18 Cross-border Loss Relief[1]

Update by Ana Paula Dourado[2]

18.1 Introduction; the Issues; Overview; Distinction between Individuals and Companies

Profits and losses made by different branches of an undertaking within one single tax jurisdiction are aggregated automatically, and in most Member States group taxation schemes apply in order to provide for the same offsetting of profits and losses between companies belonging to the same group of companies within the same jurisdiction, both horizontally (between subsidiaries) and vertically (between the parent company and its subsidiary). These schemes (*e.g. intégration fiscale*; group relief; *Organschaft*; *fiscale eenheid*, etc.) provide for some form of fiscal consolidation, loss carry-over mechanism, or profit carry-over mechanism. Similarly, within one

1. *See*, inter alia, Alex Cordewener, Mattias Dahlberg, Pasquale Pistone, Ekkehart Reimer & Carlo Romano, *The Tax Treatment of Foreign Losses: Ritter, M&S, and the Way Ahead*, 44 Eur. Taxn. 135 (Part 1) and 218 (Part 2) (2004); Michael Lang, *The Open Issues Following the ECJ's Final Word*, 46 Eur. Taxn. 54 (2006); Tigran Mkrtchyan, *In Search of Ariadne's Thread: Permanent Establishments and Losses in the European Union*, 63 Bull. Intl. Taxn. 586 (2009); Violeta Ruiz Almendral, *An Ever Distant Union: The Cross-Border Loss Relief Conundrum in EU Law*, 38 Intertax 476 (2010); Reinout Kok, *Domestic and Cross-Border Loss Relief in the European Union*,' 38 Intertax 663 (2010); Maarten de Wilde, *On X Holding and the ECJ's Ambiguous Approach Towards the Proportionality Test*, 19 EC Tax Rev. 170 (2010); Otto Marres, *The Principle of Territoriality and Cross-Border Loss Compensation*, 39 Intertax 112 (2011); Bruno Da Silva, *From Marks & Spencer to X Holding, The Future of Cross-Border Group Taxation*, 39 Intertax 257 (2011); Axel Cordewener, *Cross-Border Loss Relief and the 'Effet Utile' of EU Law: Are We Losing It?*, 20 EC Tax Rev. 58 (2011); Michael Lang, *Has the Case Law of the ECJ on Final Losses Reached the End of the Line?*, 54 Eur. Taxn. 530 (2014); Robert Neyt & Steven Peeters, *Balanced Allocation and Coherence: Some Thoughts in Light of* Argenta *and* K, 23 EC Tax Rev. 64 (2014); Marie-Aline Peetersmans & Mélanie Staes, K v. Finland: EU Developments in the Area of Foreign Loss Deduction Rules, 23 EC Tax Rev. 56 (2014); Yariv Brauner, Ana Paula Dourado & Edoardo Traversa, *Ten Years of Marks & Spencer*, 43 Intertax 306 (2015); Thomas Rønfeldt, *Use of Foreign Losses: The Advocate General Wants to Turn on the Marks Exemption, but the ECJ Rejects the Argument and States that EU Law Constitutes Rights to Deduct Foreign Losses*, 43 Intertax 688 (2015); Erik Pinetz & Karoline Spies, *'Final Losses' after the Decision in Commission v. UK ('Marks & Spencer II')*, 24 EC Tax Rev. 309 (2015); Luca Cerioni, *The Never-Ending Issue of Cross-Border Loss Compensation within the EU: Reconciling Balanced Allocation of Taxing Rights and Cross-Border Ability-to-Pay*, 24 EC Tax Rev. 268 (2015).
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jurisdiction, an individual deriving income from two different sources, one plus (employment), one minus (negative income from debt-financing a personal dwelling), can aggregate the plus and the minus and pay tax only on the balance.

By contrast, if there is a border between the headquarters of a company and its branches, or between the parent company and its subsidiary (or between sister companies, etc.), the taking into account of foreign branch or subsidiary losses is either restricted, impossible or only temporary. Rightly so, in principle, because these losses may be offset against future or previous profits in that foreign jurisdiction. Similarly, if there is a border between the employee's job and his home, he may find himself in a position where he cannot deduct the loss from a private dwelling from his wages in the other State (see section 18.10)). The result may be, for the employee, that he is semi-permanently paying tax on a higher income than he actually earns, and for a group of companies that the profit centers are paying tax in the Member States of establishment although the group on balance on a EU basis may have made an overall loss. The losses made in a particular Member State stay locked in that jurisdiction, awaiting better times for setting off. Obviously, this fragmentation of the loss relief market along national borders disadvantages cross-border investment as compared to investment in just one single tax jurisdiction. Particularly groups of companies headquartered in smaller Member States feel the drawbacks of this fragmentation. The larger a group's home market, the larger the chance that profits and losses will fall within the same tax jurisdiction and cancel each other out, avoiding current tax exposure on profits not made from an overall perspective.

In December 1990 the Commission tabled a proposal[3] for a Directive on cross-border offsetting of losses between group companies and between headquarters and branches. The Ruding Committee, the Commission and European industry had all been urging the Council to adopt the proposal, but to no avail. In particular, agreement within the Council was precluded by (i) the inclusion of not only foreign branch losses, but also foreign subsidiary losses, and (ii) the principle of mutual recognition of loss determination. In December 2001, the Commission withdrew its proposal as 'obsolete'.[4] The Commission published a tax policy document in November 2003[5] indicating that it was contemplating the Danish 'joint taxation' system of international group taxation. That system provided for an international group of companies with a Danish top-holding to be taxed as if the subsidiaries were branches, with Denmark taxing the consolidated results of the group, thus auto-

3. Proposal for a Council Directive concerning arrangements for the taking into account by enterprises of the losses of their permanent establishments and subsidiaries situated in other Member States, COM (90) 595 final of 6 December 1990, O.J. C 53 of 28 February 1991, p. 30.
4. Communication from the Commission: Withdrawal of Commission proposals which are no longer topical; COM (2001) 763 final/2 of 21 December 2001, O.J. No. C 5, p. 2, of 9 January 2002.
5. Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee: 'An Internal Market without company tax obstacles: achievements, ongoing initiatives and remaining challenges', 24 November 2003, COM (2003) 726 final.

matically 'importing' foreign subsidiary losses as if they were branch losses, but obviously recapturing the loss deduction in subsequent profitable years by excluding double tax relief for those subsequent profits until the previously imported subsidiary losses have been exhausted. The Commission expected to launch new initiatives in 2004, but nothing much happened until after the judgment in Case C-443/03, *Marks & Spencer II*,[6] to be discussed below.

It was hoped that the problem for individuals of a cross-border tax base division into a negative and a positive portion would be addressed in the *Ritter-Coulais*[7] case or the subsequent *Lakebrink case*,[8] but it was not, as eventually only *rate* progression issues (regarding only the positive part of the income) were addressed. The tax *base* division matter was tackled in the subsequent Case C-527/06, *Renneberg*,[9] already extensively discussed in section. The Court considered Mr *Renneberg* to be a *Schumacker*-like taxpayer (see section 18.10) earning his entire income in the employment State and therefore to be entitled to the same tax treatment as residents in respect of all elements concerning his ability to pay, such as, in this case, also the payment of mortgage interest financing foreign real estate. Therefore, nonresident individuals in a *Schumacker* position are ensured of cross-border loss relief also in the opposite direction: from the home State tax base to the job State tax base, provided the latter applies exemption with progression for its residents. We observe at the outset that nonresidents are *always*, by definition, in a *Schumacker*-position in case of home State losses, as the Court ignores negative income when applying its *Schumacker* test (see section 18.10).

The loss market fragmentation problem for international groups of companies was to a minor extend solved in Case C-446/03 *Marks & Spencer II*.[10] That case required the parent company State to provide relief (only) for *definitive* foreign subsidiary losses, i.e. losses for which no possibilities remain to be offset in the correct (source) jurisdiction, i.e. the subsidiary State (see section 18.5 below).

In December 2006, following up on that judgment, which did not bring the hoped-for solution for the main problem (current losses), the European Commission published a Communication[11] on 'Tax Treatment of Losses in Cross-border Situations' (see section 18.3 below), which addresses the group problems described (but not the individual's problem of employment income in one State and negative income from a personal dwelling in the other State). There was little response. The Commission later concentrated on the common consolidated tax base, by putting forward one proposal of Directive on a common consolidated corporate tax base

6. Case C-446/03, *Marks & Spencer II*, EU:C:2005:763.
7. Case C-152/03, *Ritter- Coulais, EU:C:2006:123.*
8. Case C-182/06, *Lakebrink-Peters, EU:C:2007:452.*
9. Case C-527/06, *Renneberg*, EU:C:2008:566.
10. Case C-446/03, *Marks & Spencer II*, EU:C:2005:763.
11. Communication from the Commission to the Council, the EP and the EcoSoC of 19 December 2006, COM(2006) 824 final.

(CCCTB) in 2011(COM (2011) 121) that did not move forward. The Commission has decided to re-launch the CCCTB project in a two-step approach, with the publication on 25 October 2016 of two new interconnected proposals: on a common corporate tax base (CCTB), and on a common consolidated corporate tax base (CCCTB). The 2011 CCCTB proposal was withdrawn on the same day. Both the 2011 and the 2016 CC(C)TB proposals absorb(ed) cross-border loss relief for companies (see Chapter 11).

In the meantime, the Court handed down several judgments on cross-border loss relief in respect of branches and subsidiaries, all of which resulted in the impossibility or very limited possibility of cross-border loss relief. Exceptions were *Papillon* and *Philips Electronics* (section 18.9.) where the taxpayers wanted to transfer losses incurred in the territory to a company within the same territory, but one of the subsidiaries (*Papillon*) or the head office (*Phillips Electronics*) was abroad.

Thus, the upshot is very modest until now: only definitive (liquidation) losses of foreign subsidiaries must be carried over to the parent company State, provided that the subsidiary State allows deductibility of domestic losses and the latter State also allows deduction of liquidation losses of domestic subsidiaries from the parent company's tax base. The same rule applies in respect of definitive losses of foreign branches (losses remaining after the closing down or the transfer of the non-resident branch), as long as the head office state applies a tax exemption system and not a base exemption system for the permanent establishment income (see *Timac Agro*[12]).

18.2 Technical Background

In general, a loss-making foreign PE or subsidiary may offset the loss against its own profits of the previous (usually three) years and against future profits (limited or unlimited in time). Therefore, at first glance, there is no reason to provide for the possibility of carrying over the loss across the border to the headquarters or to the parent company, respectively. However, if no profits from previous years are available, while at the same time the remainder of the undertaking or of the group made a profit, the undertaking or the group as a whole will pay more tax than is justified by the overall balance of profits and losses. Although in later years enough profit may be made to offset the loss in the source State, in the meantime the tax must be paid and a cash-flow and interest loss is suffered as compared to the same facts within one single taxing jurisdiction.

Most States apply worldwide taxation to their residents, including in the tax base all positive and negative results, as well as those of foreign branches, with subsequent

12. Case C-388/14 (*Timac Agro Deutschland GmbH*), EU:C:2015:829. We note however that in the pending case C-650/16, *A/S Bevola*, the advocate-general seems to argue that definitive losses of foreign branches should also be taken into account in the head office state where that Member State has a territorial system, but as long as there is a legal option equating resident and non-resident Pes. See Section 18.12 below.

relief to prevent double taxation of positive results (see sections 3.2.7.3 and 14.1.1). As a branch is not a separate legal entity, but a part of the undertaking of the head office, most Member States consider foreign branch results to be an integral part of the total result of the undertaking (but the *Lidl Belgium* case shows there are also Member States that ignore foreign branch results altogether: *base* exemption). Foreign branch losses are thus automatically imported, like foreign branch profits. This is not the case in respect of foreign subsidiaries. These are separate legal entities, resident for tax purposes in the country of their location. They are not subject to tax in the State of the parent company if they do not carry on any business there; they are entirely outside the taxing jurisdiction of that State (disregarding CFC legislation). Their taxable base is not in any way part of the taxable base of their parent companies, although the subsidiary's results may be reflected in the parent's results through the valuation of the parent's holding in the subsidiary on the parent's balance sheet. Thus, there is no automatic cross-border carry-over of losses (or profits) of a subsidiary to its parent company abroad or vice versa. Even if Member States provide, internally, for group relief schemes, they do not generally do so in respect of non-subjected group companies, except, as observed, Denmark.

For the prevention of international double taxation of business income either the direct credit method or the exemption method is used (CEN and CIN; see sections 16.2.2 and 16.2.3). The first system credits the foreign tax paid by the foreign branch (or by the subsidiary, if it distributes its profits to the home State of the parent: indirect credit) against the home State tax on the foreign source income. The exemption method, as applied to the results of the foreign branches, exists in two sub-methods: *tax* exemption and *base* exemption. The latter method (also called territorial taxation) involves elimination of the result of the foreign branch from the taxable base of the undertaking altogether. The *Lidl Belgium* case[13] (to be discussed below), and the *Stahlwerk* case[14] show that this method has been applied by Germany under some of its tax treaties.[15] Under such a territoriality system, both non-domestic losses and non-domestic profits are ignored, as regards both non-resident and resident taxpayers.[16] This method is often applied for foreign subsidiary dividends, which can only be positive: participation exemption or affiliation privilege (applied by,for example, Austria and the United Kingdom only for domestic group dividends (indirect credit for foreign group dividends; see the *FII GLO* and *Haribo and Salinen* cases); applied by, for example, the Netherlands for both domestic and

13. Case C-414/06, *Lidl Belgium*, EU:C:2008:278.
14. Case C-415/06, *Stahlwerk Ergste Westig*, EU:C:2007:651.
15. Cf. Case C-388/14, *Timac Agro Deutschland GmbH*, EU:C:2015:829, where tax exemption gave place to base exemption.
16. According to Marres ('The Principle of Territoriality and Cross-Border Loss Compensation,' 39 *Intertax* 2 (2011), p. 112-125), the Court uses the term 'territoriality' with a different meaning, *i.e.* as meaning full jurisdiction as regards residents and territorial jurisdiction as regards nonresidents, which in tax terms leads to worldwide jurisdiction in respect of residents and source jurisdiction as regards nonresidents.

foreign group dividends; see the *Bosal* case). For branch results, Austria and Luxembourg used to adhere, like Germany, to an 'exclusionary' interpretation of the tax treaty provision on prevention of double taxation of business profits, but their courts later interpreted the tax treaty exemption mechanism so, as to allow branch results into their tax bases (with relief for double taxation of branch profits, and recapture of branch losses deducted).

Such a system (*tax* exemption) is the usual system for branch profits and losses, as it takes away the timing and cash-flow disadvantage caused by the *base* exemption (territoriality) method. It entails taxing the company's worldwide income with subsequent deduction of the portion of the home State total tax on worldwide income which is attributable to the foreign portion of the total result. It also entails automatic deduction of foreign branch losses, and reinstatement of such loss deduction in subsequent profitable branch years. The functioning of this system, especially the reinstatement of branch losses previously deducted was at issue in the *Krankenheim Ruhesitz*[17] and *Timac Agro* cases.[18] The difference of principle between tax exemption and the credit method is that under the credit method the *foreign* tax attributable to the foreign income is deducted from the total tax due on the worldwide income, whereas under the tax exemption method the *home State* tax attributable to the foreign income is deducted (see sections 16.2.2 and 16.2.3).

Where a foreign branch loss has been taken into account by a home State applying worldwide taxation and tax exemption to eliminate double taxation, no relief for double taxation will be provided for subsequent branch profits until the loss previously deducted has been recaptured. Rightly so, as the branch loss will be set off in the branch State against these subsequent branch profits. This mechanism ensures that the import of foreign losses by the home State is only temporary, i.e. only as long as is necessary to enable the branch to offset its losses against its own profits. The amount of the loss deducted previously is reinstated in the home State tax base. In order to ensure that the deduction of foreign-source losses is only temporary, many States require the head office to reinstate previously deducted foreign branch losses in any case after a certain number of years, irrespective of whether sufficient branch profits were subsequently generated, as the home State cannot be required to grant relief indefinitely for losses from foreign sources form which it does not tax the positive results either (indeed, these are exempted).

Under a *credit* system, this reinstatement in the home State tax base of the amount of previously deducted foreign branch losses occurs automatically, as a credit home State will not grant any credit relief in respect of subsequent foreign profits if no foreign tax has been paid on them; no such foreign tax will be paid on the subsequent branch profits as long as the branch can offset its previous losses in the branch State against these subsequent profits.

17. Case C-157/07, *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt*, EU:C:2008:588.
18. Case C-388/14, *Timac Agro Deutschland GmbH*, EU:C:2015:829.

Under a *base* exemption method (territorial taxation), evidently no recapture is needed, as the foreign loss is never included in the taxable base in the home State.

18.3 The Commission Proposal Withdrawn in 2001

The Commission proposal (see section 18.1) was, in substance, at least as regards subsidiaries, the exact opposite of the result reached by the Court in the *Marks & Spencer II* case, and, as regards the base exemption method, the opposite of the result of the *Lidl Belgium* case. The Commission proposed to carry over current subsidiary and branch losses to the group's home State, but to re-export them (to undo their deduction in the home State: 'reinstatement' of the loss amount in the tax base of the home State) where they would become definitive (would be exhausted in the source State), whereas the Court, in *Marks & Spencer II*, on the basis of the right of establishment, conversely did *not* require the carry-over of *current* foreign losses for which relief is still possible in future years in the source State, but *did* require the carry-over of *definitive* foreign subsidiary losses (losses for which no possibilities remain for set off in the subsidiary State).

In respect of cross-border relief for foreign *branch* losses, the proposal recognized both the credit method (CEN) and the deduction and subsequent reincorporation method (CIN; tax exemption and recapture). Base exemption (territoriality) was thus *not* envisaged, probably because that system, although neutral, fragmentizes the tax base permanently along national borders and therefore moves away from the ideal of one loss relief market. The Court, by contrast, in *Lidl Belgium*, accepted the German base exemption method, which excluded both losses and profits from foreign business operations from the tax base also for resident companies.

As observed, in respect of losses of foreign branches, the current practice is generally the same as the Commission proposed (deduction and reinstatement method). However, as regards subsidiaries, currently, on the basis of the *Marks & Spencer II* case, only definitive losses may be carried over cross-border to the parent company. It is in respect of cross-border carry-over of subsidiary losses that a Directive would have had by far the largest impact.[19]

(i) Foreign Branch Losses

In the Commission proposal, the home State of the enterprise was required to choose between the credit method or the deduction and reincorporation method. Apparently, the credit method had to be applied on a *per country* basis, *i.e.* if the enterprise has several foreign branches, the results of those branches must be aggregated per Member State, but the balances per Member State were not in turn aggregated into a grand balance of total foreign branch income. The amount of the loss of a foreign branch was

19. We note that this temporary cross-border carry-over of subsidiary losses is an element of the aforementioned proposal on a common corporate tax base (CCTB; see Chapter 12).

to be determined on the basis of the tax rules of the *home* State of the undertaking. Under the second method (tax exemption, CIN), however, profits and losses of the foreign branch had to be determined in accordance with the laws of the Member State in which it was situated. This implies that the home State of the enterprise was required to simply accept branch losses and profits as they were calculated by the *source* State (mutual recognition). The authors surmise that this rule did not contribute to the enthusiasm of the Member States. In its 2003 policy document,[20] the Commission indicated that it considered new proposals in which the loss would be determined according to the tax rules of the head office/parent company State, or along the lines of the Danish joint taxation system (cross-border group relief with recapture).

If a Member State were to choose the credit method, that method would be mandatory for its undertakings. If a Member State were to choose the deduction and reincorporation method, however, each of its enterprises could decide for itself whether or not to apply it. An enterprise could choose to waive the benefit.

(ii) Foreign Subsidiary Losses

In respect of losses of foreign subsidiaries, on the other hand, one single method was proposed: deduction and reincorporation. Losses of a foreign subsidiary were deducted from the taxable profit of its parent company, followed by the incorporation of subsequent profits of the subsidiary into the taxable base of its parent until the losses previously deducted would have been recaptured. The loss and subsequent profits were to be determined in accordance with the tax rules of the subsidiary State. Consequently, the State of the parent company was required to accept the subsidiary's losses and profits as determined by the subsidiary State (mutual recognition). As observed, this may not have added to the resolve of Member States to adopt the proposal. As also observed, in its 2003 policy document,[21] the Commission indicated that it considered new proposals in which the loss would be determined under the tax rules of the head office/parent company State. The deductible loss and the subsequent profits to be reincorporated were to be determined in proportion to the parent's holding in the subsidiary, which in general should be at least 75% for the system to apply. If the holding percentage had not been constant during the taxable year, the lowest level occurring was to be applied. In order to prevent double deduction of losses of foreign subsidiaries (so-called 'double dips'), the withdrawn proposal provided that the deduction and reincorporation method was incompatible with corrections of the value of the holding in the subsidiary on the balance sheet of the parent company in relation to losses incurred by the subsidiary.

20. Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee: 'An Internal Market without company tax obstacles: achievements, ongoing initiatives and remaining challenges', 24 November 2003, COM (2003) 726 final.
21. See the previous footnote.

Two other possible methods did not make it to the proposal, namely (i) the credit method and (ii) the method of writing off the book value of the holding. A credit method for the taking into account of losses of foreign subsidiaries would amount to a technically cumbersome and politically unattainable cross-border consolidation of profits and losses within EU groups of companies. The authors observe, however, that Denmark already has applied a cross-border group taxation system. The writing-off method would also pose too many technical difficulties, given the existing differences between the profit determination systems of Member States.[22] Nevertheless, the proposal left Member States at liberty to choose a method other than deduction/reinstatement for the taking into account of losses of foreign subsidiaries, including the cross-border consolidated profit method. Therefore, in respect of losses of foreign subsidiaries, the withdrawn proposal did not, in fact, seem to require any specific method.

The Commission probably did not pursue any new proposal on cross-border loss relief after *Marks & Spencer II* because it was working on a comprehensive project, the CCCTB (see Chapter 11), which, now has the form of two new interconnected proposals: on a common corporate tax base (CCTB), and on a common consolidated corporate tax base (CCCTB). The former provides for *temporary* cross-border carry-over of subsidiary losses and the latter for *permanent* cross-border carry-over of subsidiary losses. That latter if adopted, will do away with the limited possibilities and cumbersome mechanics of cross-border loss relief, at least for EU groups of companies applying such EU-wide consolidated tax base. See also Chapter 11.

18.4 Negative Integration; Pre-*Marks & Spencer II* Case Law

Four cases on loss relief were decided by the CJEU before *Marks & Spencer II*, but eventually, although featuring cross-border aspects, they all concerned loss relief within one single taxing jurisdiction. All four already showed that the Court does not accept limitations on the taking into account of (domestic) losses if that limitation is based on the fact that there is a cross-border aspect to the case and the limitation would not have occurred if no such cross-border aspect had been present.

The *AMID* case[23] involved a Belgian company with a Luxembourg branch. It made a loss in Belgium and a profit in Luxembourg in Year 1. The Luxembourg profit was included in the worldwide tax base to be taxed in Belgium. No tax was due, as on (worldwide) balance, there was a loss. In Year 2, AMID made a profit in Belgium against which it wanted to offset its Belgian loss of Year 1. Belgian law, however, required it to offset its Belgian Year 1 loss against its Luxembourg Year 1 profit (set-off *within* the same tax year before set-off in another tax year). The Belgian Year 2 loss could thus not be set off. The effect was that AMID lost its double

22. See Otmar Thömmes, 'The New EC Commission's Proposals for Directives on Cross-Border Investments,' *Intertax* 1991/3, p. 162.
23. Case C-141/99,*AMID v. Belgium*, EU:C:2000:696.

taxation relief for the Year 1 Luxembourg profit. Erasure of foreign-source income against a domestic loss obviously also erases any double tax relief for that (erased) foreign income. What was missing in the Belgian system, was a rule that would roll over the double-tax relief missed in Year 1 to subsequent years in which there would be tax exposure against which to offset it. The Belgian system rolled over to Year 2 neither the Belgian Year 1 loss (because it was considered to be erased by the Luxembourg profit) nor the double tax relief missed in Year 1. It was common ground that if AMID had not had a (profitable) branch in another Member State, but only domestic activities, there would have been no similar impediment. Therefore, the Belgian system handicapped Belgian undertakings with branches in other Member States. The Court therefore held the Belgian system to be incompatible with the freedom of establishment.

Although the case looks rather straightforward at first (Belgium refused to roll over a Belgian loss although it would have allowed rollover in the absence of a foreign branch), it is nevertheless puzzling, as Belgium was not required in the first place to provide any relief for double taxation of foreign-source income (as the Court later explicitly held in *Damseaux* and *Block*). The discrimination found no longer looks discriminatory any more if one frames its description slightly differently: Belgium does not provide relief for double taxation of foreign profits as long as these profits do not exceed the taxpayer's unused losses.

Futura[24] also concerned domestic loss relief frustrated by a cross-border aspect. It involved a French investment company and its Luxembourg branch. Luxembourg allowed the profit attributable to the Luxembourg branch to be determined on the basis of the *French* accounts of the worldwide income, which was divided between France and Luxembourg by way of a division formula, probably a fraction containing the Luxembourg client contributions as the numerator and the total client contributions as the denominator (profit-split method). However, if a loss carry-over from a previous fiscal year was requested (i.e. a loss carry-over *within* Luxembourg, from one branch year to a subsequent branch year), Luxembourg required separate accounting according to *Luxembourg* fiscal standards and on the basis of *Luxembourg* accounts, which moreover should have been kept *in Luxembourg* during the (previous) year in which the loss to be carried over had been made. The Court accepted that Member States may require adequate evidence that a loss to be offset against domestic profits is economically connected to their territory (to the domestic branch) and therefore accepted the Luxembourg rule that the branch loss to be offset had to be determined on the basis of *Luxembourg* fiscal accounting and allocation rules, even though the Luxembourg rules were inconsistent and asymmetric (*profit* allocation by way of profit-split on the basis of the *foreign* head office accounts, but *loss* allocation on the basis of separate and *Luxembourg* accounting, disregarding the foreign head office accounts). However, the Court did not accept the rule that such

24. Case C-250/95, *Futura Participations SA et Singer v. Administration des contributions*, EU:C:1997:239.

loss carry-over could be accepted only if it was determined on the basis of Luxembourg accounts which were kept in Luxembourg in the year in which the loss was suffered. The latter requirement would make loss relief virtually impossible, given that the taxpayer was faced with it only in a year in which he would not be able to satisfy it ever any more: indeed, it is impossible to start keeping books with retroactive effect for previous years. Luxembourg was therefore required to allow any reliable form of evidence, for instance evidence on the basis of the French accounts, adapted for Luxembourg fiscal purposes.

The third case is *ICI v. Colmer*[25] which concerned a UK tax measure (consortium relief) allowing *pro rata parte* loss carry-over from joint venture subsidiaries to the parent companies of the joint venture. Imperial Chemical Industries (ICI) held 49% in a joint Holding company (CAHH), which in turn held 23 subsidiaries, one of which (Coopers Animal Health Ltd.) had suffered a UK loss. ICI wanted to deduct 49% of that UK loss from its UK taxable profits, but this was denied because the majority of CAHH's subsidiaries (19 out of 23) were not resident in the United Kingdom, as UK tax law required. Obviously, the Court held this measure to be incompatible with the freedom of establishment, as it discriminated against companies holding EU subsidiaries as compared to companies holding UK subsidiaries.

The last case, *Mertens*,[26] concerns an individual taxpayer who was both employed in Germany and self-employed in Belgium, where he lived. He wanted to offset his loss made in Belgium in Year 1 against his profit made in Belgium in Year 2. However, as in the *AMID* case, Belgian law set off the Belgian Year 1 loss against the German Year 1 positive employment income, therefore refusing deduction from Belgian income in Year 2 (set-off *within* the same tax year before set-off in another tax year). As in the *AMID* case, this effectively (partly) robbed Mr Mertens of his double tax relief in respect of his German-source employment income. It was common ground that if Mr Mertens had been employed in Belgium instead of in another Member State, no such disadvantageous compartmentalization of income would have occurred. Referring to the *AMID* case, the CJEU considered the Belgian measure to be incompatible with the free movement of workers. Again, one may wonder whether this judgment is, in light of the later *Damseaux* and *Block* cases, very logical: Belgium, choosing to assume taxing jurisdiction over worldwide income of its residents, is not required to prevent double taxation on foreign-source income at all. Obviously, in a purely domestic situation (Belgian employment income), the question of whether international double taxation will be relieved does not pose itself.

25. Case C-264/96, *ICI v. Colmer*, EU:C:1998:370.
26. Court Order C-431/01, *Mertens v. Belgium*, EU:C:2002:492.

18.5 Nonresident Group Companies; *Marks & Spencer II*[27] and Oy AA: Relief (only) for Definitive Losses; No Profit Carry-Over

Marks & Spencer II[28] concerned losses incurred by the French, German and Belgian subsidiaries of the UK-based Marks & Spencer group. Marks & Spencer argued that the United Kingdom should allow deduction of the foreign subsidiary losses by the UK parent, as the United Kingdom also allowed deduction of (i) losses of foreign branches and (ii) losses of UK resident subsidiaries (group relief; limited to group companies subject to UK tax). The outcome of the proceedings seemed to announce that Marks & Spencer won their case, but that the tax administration did not lose it. The Court did not delve into comparison (i), but it found a discrimination under the right of establishment on the basis of comparison (ii), as parent companies holding nonresident subsidiaries were treated less favourably than parent companies holding resident subsidiaries. In contrast to the *Bosal* Case[29] (see section 6.4.7), in which the Court required mechanical equal treatment of parents of subject-to-tax subsidiaries and parents of non-subject subsidiaries irrespective of the resulting unreasonable and incoherent jurisdictional mismatch between profit taxation and loss deduction, the Court in *Marks & Spencer II* accepted that in principle, there was a justification for preventing such a mismatch. There were, in fact, three justifications, which 'taken together' warranted not to deduct nonresident subsidiary losses: (i) the need for 'preservation of the allocation of the power to impose taxes between the member States' ('two sides of the same coin'), (ii) the risk of tax avoidance, and (iii) the danger that losses would be deducted twice (double dip). Losses belong in the jurisdiction where the corresponding profits (the other side of the same coin) are subject to tax, which is the subsidiary State. However, this justification holds only as long as the foreign losses are not definitive. As soon as they are definitive – as soon as there are no possibilities left in the subsidiary State to use them there – the justification(s) for refusing national treatment expire(s): definitive non-resident subsidiary losses could be carried over to a (profitable) UK resident group company on the same footing as a resident subsidiary loss would be carried over to such UK group company. According to the Court, it would be 'disproportionate' to deny deduction of foreign losses in cases in which deduction in the subsidiary State has become impossible.

The Member States thus appear to have won the case in respect of current (non-definitive) losses of nonresident subsidiaries. But Marks & Spencer also seemed to win *its* specific case, as its losses resulted from the closing down of department stores on the continent and the winding-up of the local legal entities enveloping these

27. See, among many, many other commentators, Michael Lang: 'The Marks & Spencer Case – The Open Issues Following the ECJ's Final Word', *European taxation*, 2006, p. 54-67, and Axel Cordewener and Ingmar Dorr: case note in 43 CML Rev. 3 (June 2006), p. 855-884.
28. Case C-446/03, *Marks & Spencer II*, EU:C:2005:763.
29. Case C-168/01, *Bosal Holding BV*, EU:C:2003:479.

stores,[30] meaning that its losses were definitive losses and could therefore be set off against UK-source group profit.

The judgment implies that the Court accepts a significant difference in timing of intra-group loss relief and therefore in cash-flow position: a non-resident subsidiary in a loss position will have to wait for better years in order to offset its losses against its own future profits, whereas a resident subsidiary may carry over its losses immediately within the same tax year to profitable resident group companies to limit tax exposure there.

Marks & Spencer and the UK tax administration agreed that the terminal foreign subsidiary losses to be carried over to the United Kingdom were to be calculated on the basis of UK tax accounting rules. Had they not agreed, it would not have been clear which State's legislation would take priority. National treatment would point in the direction of the UK accounting rules, but the message of the judgment is that the loss relief possibilities evaporating in the *subsidiary* State must be carried over, which points at loss calculation on the basis of the accounting rules of the subsidiary State, which rules may deviate considerably from loss calculation on the basis of the parent State's accounting rules. In subsequent cases, the Court gives more emphasis to the symmetry principle or allocation of taxing rights holding that they may make it necessary to apply to the economic activities of companies established in one of the Member States only the tax rules of that State in respect of both profits and losses. That position was held in *K*. (C-322/11, point 50; *Timac Agro*, in respect of reincorporation of cross-border losses (points 34-38)[31] and *A Oy* (C-123/11). The latter related to a planned cross-border merger with subsequent transfer of losses from the merged subsidiary to the parent, and the Court held that in the present state of Union law, the freedom of establishment does not in principle require the application of a particular law to the calculation of the losses of the merged subsidiary. Then, the Court requires equal treatment between the results achieved by the method of calculation applied to a domestic merger and a cross-border merger.

As the Treaty freedoms do not require better treatment than for domestic groups, *Marks & Spencer II* (*M&S II*) in the authors opinion does not mean that the parent company State is required to provide relief for foreign subsidiary losses becoming definitive because of expiry of the local relief time-limit if the parent company State's domestic relief time-limit for comparable domestic losses has also expired. In fact, given the later *Krankenheim* judgment (see section 18.7) and also *K*., such expired losses probably need not be taken into account at all,[32] as their evaporation emanates from a particularity of the subsidiary State (that State's time-limits), which the parent

30. Except one, which was sold to a third party.
31. Case C-388/14,Timac Agro Deutschland GmbH,EU:C:2015:829.
32. The German Federal Tax Court has taken this position: *Bundesfinanzhof* 3 February 2010, I R 23/09, *Bundessteuerblatt* II 2010, 599, and *Bundesfinanzhof* 9 June 2010, I R 100/09, *Bundessteuerblatt* II 2010, 1065. See also Cordewener, o.c.

State is not required to compensate for or adapt to (see section 18.7). Losses upon closure of the foreign business are 'definitive'.[33] If expired losses were also covered, the effect of the judgment would be that a reduction of the time-limit in the subsidiary State would increase the risk for the parent State of having to absorb foreign losses (unless the parent State astutely also reduces its time-limits). It does not seem likely that if the loss relief period in the subsidiary State is naught (meaning that the subsidiary State does not provide for any loss relief over year-end), the parent State would be required to absorb *every* subsidiary loss. Indeed, in such a case, the lack of loss relief availability is not caused by the *parent* State excluding foreign losses, but by the *subsidiary* State excluding domestic ones, and there is no reason – as the Court pointed out several times[34] – why the parent State should compensate for the disadvantageous effect of disparities between the laws of the secondary establishment State and the home State, as 'the decisions made by a company as to the establishment of commercial structures abroad may be to the company's advantage or not, according to circumstances.'[35]

M&S II was not clear on the meaning of *definitive losses*. The main idea on which the judgment floats, seems to be the (sympathetic) 'always *some*where' idea: it cannot be that deductions which would have been effectuated if the taxpayer had (secondary) established at home, evaporate as a result of exercising the right of secondary establishment. Unfortunately, that *can* be, as the Court has already acknowledged in respect of *double taxation* of the same item of income as a result of 'exercise in parallel' of taxing jurisdiction (*Kerckhaert-Morres*, *Damseaux*, *Block*; see sections 3.2.7.1, 3.2.7.2, 14.5.1 and 16.1.2). And in fact, the Court nuanced its idea of 'always somewhere' deductible losses subsequently, in cases *Oy A.* (Case C-231/05), pertaining to current losses (see below), *K.* (Case C-322/11), as Finland applied a territorial system (no import of losses and conversely no import of profits; see section 18.10), *Timac Agro* (Case C-388/14), for the period in which Germany applied a base exemption system (in essence a territorial taxation; see section 18.12) and in *M&S III*. In the latter case, the Court apparently accepted UK time limits often causing final losses to be deductible nowhere. It eventually accepted the other side of the same coin, namely that parallel exercise of taxing power may by the same token also result in irremediable *double non-deductibility* of certain charges or losses. See section 18.11 for a further elaboration on *M&SIII*.

In the authors' view, definitive losses of a nonresident, non-subject person do not belong in the taxing jurisdiction of the home State of its shareholder(s). *M&S* was a

33. The German Federal Tax Court has taken the position that definitive losses are only losses upon closure of the foreign business: *Bundesfinanzhof* 9 June 2010, I R 107/09, *IStR* 2010, 663. See also Cordewener, o.c.
34. Case C-298/05, *Columbus Container Services*, EU:C:2007:754, Case C-293/06,*Deutsche Shell*, EU:C:2008:129, and Case C-157/07, *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt*, EU:C:2008:588.
35. The quote is from *Krankenheim*, point 50.

two-country problem which is demonstrated by the fact that the Court, in order to reach the result desired by it (always *some*where), had to force a Member State to asymmetrically assert wider taxing jurisdiction than it had symmetrically and sovereignly chosen to do. However sympathetic the outcome, the effect of *M&SII* was that the United Kingdom must asymmetrically *extend* its taxing jurisdiction to a part of the foreign income (the terminal negative part) of a non-subject non-resident company over which it had symmetrically *not* asserted any taxing jurisdiction. That is at odds with a correct comparability analysis, i.e. on the basis of a comparison *within* the area of assumption of taxing power (see sections 3.2.2 and 14.4.2).[36] It is true that the United Kingdom had assumed taxing power in respect of resident *parents* holding resident subsidiaries subject to UK tax, and resident *parents* holding non-resident subsidiaries *not* subject to UK tax, but in light of the rationale of the group relief system, these parents are not in comparable positions, as their *subsidiaries* are quite incomparable (completely inside and completely outside the United Kingdom's assumption of taxing jurisdiction, respectively).

This (the wrong comparison level) is why the *Bosal* judgment went wrong. *M&S II* shows the same flaw: it required the UK to relinquish – to refund – corporation tax levied in respect of economic activities carried out in its territory. That is at odds with the Court's finding in, for example, *Oy AA*[37] and *Class IV ACT*,[38] that a Member State cannot

> 'be obliged to abandon its right to tax a profit generated through an economic activity undertaken on its territory.'

Already in *Gilly*,[39] the Court considered that forcing a Member State to refund tax on domestic-source income to compensate for a tax disadvantage suffered entirely outside the taxing jurisdiction of that State, would unjustly encroach on its tax sovereignty:

> '48. (…), if the State of residence were required to accord a tax credit greater than the fraction of its national tax corresponding to the income from abroad, it would have to reduce its tax in respect of the remaining income, which would entail a loss of tax revenue for it and would thus be such as to encroach on its sovereignty in matters of direct taxation.' [40]

36. See Brauner/Dourado/Traversa, 'Ten Years of Marks & Spencer', 43 *Intertax* 4, 2015, at 308-309.
37. Case C-231/05, *Oy AA*, EU:C:2007:439.
38. Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue*, EU:C:2006:773.
39. Case C-336/96, *R. Gilly v. Directeur des services fiscaux du Bas-Rhin*, EU:C:1998:221.
40. Case C-336/96, *R. Gilly v. Directeur des services fiscaux du Bas-Rhin*, EU:C:1998:221.

Taking the perspective of the subjection to tax of the *parents* instead of the (non-) subjection to tax of the *subsidiaries*, thus seems to bring the Court in conflict with its own concepts. Possibly, it saw *M&S II* as conceptually similar to *Manninen*[41] (see section 19.1.5). Finland had decided to eliminate economic double taxation on distributed domestic company profits and was required by the Court to do the same as regards foreign dividends. Foreign dividends and domestic dividends were considered to be comparable because Finland had subjected its resident shareholders to income tax for dividends irrespective of the source thereof. It is true that the United Kingdom in the *M&S* case had subjected both types of parent company to the same UK corporation tax, but that case is not comparable to *Manninen*, as *Manninen* concerned taxation of distributed foreign company income which had clearly arrived within Finland's taxing jurisdiction, whereas *M&S II* concerns taxation (deduction) of non-distributed income (losses) clearly *not* in the taxing jurisdiction of the United Kingdom.

In the authors' opinion, the Court in *M&S II* mixed up the comparability question and the justification question. It considered something justified which did not need justification, as it was not discriminatory, but an exercise in parallel of two taxing jurisdictions both acting in accordance with their (non-discriminatory) choice of tax connecting factor (*residence* (of the subsidiary)). *M&S II* was a factually negative conflict of jurisdiction.

Even if one were to equate non-subjected non-resident subsidiaries to resident subsidiaries – even though the Court, since *Schumacker*, has consistently held that residents and non-residents are not, as a rule, comparable – one may wonder what the fundamental difference is between their current losses and their definitive losses. Why does the need to protect a balanced allocation of taxing power selectively work only for non-definitive losses? Why is evaporation in the correct jurisdiction less balanced than erasing domestic positive tax base in the wrong jurisdiction? Just because it saves the taxpayer money? In that case, time-barred foreign subsidiary losses should also be taken into account. In the authors' opinion, the fact that the foreign subsidiary was liquidated, is a result of particularities of the economy of the subsidiary State, just like non-deductibility or expiry of losses in the subsidiary State is a particularity of the legal system of the subsidiary State. From a conceptual and consistency perspective, it is difficult to see why it is 'disproportionate' to refuse a definitive loss, which, in terms of 'symmetry' and 'coherence', is just as wrong-placed as a current loss in the jurisdiction which symmetrically did *not* assert taxing power. If the subsidiary State does not or cannot provide loss relief, then that is that. The parent State cannot be required to take over. It has nothing to do with either the legal or commercial goings-on in the subsidiary State. *Krankenheim Ruhesitz* acknowledges that view (see section 18.7).

41. Case C-319/02, *Manninen*, EU:C:2004:484.

If the Court had decided the case the other way around (current subsidiary losses temporarily deductible, definite subsidiary losses not deductible), the result would have been what the Commission initially proposed (deduction and subsequent reinstatement, at the latest after a fixed number of years) and that fundamentally, this would have encroached less on the tax sovereignty of the Member States than does *M&S II*. Assimilating foreign (100%) subsidiaries to foreign branches would have entailed only *temporary* importation of alien losses instead of *definitive* absorption of alien losses, as *M&S II* requires. Nonetheless, the Member States may be less unhappy with *M&S II* than with the system the Commission proposed and withdrew, as the *M&S II* regime avoids a temporary but significant dip in their corporate tax revenues: as observed, the cash-flow effect of the timing difference between immediate set-off and having to wait for better years to come, is significant.

Litigation in Member States has next focused on the question of what constitutes 'definitive'. Obviously, tax administrations tend to take the position that the subsidiary must be wound up, while taxpayers tend to take the position that legal exhaustion of relief possibilities (even expiry of the local relief time-limit) already causes a refusal to be 'disproportionate'. Case C-231/05, *Oy AA*,[42] concerned the inverse of the UK system at issue in *M&S II*: the Finnish group contribution system allowed profitable group companies to contribute (and deduct) their profits to loss-making group companies, provided that the latter were subject to Finnish corporate income tax for that contribution. *Oy AA*, however, wished to contribute its profits to its loss-making UK parent. Obviously, if that were to fly, international groups could drop their profits anywhere they wish. As the Court put it: the limitation of the system to Finnish-tax-subject companies was 'designed to prevent conduct capable of jeopardising the right of Member States to exercise their taxing powers in relation to activities carried on in their territory.'

Moreover, as the United Kingdom pointed out in its observations during the proceedings: such profit contributions did not exist under UK tax law, meaning that the United Kingdom would not (be able to) tax the profit contribution in the hands of the UK parent. Thus, not only would Finland be precluded from taxing Finnish-source profits of Finnish residents, but also a double dip was imminent: the UK loss would remain unaffected and could still be used. As was to be expected after *M&S II*, the Court considered it justified to limit the scope of this scheme to group companies subject to tax in Finland. It referred to two of the three justifications it used in *M&S II*, namely: (i) the need to prevent undermining of 'a balanced allocation of the power to impose taxes between the Member States;' allowing cross-border profit contribution would force Finland '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;' and (ii) the prevention of tax avoidance. The double dip justification was not considered present.

42. Case C-231/05, *Oy AA*, EU:C:2007:439.

The Court held these two out of the three justifications in *M&S II* to be enough justification.

In the EFTA Court case Yara,[43] a Norwegian company claimed a tax deduction in Norway for its group contribution to UAB, a Lithuanian subsidiary of Yara. However, in its tax assessment for 2009, *Yara* was denied this deduction of the group contribution, as Norwegian Law does not permit the payment of group contributions with tax effect from a company liable to taxation in Norway to a subsidiary that is not liable to taxation in the realm. The EFTA Court followed the reasoning and steps of *M&S II*. The EFTA Court found that legislation, such as that described in the question referred, constituted a restriction of Article 31 EEA (*Yara*, points 35-36). It recognized that the national rules must serve a legitimate objective such as the need to safeguard the balanced allocation of taxation powers between EEA States or to prevent wholly artificial arrangements leading to tax avoidance (point 38). It finally concluded that the requirements of national law go beyond what is necessary to pursue those objectives in cases where the loss sustained by the foreign subsidiary is final.

In the authors' opinion, in *M&S II, OY AA* and *Yara International*, from the perspective of the proper comparator (subject to tax?), there was no discrimination, as non-resident, non-subject parents or subsidiaries are not comparable to resident, subject parents or subsidiaries. Again, in the authors' view, this was a two-country problem rather than a case of discrimination.

In *X Holding* case,[44] cross-border intra-group loss compensation would be achieved automatically if Member States applying a fiscal consolidation regime (single entity taxation) were required to extend that regime so as to include group companies not subject to tax within their jurisdiction. *X Holding* makes plain that not only group relief and group contribution schemes may legitimately be limited to subject-to-tax entities, also single entity taxation schemes may be reserved for subject-to-tax subsidiaries insofar *current* losses are at stake. In *X Holding*, only *one* justification was left of the three which were taken together in *M&S II*, but that single justification was sufficient: a balanced allocation of taxing power could justify the restriction of fiscal consolidation to one jurisdiction. In the authors' view: not three, or two, or even one single justification was needed, as subject-to-tax is not comparable to not subject-to-tax. That is what the Court seems to say, in point 38 and in the operative part of *X Holding*. See sections 17.3 and 17.4.2.

The question on the meaning of definitive losses has been raised again in the pending Case C-607/17 (*Skatteverket v Memira Holding AB*).[45] It is questioned whether losses are definitive, and the parent company may therefore deduct the loss on the basis of article 49 TFEU if: (1) under the rules of the subsidiary's state, there are restrictions on the possibility for parties other than the party itself which made

43. Case E-15/16, Yara International.
44. Case C-337/08, *X Holding*, EU:C:2010:89.
45. Case C-607/17, *Skatteverket v Memira Holding AB*, pending.

the loss to deduct the loss. In case a restriction such as that referred to in (1) must be taken into consideration, it is further questioned whether (2) it is relevant that there actually is another party in the subsidiary's state which could have deducted the losses if that were permitted there.

If the Court follows *M&S III*[46] (see below 18.11), definitive losses occur "only if that subsidiary no longer has any income in its Member State of residence. So long as that subsidiary continues to be in receipt of even minimal income, there is a possibility that the losses sustained may yet be offset by future profits made in the Member State in which it is resident" (point 36, *M&S III*[47]).

Thus, if the subsidiary State does not apply a loss relief group regime (which seems to be the case in *Skatteverket v Memira Holding AB*), what matters is whether the subsidiary has been liquidated (no longer has the possibility of receiving income in its Member State of residence).

Another referral to the CJEU was made by the Swedish *Högsta förvaltningsdomstolen* for a preliminary ruling in the case of *Skatteverket v Holmen AB* (Case C-608/17). The national court asks whether deductibility of definitive losses in a cross-border situation by a parent company requires a direct holding by the parent company. This issue has not been yet addressed by the CJEU. First, the answer to the meaning of definitive losses should follow *M&S III* [48] (point 36) – as long as those losses cannot be deducted in the subsidiary State. Second, if the subsidiary is directly held by a parent company in another Member State, it has to be assessed whether this parent company is entitled to deduct its subsidiary's final losses, in light of *M&S II* and subsequent case law (including *M&S III*). If that (direct) parent company is not entitled to deduct the afore-mentioned losses, all necessary steps – restriction, justifications, proportionality – will have to be followed in order to conclude whether the parent company with an indirect-holding in the subsidiary is entitled to deduct the subsidiary's losses.

The second question seems to raise an acte clair issue: whether 'that part of a loss which, as a result of the rules in the subsidiary's state, has not been possible to be set off against profits which were made there in a particular year, but instead could be carried over so that they could potentially be deducted in a future year', is also to be regarded as definitive' deserves a negative answer, as long as there is the possibility for the subsidiary to obtain income in future years (again, point 36, *M&S III*).

The third and fourth questions are equivalent to questions 1 ("(3) In the assessment of whether a loss is definitive, must account be taken of the fact that, under the rules in the subsidiary's state, the possibility for parties other than the party making the loss itself to deduct the loss is restricted?"); and 2, in *Memira Holding AB* ("(4) If account is to be taken of a restriction such as that referred to in (3), must regard be had to the extent to which the restriction has in fact led to it not

46. Case C-172/13, *Commission v. UK*, EU:C:2015:50.
47. Case C-172/13, *Commission v. UK*, EU:C:2015:50.
48. Case C-172/13, *Commission v. UK*, EU:C:2015:50.

being possible to set off any part of the losses against profits made by another party?”).

18.6 The 2006 Commission Communication

In December 2006, following on the *M & S II* judgment, the Commission published a Communication[49] on ‘Tax Treatment of Losses in Cross-Border Situations.’ The Commission abandoned the idea of a common system and instead encouraged the Member States to adopt unilateral measures as regards cross-border loss relief within groups of companies, meeting the following criteria:

> ‘A targeted measure addressing cross-border loss relief should ensure that corporate groups doing business in several Member States are treated as far as possible in the same way as groups doing business with a single Member State. In particular, it should allow losses to be set off from the tax base for the year in which they are incurred. A targeted measure should thus:
> (a) permit an effective and immediate, once-only deduction of losses; (b) allow, as a minimum, losses to be taken into account at the level of the parent company (“vertical upward” set-off);
> (c) not normally result in a definite shift of income from one Member State to another, unless the losses are terminal and there is no possibility for relief in the State where such losses were incurred;
> (d) exhaust domestic possibilities for current loss relief first; and
> (e) not offer scope for abuse.’

In the Commission’s view, there are three types of measure that would suffice:

(i) a definitive cross-border transfer of group company losses (without recapture), or, vice versa, an intra-group cross-border profit contribution system (see case C-231/05, *Oy AA*), both accompanied by a clearing system ensuring that the Member State of the company surrendering the loss compensates the Member State of the company absorbing the loss or, as the case may be, the State taking over the profit compensates the State contributing the profit. The authors believe this to be a non-starter for lack of mutual trust;

(ii) a temporary cross-border loss transfer system along the lines of the withdrawn proposal discussed above (the deduction/reintegration method). Foreign subsidiary losses deducted from the parent company’s profit will be recaptured when the subsidiary subsequently returns to profitability. This might work if the parent company State were to apply its own tax accounting rules.

49. Communication from the Commission to the Council, the EP and the EESC of 19 December 2006, COM(2006) 824 final.

(iii) fiscal consolidation of foreign subsidiaries. This would imply treating sufficiently controlled foreign subsidiaries entirely as foreign branches. The Commission recommends the credit method rather than the exemption method for the prevention of double taxation of foreign profits. Profit distributions between the group members would not be taken into account. The *X Holding* case made clear that EU law in any event does not require such consolidation. Indeed the Court accepted that limiting the Dutch optional tax consolidation scheme for controlled group companies to Dutch subject-to-tax group companies is justified by the need to preserve a balanced allocation of taxing rights. This system, coupled with a common base determination, is the core of the Commission's recent CCCTB proposal (see Chapter 11).

Thus, although the Commission withdrew its cross-border loss relief Directive proposal in December 2001, after the *Ms & S II* judgment it actually reintroduced it in 2006 as the second option in its soft law Communication on cross-border loss relief, surrounded by two other options which were less attractive for the Member States, and in 2011, it reintroduced its third soft law option (CCCTB with consolidation) as part of its wider proposal for a common consolidated corporate tax base for European groups of companies. This proposal now has the form of two new interconnected proposals: on a common corporate tax base (CCTB), and on a common consolidated corporate tax base (CCCTB). As was noted before, the former provides for *temporary* cross-border carry-over of subsidiary losses and the latter for *permanent* cross-border carry-over of subsidiary losses. See Chapter 11.

18.7 Foreign Branches; *Lidl Belgium* and *Krankenheim Ruhesitz*

In *Lidl Belgium*,[50] the Court arrived at the same result for foreign branches as it arrived at for non-subject subsidiaries in *M&S II*. *Lidl Belgium* involved the German application of (base) exemption for foreign branch profits under the German tax treaty with Luxembourg. The German company Lidl Belgium had started a (sub) branch in Luxembourg, which had made a loss. As that loss had been carried forward in Luxembourg and had in subsequent years (at the time of litigation) in fact already been set off against subsequent branch profits, there was no issue of definitive losses. *Lidl Belgium* sought (temporary) loss deduction from its German tax base in the previous year in which the loss was made (it sought *tax* exemption instead of *base* exemption), which was denied, as under the applicable tax treaty, Germany excluded from its tax base business profits and losses attributable to the territory of its treaty partner (base exemption). Obviously, Germany did *not* exclude profits and losses of *domestic* business activity from its tax base.

Because of that difference in treatment, the Court – mechanically – saw a discrimination ('less favourable'; point 25). However, Germany had not extended

50. Case C-414/06, *Lidl Belgium*, EU:C:2008:278.

its taxing power to foreign business results symmetrically. It thus applied an entirely neutral territoriality system of delineating its taxing jurisdiction. As the Court reiterated (see sections 14.2 and 3.2.7), EU law has no bearing on the connecting factors for asserting taxing power; Member States are free to choose residence, source, territory, nationality or asset location. Germany had adhered to the source principle not only for non-resident undertakings, but also for its resident undertakings. This is nondiscriminatory: to domestic branches the exact same territoriality system is applied, but obviously, in their case, as their profits and losses arose *within* Germany territory, their results were included in the German tax base. The Court explicitly accepted source taxation (territoriality) as *not* discriminatory in *Futura*.[51] The facts that the autonomous choice of tax connecting factors by the two States involved has the effect of dividing the tax base into two parts falling in different taxing jurisdictions, and that this may be disadvantageous if one part is positive and the other part negative (dislocation; see sections 3.1.2, 3.2.7.3 and 14.4.1), is not the result of a discrimination, but of the exercise in parallel by two Member States of their taxing jurisdictions, both of which are at liberty to base the delineation of their taxing power on the territoriality principle. Therefore, no discrimination was present and the case should in the authors' opinion have been closed at the first step of the rule of reason test, as the Court did in *Futura*, *Kerckhaert-Morres*, and *Truck Center*. Again – we are beginning to sound monotonous – this was a two-country problem rather than a case of discrimination. In *Timac Agro* the Court indeed held that under a territoriality system (base exemption) a foreign branch is not comparable to a domestic branch as regards current losses. The CJEU closed the case at the first step of the rule of reason test: no comparability.[52]

Because in *Lidl Belgium* the Court discerned a discrimination, it had to turn to justifications. It found two, considering them both separately capable of justifying the 'discrimination' found: (i) the need to prevent double dips and (ii) a balanced allocation of taxing rights, in particular the need for 'safeguarding the symmetry between the right to tax profits and the right to deduct losses'. This is confusing, as Germany did *not* have the right to tax the profits and therefore – according to Germany – neither the *obligation* to accept the losses from the same exempted foreign source. As in *M&S II*, the Court thus seems to have mixed up the discrimination and justification questions. This got it into conceptual trouble, as obviously the Commission, Lidl Belgium, and the advocate-general all three pointed out to it that base exemption was a disproportionate means for attaining tax base integrity, as there is a less restrictive system for safeguarding symmetry, namely tax exemption (worldwide taxation with relief for double taxation and deduction and subsequent reinstatement of foreign losses). They also noted that Germany itself had operated a

51. Case C-250/95, *Futura*, EU:C:1997:239.
52. Case C-388/14, *Timac Agro Deutschland GmbH*, EU:C:2015:829.

tax exemption system without difficulties in the past, and that at least five other Member States still did, and had always done so. The Court's rejection of this argument (points. 45-53) is very difficult to follow and seems flawed by misconceptions and result-reasoning,[53] which is caused by the fact that the argument is simply valid: *if* base exemption (assertion of tax jurisdiction on the basis of territoriality) constitutes a discrimination, *then* it is a disproportionate means to attain tax base integrity, as the less restrictive tax exemption system serves that aim just as well. However, the Court – rightly – did not feel competent to order Germany to make that particular choice of defining and exercising its taxing jurisdiction (worldwide taxation with double tax relief), as indeed, there is no basis for such prescription in the Treaties. This is precisely why the Court should have stopped at the first step.

Possibly, the Court became entangled because of its previous *M&S II* case. It wanted to reach the same result for branches in *Lidl Belgium* as for subsidiaries in *M&S II*, but it had to deal with the fact that in *M&S II* a discrimination had been postulated – which was subsequently justified – where there was none (see section 3.2.7.3). Neither the non-resident subsidiaries in *M&S II*, nor the foreign branch results in *Lidl* were within the purview of the home State's assumption of taxing power. They were, therefore, not comparable to residents and domestic results, respectively (see section 3.2.7.3). The difference between the cases is that in *M&S II* the entire legal entity was outside the UK jurisdiction, whereas in *Lidl Belgium* only foreign-sourced income was outside the German jurisdiction, but from a tax power delineation point of view – which is the correct comparability standard (see section 3.2.7.3) – that is not a difference of principle. Thus, in *Lidl* the Court forced itself to accept a measure as proportional (base exemption), which was clearly not the least restrictive measure to serve tax base integrity; that was deduction and reinstatement, applied by at least five Member States.

Be that as it may, *Lidl Belgium* showed that base exemption is acceptable under the Treaty freedoms, in either the first step or in the third step of the rule of reason.[54]

In *Krankenheim Ruhesitz*,[55] subsequently, the Court – obviously – also accepted the tax exemption system, i.e. worldwide taxation with (i) proportionate home State

53. Unlike the Court posits (point 52), tax exemption does *not* undermine the balance of taxing power. Obviously not, as those (at least five) Member States using it are not daft. The Court itself spoke highly of tax exemption in *Krankenheim Ruhesitz* (see below in this section). Tax exemption does *not* produce any significant risk of double dips, and it is *not* inviting abuse. If it might, nothing prevents the Member State concerned to switch over to the credit system (see the *Columbus Container* Case C-298/05, EU:C:2007:754), which also includes deduction of foreign losses. None of the *Marks & Spencer* justifications plead against tax exemption.

54. The pending case C-650/16, *A/S Bevola*, will make clear whether that also holds true for final losses under a base system, as long as there is a legal option that equates resident and non-resident PEs. See Section 18.12 below.

55. Case C-157/07, *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt*, EU:C:2008:588.

tax reduction for foreign-source income and (ii) deduction and subsequent reinstatement of foreign losses. The case concerned a German company with a permanent establishment in Austria which had made a loss and had subsequently made profit again. Unlike in *Lidl Belgium*, in this case Germany had applied tax exemption instead of base exemption, probably because the facts had arisen before its system change. The Austrian losses had therefore been deducted from the German tax base. The litigation concerned the reinstatement of these losses in a subsequent year, in which the branch had made a profit again (for which, obviously, Germany granted no double tax relief until the losses previously deducted were recaptured; see section 3.2.7.3). Krankenheim opposed reintegration, considering it to offend its freedom of establishment. The branch was later sold, leaving – on balance - an overall branch loss in the books of the undertaking as a whole.

Again, the Court found a discrimination: reinstatement of foreign branch loss deduction was considered 'less favourable treatment' (point 37) of undertakings with foreign branches. In the authors' opinion, with all due respect, that is a mistake. The location of the branch was irrelevant for the tax treatment of its results in the hands of the resident company. If a domestic branch made a loss, that loss could be deducted from the company's profits in Germany; if a foreign branch made a loss, that foreign loss could also be deducted from the company's profits in Germany. If the domestic branch subsequently made a profit, that profit was taxed in Germany. If the foreign branch subsequently made a profit, that foreign profit was also taxed in Germany. That is precisely what the reinstatement mechanism does: it erases the foreign profit for double tax relief purposes, meaning that the foreign profit will be fully taxed, exactly as a comparable domestic profit. The cross-border and domestic situations are thus treated exactly alike. Therefore, this case certainly should have ended at the first step of the rule of reason. But again the Court got itself into a position where it had to answer the (in the authors' opinion pointless) questions of justification and proportionality. A justification was easily found: the need to guarantee the coherence of the German tax system. According to the Court, reintegration of foreign losses previously deducted 'reflects a logical symmetry'; there was 'a direct, personal and material link' between the two; reintegration was 'the logical complement' of the previous deduction; the German system operated 'in a perfectly symmetrical manner'. Moreover, reintegration was 'entirely proportionate' to the objective of coherence, as no more was reintegrated than the amount previously deducted.

It is not often that the Court extols the virtues of a national tax system in such laudatory language. The authors observe, however, that *of course* the system was entirely symmetric and proportionate; *of course* the system justified itself; indeed, it was *identical* to the system applied to domestic branches. As there was no discrimination in the first place, it was impossible *not* to find justification and proportionality for the disadvantage caused by the exercise in parallel of two taxing jurisdictions (negative jurisdiction conflict). Therefore, again: the disadvantage resulting for the taxpayer was a two-country-problem (a dislocation or a disparity), not a discrimination.

If one insists on finding a discrimination, it seems correct to use the 'fiscal coherence' justification rather than the 'balanced allocation of taxing rights' justification in the *Krankenheim* case (see section 14.4.2 on 'justifiability'). As the Court pointed out, the reinstatement mechanism functions in respect of one and the same taxpayer, within one and the same national tax and as regards the results of one and the same business activity. It is thus similar to the recapture of deduction of annuity contributions if the benefits cannot be taxed in respect of the same contract, the same taxpayer and the same income tax (*Bachmann*[56]).

Interestingly, the Court went on to explain that it was immaterial that possibly, the pertinent reinstating of the loss deduction in Germany could lead to the losses being deductible nowhere, as possibly, Austria did not allow the loss to be set off in other tax years (probably because the branch had been sold, and Austria did not want the new owners to use losses made by another taxpayer in the past). The Court observed that Germany could not be made responsible for 'particularities of legislation of another Member State' (point 49) and that if the combined effect of the two national systems in this case was disadvantageous, that disadvantage was imputable only to the branch State, *i.e.* Austria. The authors fully agree, and observe that possibly, this may mean that Germany was not required to abstain from reinstating *definitive* losses either.

As the branch business still existed, albeit in other hands, Germany was, in the authors' opinion, authorized to reinstate the entire loss deducted previously anyway, as there was no cessation of the branch's business. Whether that view is correct, cannot be ascertained from the case, as Germany apparently had *not* reinstated the part of the total loss which exceeded the total profit made in the years in which *Krankenheim Ruhesitz* had owned the foreign business. However, the Court's reasoning indicates that if it had reinstated the entire loss deduction, that would have been acceptable, as the fact that the losses had evaporated in Austria, was due to Austrian peculiarities. That would mean that the home State in no case is required to absorb foreign branch or subsidiary losses that have become definitive through expiration of the relief period of the branch State, as that period is a peculiarity of the law of the branch State. The question still remains how the Court would decide a case like *Krankenheim* if the unsuccessful branch were not sold but closed down and the home State reinstates all remaining losses previously deducted. The facts in *Timac Agro* are similar to the ones in *Krankenheim* in respect of the years 1997 and 1998. Germany then applied a tax exemption regime, and former losses were taken into account and reinstated. The CJEU followed *Krankenheim*, by holding the

56. Case C-204/90, *Bachmann*, EU:C:1992:35.

reinstatement restrictive to the freedom of establishment, but justified.[57] The authors understand *M&S II* was reconsidered in *Timac Agro* in respect of the facts referring to the tax years from 1999 onwards. Losses incurred in Austria by the non-resident permanent establishment over which Germany has symmetrically not exerted any taxing power (tax base exemption regime), do not have to be deducted in Germany, even if they are final losses. Since Germany does not exercise any tax powers over the profits of such permanent establishment, and the deduction of its losses no longer being permitted in Germany, the situation of that permanent establishment in Austria is not comparable to that of a permanent establishment in Germany (*Timac Agro*, point 65). Just like double taxation, such double non-deduction is not a result of any discrimination, but from the exercise in parallel of uncoordinated sovereign taxing power (negative conflict of jurisdiction). The same reasoning and result was reached in *K* (see below 18.10).[58]

Case C-293/06, *Deutsche Shell*,[59] concerned a specific kind of loss which in principle arises only in cross-border positions, namely, a currency loss. *Deutsche Shell* claimed to have suffered a loss, calculated in German marks, in respect of its working capital contribution to its Italian branch as a consequence of the depreciation of the Italian lire against the mark. Obviously, in Italian currency, there was no such currency loss and therefore no deduction in Italy. Neither was the loss deductible in Germany, as Germany exempted foreign branch results.

The case is special because it is one of the few, if not the only direct tax case in which one must conclude that the Court did not see a discrimination, but still condemned the measure, and therefore used a pure 'obstacle'-based approach (see sections 3.2.7.1 and 14.5.1).

The authors observe, first, that currency gains, like currency losses, would have been exempted as well. Second, Deutsche Shell could have hedged the currency risk, but took the entrepreneurial decision not to do so. Third, Deutsche Shell could have had its branch borrow the money in Italian lire, but it took the entrepreneurial decision not to borrow locally ('push down the debt'). It is puzzling, therefore, that the Court at the same time condemned Germany for not taking into account an element of a tax base which Germany had symmetrically exempted, *and* emphasized that setting up business abroad may fiscally turn out good or bad, depending on circumstances:

> '41 (…) in the absence of unifying or harmonising measures adopted by the Community, the Member States remain competent to determine the criteria for

57. Case C-388/14, Timac Agro Deutschland GmbHEU:C:2015:829, points 24–28 (restriction), points 29–45 (justifications). Again we note that the pending case C-650/16, *A/S Bevola*, may provide further clarification in this respect. See Section 18.12 below.
58. Case C-322/11, *K.*, EU:C:2013:716.
59. Case C-293/06, *Deutsche Shell*, EU:C:2008:129.

> taxation of income and wealth with a view to eliminating double taxation by means, *inter alia*, of international agreements (…).
> 42 That competence also implies that a Member State cannot be required to take account, for the purposes of applying its tax law, of the negative results of a permanent establishment situated in another Member State (….) solely because those negative results are not capable of being taken into account for tax purposes in the Member State where the permanent establishment is situated.
> 43 Freedom of establishment cannot be understood as meaning that a Member State is required to draw up its tax rules on the basis of those in another Member State in order to ensure, in all circumstances, taxation which removes any disparities arising from national tax rules, given that the decisions made by a company as to the establishment of commercial structures abroad may be to the company's advantage or not, according to circumstances (see, by analogy, Case C-403/03 *Schempp* [2005] ECR I-6421, point 45).
> 44 As far as concerns the main proceedings, it must be noted that the tax disadvantage concerned relates to a specific operational factor which is capable of being taken into consideration only by the German tax authorities. Although it is true that any Member State which has concluded a double taxation convention must implement it by applying its own tax law and thereby calculate the income attributable to a permanent establishment, it is unacceptable for a Member State to exclude from the basis of assessment of the principal establishment currency losses which, by their nature, can never be suffered by the permanent establishment.'

If the authors understand this correctly, it says that Germany had done nothing wrong and was entitled to exclude from its assertion of taxing jurisdiction foreign business results (as the Court later explicitly held in *Lidl Belgium* and *Timac Agro*), but that unfortunately, a currency loss *must* be deductible *somewhere* in an internal market, and as Germany was the only eligible jurisdiction with positive tax base available, Germany it was. This judgment thus seems to be a fine example of the Court's – sympathetic – reluctance to accept that dislocations and disparities ('exercise in parallel' of taxing jurisdiction) may lead, not only to double taxation irremediable under the Treaty Freedoms (which it did accept in, for example, C-128/08 *Damseaux* and C-67/08 *Block*), but also to double non-deductibility. *Deutsche Shell* is the purest example of the Court's 'always-somewhere'-approach (see section 14.5.1), which also prominently features in the Court's *Schumacker* and *De Groot* line of case law, and which also seems to underlie the definite-losses jurisdiction-transfer in *M&S II*. Obviously, if the unshakeable point of departure is that something *has* to be deductible *somewhere*, further legal analysis is futile. Obviously, the judgment prompts Member States to the rational, symmetric and coherent countermeasure to also tax currency gains. The Netherlands is introducing legislation which, in principle, continues the perfectly symmetrical exemption of both currency gains and losses in respect of exempted participations, but which will still tax currency gains if the taxpayer claims a deduction of currency losses.

Possibly, however, *Deutsche Shell* does not need to be read as meaning that home States are forced to always asymmetrically take into account currency losses, as the facts of the case show that the Italian branch had been incorporated and sold, implying that the branch had ceased to exist, and that there would never again be any positive (currency) results flowing from it. From that perspective, the loss was a one-off terminal loss comparable to the liquidation losses in the *M&S II* case. Moreover, the X AB case discussed in 18.8 below

18.8 *X AB*: Currency Loss on the Transfer of a Holding; *Deutsche Shell* Revoked?

The *X AB* case[60] seems to overturn *Deutsche Shell*, or at least to considerably reduce its significance as a manifestation of the 'always somewhere approach'. In 2003, X AB, with seat in Sweden, set up a subsidiary in the United Kingdom, Y Ltd, the shares of which were issued in US dollars. X AB held 45% of the shares in Y Ltd. X AB later planned to discontinue Y Ltd's business activities and to transfer the Y Ltd shares, but a dollar currency loss on the transfer of the holding was imminent, and capital losses on holdings for business purposes were not deductible in Sweden. Relying on *Deutsche Shell*, X AB therefore requested a ruling from the tax authorities on the compatibility of this non-deductibility with the EU fundamental freedoms. The latter replied that symmetrically, neither capital gains nor capital losses on holdings for business purposes were taken into account for corporation tax purposes, so the currency loss would not be deductible and this was not considered contrary to EU law. This ruling was taken to the Swedish court, which asked preliminary questions. The CJEU observed that currency losses were not deductible on shares held in both domestic and foreign companies and inferred that there was no discriminatory treatment. The Court admitted that currency losses might be a disadvantage for a cross-border investment, but the freedom of establishment does not require a Member State to adapt its tax system to the different taxations systems of other Member States or to different currencies used elsewhere. It concluded that national law that across the board does not recognize losses as a result of currency risks, is not restrictive, and that the Swedish regime is symmetric. The Court tried to distinguish this case from *Deutsche Shell* by pointing out that under the German system under scrutiny in *Deutsche Shell*, currency results, both positive and negative, were in principle included in the taxable base unless a tax treaty provided otherwise. It must be noted that the German-Italian tax treaty did provide otherwise.

60. Case C-686/13, *X AB v Skatteverket*, EU:C:2015:375.

18.9 Double Branch Dip (*Philips Electronics*) and Cross-Border Loss Importation by Merger (*A Oy*)

Subsequent cases seemed to escape the conceptual framework created by the case law until now. The first one, *Philips Electronics* (6 September 2012),[61] concerns the UK branch of a Netherlands company. That company wanted to surrender the UK loss suffered by its UK branch to a UK group company. Thus, this case is not really on cross-border loss relief, as both the loss and the profit against which to offset it are UK-sourced. Conceptually, the case is like the *Papillon* case (see section 17.3). UK law provides that such UK branch loss may be carried over to another group company, but only if it cannot be used abroad. As the Netherlands applies exemption with progression to foreign branch results, implying deductibility of the UK branch loss in the Netherlands, subject to later reinstatement in profitable years (cf. the German system in the *Krankenheim* and *Timac Agro* cases (the latter concerning the facts that refer to the 1997-1998 tax periods)), the loss could be used in the Netherlands, but only temporarily, until the branch would return to profit. At any rate, HMRC refused surrender of the UK branch loss.

Taking into account the *Papillon* case, the UK should allow surrender, as the branch results are subject to tax in the UK and in a comparable internal situation (a UK resident subsidiary with a loss) the loss would be carried over. And in fact, the Court decided that the UK legislation constituted a restriction on the freedom of establishment.

When assessing whether the restriction could be justified by overriding principles in the public interest, the Court concluded that two of the justifications used in M&S II did not apply. First, whereas preserving the allocation of taxing rights is a legitimate objective, in Philips Electronics, the UK had the power to tax the branch profits as a result of its activity within the UK territory, and that power was not affected by the possibility of that branch transferring its losses to a UK resident company.

Second, the fact that the loss might also temporarily be deducted in the Netherlands could have been viewed as a 'neutralization' of the source State discrimination by the home State (the 'overall' approach; see section 17.5.4). However, the Court interpreted this justification in connection with the first one (the power to impose taxes or symmetry principle). It held that the risk that those losses may be deducted twice had no influence on the UK taxing power and that the combination of the two arguments did not justify the restriction.

The risk of tax avoidance was not analyzed by the Court, but it can be deduced that it would not be held by the Court as an independent justification. In *Philips Electronic* as well as in *Papillon*, the fact that the restrictive national legislation might prevent avoidance or aggressive tax planning by the interposition of a company

61. Case C-18/11, *Philips Electronics*, EU:C:2012:532.

abroad and through the misuse of transfer pricing rules was disregarded by the Court.

The internal market (cohesion) approach was not adopted to assess a justification to the UK restrictive legislation. It could have been discussed, whether the Netherlands' deduction and later reinstatement of the UK loss was treaty-based (as required for acceptance of the 'neutralization'-defence). Because the Netherlands was free under the tax treaty to apply base exemption instead of exemption with progression, the internal market approach would not necessarily lead to a justification of the UK rules.

Another way of looking at this case is seeing an 'exercise in parallel' of two taxing jurisdictions *benefiting* instead of disadvantaging the taxpayer: both Member States extended their taxing jurisdiction to the same branch loss. In the previous edition to this book, Peter Wattel argued, "he would be inclined to think that this case is an exercise in parallel of taxing power just like the parallel exercise in *Kerckhaert-Morres* and *Damseaux*. At any rate, nothing prevents the Netherlands from enacting a provision that foreign branch losses are not – temporarily – deductible if the branch State itself is required by EU law to take them into account currently".[62]

A Oy (21 February 2013) [63] concerned a Finnish parent company holding a Swedish subsidiary that terminated its activities in 2007/2008, but remained bound by two long-term leases of business premises. The only things left in the subsidiary were trading losses from the period 2001 to 2007. The two companies planned to merge by absorption of the subsidiary by the parent. The resulting single company would not have a subsidiary or a PE in Sweden. The losses would be transferred to the parent company and would not be set off in Sweden.

If both companies had been resident in Finland, the absorbing company would have been allowed to use the absorbed company's losses, as long as had not been carried out for the sole purpose of obtaining a tax advantage. By an advance decision, the Finnish tax authorities decided that these Swedish losses could not be used in Finland, because they had been determined pursuant to Swedish law. Finnish law did not give any indication on the conditions to deduct foreign losses in case of cross-border mergers.

The CJEU followed the *M&S II* reasoning and approach. It held the freedom of establishment was applicable and the fact that Finnish law excluded the taking into account of foreign losses in the case of a cross-border merger, whereas that advantage would be granted in case of a domestic merger, constituted an obstacle to the exercise of the freedom, and that the situations were objectively comparable.

Furthermore, the Court accepted the *M&S II* case justifications: first, it held the need to safeguard the allocation of taxing rights justified that a Member State (Finland, in the case) applied to economic activities of companies established in one

62. Ben. J. M. Terra and Peter J. Wattel, *European Tax Law*, 2012, 6th ed., at 1041.
63. Case C-123/11, *A Oy*, EU:C:2013:84.

of the Member States, its tax rules in respect of both profits and losses (territoriality or symmetry principle). It was therefore justified that domestic tax rules did not allow taxpayers to elect the Member State where to deduct losses. It also concluded that a risk of double deduction of losses existed, if the parent company was allowed to deduct those losses. The Court also held that deduction of cross-border losses entailed a risk of tax avoidance by allowing the possibility of deducting losses in the Member State of highest tax rates.

Finally, the Court deemed there would be no final losses under two joint conditions, to be checked by the referring national court: if the Swedish law accepted the possibility for deduction of losses in future tax years, and if, under the specific circumstances, there would still be the possibility to deduct those losses in the subsidiary's State of residence either by the subsidiary or a third party.

In its second question the referring court asked the Court of Justice to clarify how the alien loss to be imported should be calculated: whether on the basis of Swedish or Finnish tax accounting rules, which would lead to significantly diverging results. The Court noted that in the absence of harmonization, freedom of establishment did not require that the law of the subsidiary or of the parent-company's Member State applied. It was up to the latter State to decide on that, as long as the calculation did not lead to unequal treatment of cross-border situations in comparison to domestic situations.

Interpretation of an obstacle to freedom of establishment on the basis of unequal treatment (comparison between the tax treatment granted to domestic and to cross-border situations) does not lead to neutrality, as the amount of losses calculated according to the parent-company's Member State will not correspond to the amount calculated in the subsidiary's Member State. Moreover, it brings back the territoriality principle and reduces the outcome of M&S which relied on a broad concept of restriction, based on the internal market neutrality.

18.10 **Individuals**

As observed in section 3.2.7.3, from the *Renneberg* case it follows that nonresident individuals in a *Schumacker* position (earning their entire *positive* income in the source State) are ensured of cross-border relief for a home State losses in the source State (*e.g.* transfer of their negative income from a personal dwelling in the home State to the job State, to be deducted there from employment income earned there). Regrettably, the *Renneberg* judgment is flawed (see section 3.2.7.3), but the general idea behind it seems clear: individuals are not treated as companies as regards cross-border loss relief, as they have personal circumstances and are taxed in most Member States according to their ability to pay. Therefore, if an individual is in a *Schumacker* situation, his home State loss is viewed in the same manner as a home State deduction for, say, the number of children or costs of illness: if it cannot be used in the home State, deduction must be granted by the source State to the same extent as that source State grants such deductions or loss relief to its residents. As the Court does not count negative income when applying its *Schumacker* test ('almost his entire income' in the job State), an individual is *always* in a *Schumacker* position if his home State costs exceed his home State positive income. The consequence seems to be that a home State income deficit of an individual will *always* be transferred to the job State because, by definition, that home State deficit brings him in a *Schumacker* position. It may be doubted whether the court realized this, and whether it realized the consequences, especially if the individual is self-employed rather than an employee (see section 21.4.1).

Be this as it may, Member States may be wise to conclude from the *Renneberg* case that at least nonresident *employees* who earn on balance a negative income in their home States (apparently no matter how sizeable that negative income) must be treated as if they were residents. This means that if for a resident employee a foreign loss would be (temporarily) deductible from employment income, temporary deduction should be allowed as well to a nonresident employee. This in turn means that Member States must renegotiate their tax treaties to enable themselves to reinstate foreign losses previously deducted also for *non*residents in respect of foreign sources of income to which the job State had not extended its taxing jurisdiction.

Renneberg further seems to indicate that in the inverse situation (source State loss, home State profit), the Court will, for individuals, not allow the same territoriality system (*base* exemption) it allowed in *Lidl Belgium* for companies, as that system causes significant timing and cash-flow disadvantages as compared to tax exemption (entailing immediate deduction and future reinstatement of foreign losses). *If* the Court insists on seeing a discrimination in symmetric application of base exemption, then it would probably require the home State of the individual to apply tax exemption, and in doing so, contradict *Lidl Belgium*. The Busley and Cibrian[64] case does not clearly confirm this yet, as the German system at issue in that case was not a symmetric base exemption system, but an asymmetric and therefore discriminatory system of base definition: it included *income* from foreign real estate in the worldwide tax base of resident individuals as if it were domestic income, but it allowed deduction of *losses* from foreign real estate only against subsequent positive income from foreign real estate, although losses from domestic real estate were currently deductible from other income.

K[65] was a Finnish case similar to *Busley and Cibrian*. In 2004, *K*, resident in Finland, incurred in losses by selling an immovable property in France which he had acquired in 2001. According to K's declaration, he did not receive any income in France and did not have any other property from which he could have deducted his loss. K wanted to deduct those losses from gains accrued in Finland on the sale of securities taxable in Finland. Under Finnish income tax law, resident taxpayers may

64. Case C-35/08, *Busley and Cibrian*, EU:C:2009:625.
65. Case C-322/11, *K.*, EU:C:2013:716.

deduct losses incurred on the transfer of immovable property situated in Finland. Losses incurred on the transfer of property situated in another Member State are not deductible to the extent they exceed the amount of income received in that State.

Moreover, as a result of the application of the bilateral tax treaty with France, Finland would not tax any gains resulting from the sale of immovable property located in France. The France-Finland treaty allows Finland to apply a progressive exemption method in eliminating double taxation, but that possibility is not applicable to capital gains, because the latter are taxed at proportional rates.

The Court held the Finish regime to be restrictive because the France-Finland treaty, although attributing the unlimited right to tax to the State in which territory an immovable asset is situated, did not preclude Finland to take into account the income related to an asset situated in the other Member State in the calculation of the tax of a resident taxpayer. The Court also stressed that the treaty did not preclude Finland to take into account the losses incurred in France.

When ascertaining whether the restrictive measure could be justified in light of the M&S II justifications, the Court related the balanced allocation of taxing rights to the principle of symmetry between the right to tax profits and the right to deduct losses. It then concluded that because Finland did not exercise any taxing rights over the income deriving from the transfer of immovable property situated in France, the restriction is justified. According to the Court the obligation to deduct foreign losses without a corresponding exercise of taxing rights would lead to choose freely the State in which to deduct the losses would be contrary to the principle of symmetry and would not ensure a balanced allocation of taxing rights.

The principle of symmetry contradicts the internal market approach taken in *M&S II*, where allocation of taxing rights was put forward together with two other justifications, namely the risk of double deduction of losses and the risk of tax avoidance. In *K.* the balanced allocation of taxing rights interpreted in light of the symmetry principle, was the only applicable argument – out of the aforementioned three- to justify the restriction.

As France also did not allow the deductibility of the loss, *K.* had no possibility to deduct his losses twice, which was recognized by the Court. Furthermore, and contradicting the consistency of the Court reasoning and decision in *K.*, it restricted the scope of the risk of tax avoidance justification as designed in *M&S II*. The Court held that the mere risk of tax avoidance or evasion was not a valid justification for a restrictive measure, as it was generally directed at any situations involving losses from immovable property located in other member States. According to the Court the restrictive measure would be justified only if it aimed to prevent conducts consisting in the creation of wholly artificial arrangements.

Finally, there are two more arguments used by the Court that restrict the results achieved by *M&S II*, and commonly linked to the right to a single deduction of losses within the EU, by a beneficiary of the Treaties.

First, the Court accepted the principle of cohesion, related to the balanced allocation of taxing rights (and to the principle of symmetry or territoriality, similarly to the Bachmann case) as a further justification to the restrictive measure.

Then, it emptied the principle of proportionality of the restriction, as used in M&S II. It argued that the need for the taxpayer to exhaust the possibilities of deducting the losses in the State allowed to tax the income was not applicable, where that State did not provide the possibility to deduct those losses. As note before, France did not allow the deductibility of the loss.

One could deduce from *K.* that the *M&S II* always somewhere exception cannot apply if the source state does not allow for loss relief at all. In light if this we take it that the Court held in *K.* that the non-deductibility of this final loss in the case at hand was a result of disparities. This is inconsistent with the whole reasoning endorsed by the Court. If non deductibility of losses incurred abroad is a disparity, in case the Member State in which the property is located is entitled to tax but does not provide for deduction of losses, Finish legislation should not be held as restrictive (even if justifiable).

18.11 Proportionality and *M&S III*;[66] Reduction of *M&S II*

Following the judgment in *M&S II* (C-446/03), the UK amended its Income Corporate Tax Act (which came into force on 1 April 2006), for the purposes of allowing cross-border relief but subjected it to some conditions that were not mentioned in the *M&S II* judgment. The determination as to whether losses may be taken into account in future accounting periods must be made 'as at the time immediately after the end of the accounting period in which the losses were sustained', and they are limited to losses sustained in a single tax period. In contrast, according to the general time limit applicable to group relief claims, the latter must be made within two years of the end of the accounting period in which the losses were sustained.

The Commission initiated an infringement procedure against the UK, with the argument that the UK tax rules implementing the *M&S II* decision 'are based on a particularly restrictive interpretation of the condition relating to the exhaustion of all possibility of the non-resident subsidiary's losses being taken into account in the Member State where that subsidiary is resident'.

The Court confirmed that the different treatment granted to the cross-border relief of losses is an obstacle to the freedom of establishment, but argued they were justified by the three *M&S II* justifications. It further took those justifications together, as it did in *M&S II* (the case is the same, and therefore it would have been odd to assess the justifications autonomously) but had not done in subsequent cases

66. Case C-172/13, *Commission v. UK (M&S III)*, EU:C:2015:50.

decided after the latter (e.g. *Oy AA*, *X Holding BV*, *K.*). The only aspect at stake under *M&S III*[67] had to do with the proportionality of the UK legislation implementing the CJEU *M&S II* decision.

In point 55 of *M&S II*, the Court "considers that the restrictive measure at issue in the main proceedings goes beyond what is necessary to attain the essential part of the objectives pursued where: – the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods, if necessary by transferring those losses to a third party or by offsetting the losses against the profits made by the subsidiary in previous periods, and – there is no possibility for the foreign subsidiary's losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party".

In *M&S III*, and contrary to the Commission's assessment, the Court held that the UK implementation of the aforementioned point 55 is compatible with it, does not require that the subsidiary concerned is wound up before the end of the accounting period in which the losses are sustained and that losses may be characterized as definitive "only if that subsidiary no longer has any income in its Member State of residence. So long as that subsidiary continues to be in receipt of even minimal income, there is a possibility that the losses sustained may yet be offset by future profits made in the Member State in which it is resident" (point 36, *M&S III*).

Thus, with this decision, the CJEU clarifies that final losses can only occur when the subsidiary no longer has any income in its Member State of residence or does not have the possibility, in the future, of having income in that State.

The fact that the Member State restricts the deadline for claiming the relief to "the time immediately after the end" of the account period in which the losses were incurred and limited to losses incurred in a single tax period was not held disproportionate by the Court. By assuming that the UK restrictive legislation and deadline was justified in light of the three M&S II justifications without discussing it, the Court promotes that same restrictive legislation in other Member States.

18.12 Reincorporation of p.e. Losses Under a Credit System (*Nordea Bank*); Recapture/Exclusion of p.e. Losses under an Exemption System (*Timac Agro*); Final p.e. Losses (*A/S Bevola*)

Nordea Bank Danmark A/S[68] was established in Denmark. Between 1996 and 2000 it engaged rather unsuccessfully in retail banking in Finland, Sweden and Norway through permanent establishments in these countries. These p.e.'s made losses,

67. Case C-172/13, *Commission v. UK (M&S III)*, EU:C:2015:50.
68. C-48/13, *Nordea Bank Danmark A/S*, EU:C:2014:2087.

which were deducted from Nordea's tax base in Denmark (worldwide taxation). In 2000, the activities of the p.e.'s were restructured, resulting in a transfer of their businesses to nonresident affiliated companies in the same Nordea group. Denmark thus lost its taxing rights as regards these p.e.'s. The former p.e.'s were part of a Danish subject-to-tax company, but the receiving foreign group companies were not subject to tax in Denmark. This loss of taxing jurisdiction upon the transfer of business by a resident company to a non-resident associated company triggered the reincorporation of the previously deducted p.e.-losses into Nordea's taxable profit. The aim of this rule was to prevent Danish companies from deducting foreign losses from Danish tax base, and then, after the foreign branches turn to profit, transferring these branches to nonresident group companies outside Danish taxing jurisdiction, preventing Denmark from taxing those subsequent profits. Such reincorporation did not, therefore, apply to a transfer of domestic branches within Denmark, as their subsequent profits would be taxable in Denmark. As Denmark subjected both foreign and domestic branches to tax and allowed loss deduction in respect of both foreign and domestic branches, the Court considered them to be comparable. Because they were being treated differently (domestic branch losses being fully deductible without any reincorporation upon a domestic intra-group transfer), it considered the freedom of establishment to be restricted by the Danish reincorportion rule. The Court accepted, in principle, that the needs to ensure a balanced allocation of taxing rights and to prevent tax avoidance could justify reincorporation of foreign losses:

> "30 If (…) Denmark were denied the power to reincorporate the losses thereby deducted into the taxable profit of the Danish company carrying out the transfer, when it has lost the power to tax any future profits, arrangements of the above kind would artificially erode its tax base and, therefore, affect the allocation of the power to impose taxes resulting from the Nordic Convention."

However, it considered loss reincorporation in this case to be disproportionate, as Denmark applied a credit system (and therefore did not exempt, but in principle taxed p.e. profits, *including* the expectation of future profits locked in the (arm's length) transfer price Nordea Bank Danmark received for the sale of its foreign p.e.'s:

> "31 However, the legislation goes beyond what is necessary to attain that objective.
> 32 (…)
> 33 The need to safeguard (…) symmetry means that the losses deducted in respect of the permanent establishment must be capable of being offset by taxation of the profits made by it under the tax jurisdiction of the Member State in question, that is to say, both the profits made throughout the period when the permanent establishment belonged to the resident company and those made at the time of the permanent establishment's transfer.

> 34 It is not disputed that the profits of a permanent establishment belonging to a resident company that are made before the permanent establishment's transfer (…) are taxable in Denmark, even though Article 25 of the Nordic Convention provides for the grant of a tax credit to the resident company in order to neutralise the risk of any double taxation.
> 35 Furthermore, [national law] lays down in particular a rule that assets transferred within a group are to be valued on market terms. Any gain made upon the transfer is then added to the taxable income of the Danish company carrying out the transfer.
> 36 Therefore, a provision of a Member State, (…), which provides, (…), for the reincorporation of the losses previously deducted in respect of the establishment transferred goes beyond what is necessary to attain the objective relating to the need to safeguard the balanced allocation of the power to impose taxes if the first Member State taxes the profits made in respect of that establishment before its transfer, including those resulting from the gain made upon the transfer.
> 37 This conclusion is not altered by the fact, put forward by the Danish Government, that it would be difficult for it in the event of an intragroup transfer to verify the market value of the business transferred in another Member State.
> 38 Such difficulties are not specific to cross-border situations since the Danish authorities necessarily already carry out similar checks when a business is sold in the context of an intragroup transfer of a resident establishment.
> 39 Moreover, the Danish tax authorities in any event always have the power to request from the transferring company the documents that appear to them necessary in order to verify whether the value of the business adopted for the purpose of calculating the gain on transfer of a foreign establishment is the same as the market value (…)."

At first blush, thus looks as if Denmark was punished for applying a credit system (see points 34 and 36) instead of an exemption system. Indeed, from *Lidl Belgium*, *Krankenheim Ruhesitz* and *Timac Agro* it is clear that if Denmark had applied either exemption with progression or base exemption, the Court would not have found any violation of the freedom of establishment. Apparently, under a credit system reincorporation is considered disproportionate in a transfer case like this, as Denmark taxed the transfer price which included possible goodwill (expected future profits). Any further possible future profits were simply outside Denmark's taxing power and the Court apparently viewed the reincorporation as a disproportionate attempt at taxing those further possible future profits.

The subsequent case *Timac Agro*[69] dealt with (i) the German reincorporation of p.e. losses made by a German resident company in Austria in the years 1997–1998, in which Austrian branch results were exempted with progression under the tax treaty

69. Case C-388/14, *Timac Agro Deutschland GmbH*, EU:C:2015:829.

with Austria (first period), and with (ii) the German non-deductibility of branch losses made in Austria in the years 1999–2006 as a result of Germany adopting as of 1999 a base exemption system.

For the tax years 1997 and 1998, the Court viewed domestic and foreign branches as comparable, as the losses of both types of branches were deductible in Germany (point 28). For that period, the question was whether the reincorporation of previously deducted foreign branch losses in the taxable base of the German head office was compatible with the freedom of establishment. The answer to that seems an *acte clair*, given the Court's affirmative answer in *Krankenheim Ruhesitz* (C-157/07), but the issue in *Timac Agro* was slightly different, as in *Krankenheim Ruhesitz* the recapture of the previously deducted foreign p.e. losses was triggered by subsequent profitability of the foreign p.e., whereas in *Timac Agro*, it was triggered – as in *Nordea* – by the transfer of the foreign branch to an associated nonresident company, and was therefore not linked to any subsequent profit-making by the foreign branch. The Court did not see that difference as essential; it accepted the same justifications as in *Krankenheim Ruhesitz* for the recapture of the previous deductions: fiscal coherence ('symmetry' between deduction of losses and taxation of corresponding profits), a balanced jurisdictional allocation of taxing rights, and the need to prevent abuse (all of which 'overlap', according to the Court)

In the second period at issue in *Timac Agro*, Germany did not provide exemption with progression anymore, but it disregarded foreign (Austrian) branch results altogether, whether positive or negative (base exemption). As Germany thus did *not* exercise its taxing rights in respect of the results of foreign branches any more, foreign p.e. results were not comparable any more to domestic branch results, which *were* subject to tax (points 64–65). The domestic and the cross-border situation thus not being comparable, the cross-border situation was not being discriminated against. Therefore, no justification was required, and proportionality was not an issue.

Presently pending with the Court is the case *A/S Bevola*,[70] concerning a company established in Denmark with subsidiaries and permanent establishments abroad. Bevola's p.e. in Finland ceased trading in 2009 and could therefore not offset unused Finnish losses anymore in Finland. The Danish authorities denied deduction of those unused losses by A/S Bevola in Denmark, as Danish tax legislation excluded foreign income and expenditure attributable to a foreign p.e. from the Danish tax base (tax base exemption), unless the Danish company had opted for worldwide joint taxation. That option required all subsidiaries and p.e.'s of the group to be included in the joint taxation scheme, for a period of at least ten years. A/S Bevola had not opted for the joint taxation scheme, which it considered a disproportionate and restrictive condition for eligibility for loss deduction.

70. Case C-650/16, *A/S Bevola, Jens W. Trock ApS v Skateministeriet* (pending).

The advocate-general Campos Sánchez[71] opined that Denmark cannot rely on *Nordea Bank* and *Timac Agro* (first period), because even though domestic and foreign branch results are being treated alike under the Danish international joint taxation system, the Finnish branch losses at issue are final losses and should therefore be deductible under the *M&S II*-rule (see section 18.5). The Danish legislation precludes the Finnish final loss to be absorbed by the Danish head office, whereas identical final losses of a domestic closed p.e. would be so absorbed. He therefore considered the exclusion of the definitive Finnish p.e.-loss to be discriminatory (points 57-58). *Nordea Bank* and *Timac Agro* do not apply, as the Danish international joint taxation system is not aimed at preventing or mitigating double taxation, unlike the national systems at issue in *Nordea Bank* and *Timac Agro* (first period) (point 61), and because the losses at issue in *Nordea Bank* and *Timac Agro* were not final but recurrent losses. Allowing deduction of recurrent losses produces the risk of cherry-picking by the taxpayer concerned, a risk which does not exist in respect of one-off final losses. The advocate-general on the one hand seems to consider the option for international joint taxation as illustrating that Denmark considers foreign and domestic p.e.'s as comparable, which implies that final losses should be treated identical, but on the other hand considers that option to be a disproportionate obstacle to equal treatment of foreign and domestic p.e.-losses, as it can only be applied for at least ten years and only if all foreign entities are included, which is unrealistic. We believe that if that option is unrealistic as a justification, then it is also unrealistic to consider Denmark as subjecting foreign and domestic p.e.'s alike, because it clearly does not: it applies base exemption. For unclarified reasons, the advocate-general seems to ignore that. Possibly, the reason for that is his consideration that:

> "(…) it is logical that, when (…) profits are calculated, losses incurred (…) should not be excluded, for there will have been a commensurate reduction in the taxpayer's economic capacity (more specifically, taxpaying capacity).
> 38. When, in a cross-border context, all the possibilities have been exhausted of taking those losses into account in the State of the subsidiary, that does not mean that the parent company's economic capacity is unaffected: it will definitely have been reduced. That is why the principle underlying the judgment in *Marks & Spencer* (it must be possible for account to be taken of definitive losses *somewhere*) ensures that there is a balance between the tax burden and the actual economic capacity of the taxpayer who has incurred those losses."

Ability-to-pay being the main consideration, the advocate-general concludes the Finnish loss should be deductible *somewhere*. This is odd, as (i) Denmark is thus forced to give up its taxing rights as regards Danish-sourced profits: if it has to accept

71. Opinion of the advocte-general Campos Sánchez-Bordona, delivered on 17 January 2018.

non-subject losses, it is not able to tax the Danish profits from which those alien losses are deducted; that clearly contradicts the Court's settled case law, and (ii) if a Finnish business which does not happen to have a foreign head office or parent goes out of business, there will be a loss forever as well, so it is difficult to see why this Finnish final loss should be transferred to an arbitrary foreign country. It should be noted that the parent/head office may be in a loss position as well, in which case the loss will not be deductible anywhere anyway. Since we consider *M&S II* to have been decided incorrectly, we believe the advocate-general's opinion in *Bevola* to be incorrect as well.

18.13 **Conclusion**

There is no positive integration yet in respect of cross-border loss relief. Whether the CC(C)TB will fly remains to be seen. There is not much negative integration either, at least not for companies. There has been an evolution in the case law of the Court. In its more recent jurisprudence, the Court requires cross-border loss relief only 'vertical upward' (only from subsidiaries/branches to parent companies/head offices), as long as the Member States of parent companies / head offices exercise their taxing rights and as long as the State of the subsidiary (and most probably also, the State of the permanent establishment) provides for loss deduction in its laws. Moreover, the aforementioned cross-border loss relief 'vertical upward' only applies for 'definitive' losses of foreign subsidiaries and branches; these must be accepted by the parent/headquarters State as if they were resident losses. Definitive losses include only losses upon cessation/liquidation of the business abroad. For the rest, the home State is free to use deduction and reinstatement (worldwide taxation with tax exemption) or to exclude foreign business results altogether from the tax base of its resident companies (base exemption). Furthermore, EU law does not require the Member States to extend their domestic fiscal group consolidation schemes to non-subject group companies in order to provide relief for current losses. Per the Court's "per element approach" accepted in *Groupe Stéria* there is a need to carry out a separate assessment of other particular advantages arising within a group regime than temporary cross-border carry-over of subsidiary losses. See section 17.4.

A large majority of the Member States (nonetheless) allows deduction (and reinstatement: tax exemption method) of foreign branch losses, but only a few allow cross-border vertical upward loss relief between separate legal entities (foreign subsidiaries).[72] Especially as regards groups of companies, this is an unsatisfactory situation from an Internal Market perspective, which in the authors' opinion can hardly be blamed on the Court, which in our view may even have gone further than

72. See Reinout Kok, 'Domestic and Cross-Border Loss Relief in the European Union,' 38 *Intertax* 12 (2010), at 699 and at 670, respectively.

its competence allowed. The EU legislator should move, *i.e.* adopt some form of CCCTB.

For individuals, things are relatively different, apparently because their ability to pay has to be taken into account, although one sees no provision in the Treaties or in any known general principle of EU law on which to base this overriding fiscal ability-to-pay imperative. For individuals, *base* exemption in the *home* State would probably be considered disproportionate, as tax exemption is significantly less restrictive and just as capable of attaining the legitimate aim of tax base integrity as base exemption. The *source* Member State (the State of employment or of the permanent establishment of the individual), is *always* required to import an – on balance – negative income from the individual's home Member State. This is because a nonresident employee or self-employed person with a negative home State income is by definition in a *Schumacker* position, as the Court does not count negative income for purposes of its *Schumacker* test. But in respect of cross-border losses and their deductibility in the residence jurisdiction, the same tests for assessing a restriction, justifications and proportionality are applied, independently of there being a company or an individual. Thus, in *K.*, the Court held that the residence State was not required to deduct the losses arising on the transfer of immovable property situated in another Member State from the income of other assets taxable in the first Member State, although that deductibility would have taken place if the immovable property were situated in the first Member State. This was because the Member State where the property was situated did not allow for the possibility of deduction of losses upon sale of property and that meant the impossibility to deduct those losses resulted from the interaction of both tax systems, in other words, from disparities.

Recent case law on cross-border losses, such as *K.*, *Nordea Bank* and *Timac Agro* (in respect of the first of the two periods considered in the case), by stressing the symmetry aspect of taxing rights have reduced the practical effect of the comparability between domestic investment and cross-border outbound investment.

To assert that non deductibility of cross border losses constitutes a restriction to article 49 TFEU and subsequently admitting that restriction is justified by the symmetry, coherence of the internal tax system, lack of comparability between permanent establishments located in different member states, or disparities, is not different, in its result and in most cases, from concluding that the different treatment is not restrictive because it reflects the territoriality principle, as initially argued in *Futura*.