointly taxed, or other subsidiaries included in the joint taxation. […]"*

Article 2, paragraph 1, point 1, ITA deals with unlimited tax liability and stipulates that the obligation to pay income tax on all income, regardless of where it is made, rests on certain legal entities resident in Iceland, including *"registered public limited companies and private limited companies, as well as associate limited companies, provided that the associate limited company has requested at the time of registration to be entered as an independent entity for tax purposes."*

A permanent establishment is not defined in the ITA but it follows from Article 3, paragraph 1, point 4, ITA that all entities who have a fixed place of business in Iceland or partake in running a fixed place of business have limited tax liability.

4 Relevant EEA law

Article 31 of the EEA Agreement on the right of establishment provides that:

> *"1. Within the framework of the provisions of this Agreement, there shall be no restrictions on the freedom of establishment of nationals of an EC Member State or an EFTA State in the territory of any other of these States. This shall also apply to the setting up of agencies, branches or subsidiaries by nationals of any EC Member State or EFTA State established in the territory of any of these States.*
>
> *Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of Article 34, second paragraph, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of Chapter 4. […]"*

Article 34 of the EEA Agreement extends the right of establishment to companies and provides that:

> *"Companies or firms formed in accordance with the law of an EC Member State or an EFTA State and having their registered office, central administration or principal place of business within the territory of the Contracting Parties shall, for*

[3] The translation of ITA used here may be found at:
https://eng.fjarmalaraduneyti.is/media/Act_no_90_2003_01022012.pdf

the purposes of this Chapter, be treated in the same way as natural persons who are nationals of EC Member States or EFTA States. […]"

5 The Authority's assessment

5.1 Introduction

It should be recalled that Article 31 EEA requires the abolition of restrictions on the freedom of establishment and that Article 34 EEA extends that freedom to companies. That freedom entails, for companies formed in accordance with the laws of an EEA State and having their registered office, central administration or principal place of business within the EEA, the right to pursue their activities in other EEA States through a subsidiary, a branch or an agency.[4] The freedom of establishment thus entails the right of companies having their seat in an EEA State to open a branch in another Member State in order to pursue their activities under the same conditions as those which apply to subsidiaries, and that freedom to choose the appropriate legal form must not be limited by discriminatory tax provisions.[5]

Moreover, it is clear from the CJEU's case-law that, although the provisions concerning freedom of establishment are intended to ensure 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 home Member State from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation.[6]

In the present case it follows from Article 55, paragraph 1, ITA, read in conjunction with Article 2, paragraph 1, point 1, and Article 3, paragraph 1, point 4, ITA, that only companies with unlimited tax liability in Iceland can obtain permission to be jointly taxed. Joint taxation is thus limited to situations where all the companies in question have their legal residence in Iceland and companies resident in Iceland will therefore not be granted permission to be jointly taxed with Icelandic permanent establishments of non-resident companies. This interpretation also seems to have been affirmed by the Icelandic Board of Internal Revenue in its ruling No 53/2009, where it is stipulated that Article 55, paragraph 1, ITA does not allow for joint taxation of non-resident public limited companies, which have limited tax liability in Iceland.[7]

It furthermore follows from Article 55, paragraph 1, ITA that joint taxation is granted on condition that no less than 90% shareholding in subsidiaries is held by the parent company wishing to be jointly taxed, or other subsidiaries included in the joint taxation. This means that the joint taxation regime effectively excludes joint taxation of an Icelandic parent company and its subsidiaries, resident in Iceland, in situations in which those subsidiaries are directly owned by a foreign company that does not (and cannot) participate in the joint taxation, even where the former are indirectly owned by the Icelandic parent company.

5.2 Existence of a restriction of Article 31 EEA

It is a well-established principle that, although direct taxation falls within the EEA States' competence, they must, nonetheless, exercise that competence consistently with EEA

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[4] See Case C-157/07 *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt* EU:C:2008:588, paragraph 28, and Case C-337/08 *X Holding* EU:C:2010:89, paragraph 17.
[5] Case C-18/11 *Philips Electronics UK* EU:C:2012:532, paragraphs 13 and 14.
[6] See e.g. Case C-446/03, *Marks & Spencer* EU:C:2005:763, paragraph 31.
[7] Ruling No 53/2009, p. 18.

law.[8] Discrimination in the field of taxation consists of treating, for tax purposes, comparable situations differently or different situations in a similar way. According to settled case-law, for a difference in treatment between purely domestic and cross-border situations to be regarded as compatible with the fundamental freedoms, it must either concern situations which are not objectively comparable or those which may be justified by overriding reasons in the general interest.[9]

5.2.1 The exclusion of branches of non-resident companies from joint taxation

The Authority recalls that the freedom of establishment entails the right of companies having their seat in an EEA State to open a branch in another EEA State in order to pursue their activities, under the same conditions as those which apply to subsidiaries.[10] In *Philips Electronics*,[11] the CJEU more specifically stipulated that national legislation which makes it less attractive for companies having their seat in other Member States to exercise the right to freedom of establishment through a branch, restricts the freedom to choose the appropriate legal form in which to pursue activities in another Member State.[12]

In *Philips Electronics*, the CJEU furthermore stated:

> *"The situation of a non-resident company with only a permanent establishment in the national territory and that of a resident company are, having regard to the objective of a tax regime such as that at issue in the main proceedings, objectively comparable in so far as concerns the possibility of transferring by means of group relief losses sustained in the United Kingdom to another company in that group."*[13]

In the present case, the Icelandic legislation makes it less attractive for companies having their seat in other EEA States to exercise the right to freedom of establishment through a branch than through a subsidiary, as subsidiaries resident in Iceland can benefit from the joint taxation regime, while branches of non-resident companies cannot. The Icelandic legislation moreover entails a difference in treatment between purely domestic and cross-border situations, as cross-border situations, i.e. branches of non-resident companies, are treated less favourably than purely domestic situations, i.e. two companies resident in Iceland. With reference to the above mentioned, this amounts to a restriction on the freedom of establishment.

Furthermore, the situation of a non-resident company with only a permanent establishment in Iceland and that of a resident company in Iceland are, having regard to the objective of a tax regime on joint taxation and relief from losses, objectively comparable, as concluded by the CJEU in *Philips Electronics*,[14] where the tax regime in question was essentially similar to the one at issue in the present case.

The condition of the Icelandic legislation that only companies with unlimited tax liability in Iceland can obtain permission to be jointly taxed, which effectively excludes branches

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[8] See e.g. Cases E-6/98 *Norway v EFTA Surveillance Authority* [1999] EFTA Ct. Rep. 74, paragraph 34; E-1/01 *Hörður Einarsson* [2002] EFTA Ct. Rep. 1, paragraph 17; and E-1/03 *EFTA Surveillance Authority v Iceland* [2003] EFTA Ct. Rep. 143, paragraph 26.

[9] See e.g. Cases C-279/93 *Schumacker* EU:C:1995:31, paragraph 30; C-80/94 *Wielockx* EU:C:1995:271, paragraph 17; C-107/94 *Asscher* EU:C:1996:251, paragraph 40; C-311/97 *Royal Bank of Scotland* EU:C:1999:216, paragraph 26 and C-386/04 *Centro di Musicologia Walter Stauffer* EU:C:2006:568, paragraph 32.

[10] Case C-18/11 *Philips Electronics UK*, cited above, paragraph 14.

[11] Case C-18/11 *Philips Electronics UK*, cited above.

[12] Ibid, paragraph 16.

[13] Ibid, paragraph 19.

[14] Ibid.

of non-resident companies from joint taxation, therefore constitutes a restriction on the freedom of establishment as protected by Article 31 of the EEA Agreement.

5.2.2 The condition of 90% shareholding in subsidiaries by the parent company wishing to be jointly taxed, or other subsidiaries included in the joint taxation

As noted above, Article 55, paragraph 1, ITA requires that no less than 90% shareholding in subsidiaries are held by the parent company wishing to be jointly taxed, or other subsidiaries included in the joint taxation. The preparatory works to Article 55, paragraph 1, ITA state:

> *"The main object of joint taxation is that a parent company and a subsidiary 90-100% owned by the parent company are jointly taxed. Furthermore, it is assumed that joint taxation can also apply to situations where a parent company owns 90-100% share in a subsidiary and then they jointly own 90-100% shares in a third company. The same applies to e.g. four companies where the parent company owns all shares in a subsidiary and the subsidiary own shares in its own subsidiary, and then the parent company and the subsidiary jointly own shares in the fourth company."*[15]

It follows from this that Article 55, paragraph 1, ITA assumes that joint taxation takes place between a parent company and one or more of its direct or indirect subsidiaries. What is relevant is the ownership of the companies actually participating in the joint taxation. In this context, it must be borne in mind that under the Icelandic legislation, joint taxation is excluded for foreign companies and permanent establishments of non-resident companies.

In relation to this requirement of 90% shareholding by the parent company wishing to be jointly taxed, or other subsidiaries included in the joint taxation, the Authority refers to CJEU cases such as *Société Papillon*,[16] *Felixstowe Docks*[17] and *SCA Group Holding BV et al.*[18]

In *Société Papillon*, the CJEU dealt with the situation where the French tax integration regime allowed French companies to file a consolidated tax return with their at least 95% owned direct or indirect subsidiaries.[19] This tax integration regime entailed that a parent company which had its registered office in France and which held its French sub-subsidiaries through a subsidiary established in another Member State could not benefit from the tax integration regime, while a French parent company was able to achieve tax integration with its French sub-subsidiaries where the intermediate subsidiary was established in France.[20] This followed from the fact that the parent company could, if it was to benefit from the tax integration regime, have an indirect holding in another group

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[15] Unofficial translation of the Authority. The original text reads as follows: *["Megininntak samsköttunar er að móðurfélag og dótturfélag í 90-100% eigu móðurfélagsins skattleggjast saman. Jafnframt er gert ráð fyrir að samsköttunin nái einnig til þeirra tilvika þegar móðurfélag á 90-100% hlut í dótturfélagi og þau eiga svo sameiginlega 90-100% hlutabréfa í þriðja félaginu. Sama gildir um t.d. fjögur félög þar sem móðurfélagið á hlutabréfin í dótturfélagi og dótturfélagið á hlutabréfin í eigin dótturfélagi, og móður- og dótturfélagið eiga svo saman bréf í fjórða félaginu."]*
[16] Case C-418/07, *Société Papillon*, EU:C:2008:659.
[17] Case C-80/12, *Felixstowe Dock and Railway Company Ltd and others*, EU:C:2014:200.
[18] Joined Cases C-39-41/13, *Inspecteur can de Belastingdienst/Noord/kantoor Groningen v SCA Group Holding BV* (C-39/13), *X AG and others v Inspecteur van de Belastingdienst Amsterdam* (C-40/13) *and Inspecteur van de Belastingdienst Holland-Noord/kantoor Zaandam v MSA International Holding BV and MSA Nederland BV* (C-41/13), EU:C:2014:1758.
[19] Case C-418/07, *Société Papillon*, cited above, paragraph 7.
[20] Ibid, paragraph 21.

company only if this was done through a company which was itself a member of the integrated group and was therefore liable to corporation tax in France.[21]

The CJEU found the French provisions at issue to create a difference in treatment since the ability to opt for the tax integration regime was dependent on whether the parent company held its indirect shares through a subsidiary established in France or in another Member State.[22] The CJEU concluded that those situations were objectively comparable and thus the tax regime at issue constituted a restriction on the freedom of establishment.[23]

In *Felixstowe Docks* and *SCA Group Holding BV et al,* similar situations were at issue, i.e. a difference in treatment was created for, on the one hand, resident parent companies holding resident sub-subsidiaries through resident intermediate subsidiaries and, on the other hand, resident parent companies holding resident sub-subsidiaries through non-resident subsidiaries.[24]

In the present case, the situation is in essence similar to the one in the above mentioned cases. By requiring that no less than 90% of the shares in subsidiaries are held by the parent company wishing to be jointly taxed, or other subsidiaries included in the joint taxation, Article 55, paragraph 1, ITA effectively excludes joint taxation of an Icelandic parent company and its subsidiaries, resident in Iceland, if the subsidiaries are directly owned by a foreign company, even though they are indirectly owned by the Icelandic parent company. This follows from the fact that the foreign company would not be eligible to participate in the joint taxation. A difference in treatment is therefore created between purely domestic and cross-border situations since the ability to elect for the joint taxation regime is dependent on whether the parent company holds its indirect shares through a subsidiary established in Iceland or in another Member State.

With reference to the above mentioned cases, the Icelandic legislation thus constitutes a restriction on the freedom of establishment. Furthermore, such situations are objectively comparable, on the same grounds as in *Société Papillon,* as the objectives of the French tax integration regime and the Icelandic joint taxation scheme are essentially similar.

The Authority is therefore of the opinion that the condition of no less than 90% shareholding in subsidiaries by the parent company wishing to be jointly taxed, or other subsidiaries included in the joint taxation, amounts to a restriction on the freedom of establishment.

5.3 Possible Justifications

According to established case-law, national measures restricting the fundamental freedoms may be justified by overriding reasons in the public interest, provided that they are capable of attaining the objective which they pursue and do not go beyond what is necessary in order to attain it.[25]

The Icelandic Government has not put forward any possible justifications for its restrictions and has essentially acknowledged that the legislation at issue is not compatible with the EEA Agreements and needs to be amended.

It should however be noted that in all the above mentioned cases the CJEU found the legislation at issue to be either unjustified or disproportionate.

[21] Ibid, paragraphs 4 and 20.
[22] Ibid, paragraph 22.
[23] Ibid, paragraphs 26-32.
[24] Case C-80/12, *Felixstowe Dock and Railway Company Ltd and others*, cited above, paragraph 20; Joined Cases C-39-41/13, cited above, paragraph 23.
[25] See, inter alia, Case E-8/16 Netfonds Holding and Others, not yet reported, paragraph 112 and Case E-15/16 Yara International ASA, not yet reported, paragraph 37.

In *Philips Electronics*, the CJEU concluded that the legislation at issue could not be justified by overriding reasons in the public interest relating to the objective of preventing the double use of losses, the objective of preserving a balanced allocation of the power to impose taxes between Member States, or a combination of those grounds.[26]

In *Société Papillon*, the CJEU concluded that the restriction in the case could not be justified by the allocation of the power to impose taxes between Member States. The Court did find that the restriction could, in principle, be justified by the need to ensure the coherence of the tax system, but that it was disproportionate, i.e. went beyond what was necessary in order to attain that objective.

Similarly, in *Felixstowe Docks* and *SCA Group Holding BV et al*, the CJEU found that the restrictions on the freedom of establishment at issue could not be justified by an overriding reason in the public interest relating to the coherence of the tax system, the objective of preserving a balanced allocation of powers of taxation between the Member States or to combating purely artificial arrangements.[27]

Since the situations dealt with in the above mentioned cases are essentially similar to the one at issue in the present case and since the Icelandic Government has not put forward any possible justification grounds, the Authority must conclude that the Icelandic legislation is not justified by overriding reasons in the public interest.

6 Conclusion

Accordingly, as its information presently stands, the Authority must conclude that, by maintaining in force a provision such as Article 55, paragraph 1, ITA, which (1) effectively excludes branches of non-resident companies from joint taxation and (2) excludes joint taxation of an Icelandic parent company and its subsidiaries, resident in Iceland, in situations in which those subsidiaries are directly owned by a foreign company, even when they are indirectly owned by the Icelandic parent company, Iceland has failed to fulfil its obligation arising from Article 31 EEA.

In these circumstances, and acting under Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice, the Authority requests that the Icelandic Government submits its observations on the content of this letter *within two months* of its receipt.

After the time limit has expired, the Authority will consider, in the light of any observations received from the Icelandic Government, whether to deliver a reasoned opinion in accordance with Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice.

For the EFTA Surveillance Authority,

Bente Angell-Hansen President	Frank J. Büchel Responsible College Member	Högni Kristjánsson College Member

Carsten Zatschler
Countersigning as Director,
Legal and Executive Affairs

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[26] Case C-18/11 *Philips Electronics UK*, cited above, paragraph 35.
[27] Case C-80/12, *Felixstowe Dock and Railway Company Ltd and others*, cited above, paragraph 35; Joined Cases C-39-41/13, cited above, paragraphs 41 and 53.

This document has been electronically authenticated by Bente Angell-Hansen, Carsten Zatschler.