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EDITORIAL

Ten Years of Marks & Spencer

Yariv Brauner, Ana Paula Dourado & Edoardo Traversa*

1 Marks & spencer as a groundbreaking decision

1.1 *Introductory Remarks*

Ten years of the Marks & Spencer Advocate General (AG) Opinion (7 April 2005) and decision (13 December 2005)[1] on the treatment of cross-border losses by the residence State of the parent company must be celebrated by both those who liked and those who disliked them. This is due to the impact that the decision had for good and not so good reasons: Marks & Spencer proposed a groundbreaking approach in cross-border taxes in the European Union (EU), but it did so at the cost of the legal uncertainty that it created and has not been resolved so far.[2]

The impact is still felt in the Member States and in the European Court of Justice (ECJ) itself (the ECJ recently ruled on the implementation of the *Marks & Spencer* case in the UK).[3] As AG Kokott recalls in her Opinion on Marks & Spencer 2 (i.e., *Commission v. The United Kingdom*) more than 100 of academic writings were generated by the Marks & Spencer case.[4] In this editorial, we chose to highlight and briefly comment on some of the most innovative arguments in the Marks & Spencer Opinion and Decision, as well as on some of the controversial solutions put forward by the aforementioned Opinion and Decision.

The facts can be simplified as follows: In the UK, legislation on 'group relief' subjected the transfer of losses within a group of companies to the condition that those companies were resident or carried on an economic activity in that jurisdiction. Both the AG and the Court considered this to be a restrictive measure in the UK.[5]

The groundbreaking solution proposed by the AG Poiares Maduro and accepted by the ECJ in Marks & Spencer lies in overcoming the principle of non-discrimination on the ground of nationality in direct taxes (applicable to incoming tax situations or strict comparison between the national regime applicable to a resident and a non-resident), and promoting the 'same concept of restriction on freedom of establishment which is applicable in the other areas',[6] independently of the allocation of taxing rights between the Member States involved. '… [A]ll measures which prohibit, impede or render less attractive the exercise of that freedom must be regarded as restrictions.'[7] Member States are not allowed to be 'pursuing discrimination against Community nationals wishing to assert their rights derived from the freedoms of movement'.[8]

Application of this same concept of restriction to taxes seemed an unavoidable step, taking into account the

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1 Opinion of Advocate General Poiares Maduro delivered on 7 Apr. 2005, Case C-446/03 *Marks & Spencer plc v. David Halsey* (HM Inspector of Taxes); ECJ C-446/03, 13 Dec. 2005, *Marks & Spencer plc v. David Halsey* (Her Majesty's Inspector of Taxes), [2005] ECR I-10837.

2 On the questions (and legal uncertainty) raised by Marks & Spencer, see, e.g., Axel Cordewener, 'Cross-Border Relief and the "Effet Utile" of EU Law: Are We Losing it?', *EC Tax Review*, 2, 2011, 58. Michael Lang, 'Has the Case Law of the ECJ on Final Losses Reached the End of the Line?', *European Taxation* 4, 2014; Michael Lang, 'The Marks & Spencer Case – The Open Issues Following the ECJ's Final Word', *European Taxation* 2, 2006, 54; Dennis Weber, *Highlights & Insights on European Taxation*, 3, 2010, 28. See the several chapters in Weber/Silva, *From Marks & Spencer to X Holding, The Future of Cross-Border Group Taxation,* Kluwer, The Netherlands (2011); Van Thiel & Vascega, 'X Holding (Case C-337/08): Why Ulysses should stop listening to the Sirene', *European Taxation* 2, 2010, 334; De Wilde, 'On X Holding and the ECJ's Ambiguous Approach towards the Proportionality Test', *EC Tax Review* 19, 2010, 170.

3 ECJ, 3 Feb. 2015, Case C 172/13*, European Commission v. United Kingdom of Great Britain and Northern Ireland* and Opinion of Advocate General Kokott delivered on 23 Oct. 2014, see also the Opinion of Advocate General Geelhoed in *Test Claimants in Class IV of the ACT Group Litigation* (C-374/04, EU:C:2006:139, point 65) and the Opinion of Advocate General Mengozzi in *K* (C-322/11, EU:C:2013:183, points 87 and 88).

4 *Ibid.*, point 2, n. 6.

5 Opinion of AG Maduro, *supra* n. 1, e.g., points 37, 51–53; ECJ C-446/03, *supra* n. 1, paras 31 and 33.

6 Opinion of AG Maduro, *ibid.*, point 35.

7 Opinion of AG Maduro, *ibid.*, point 35.

8 Opinion of AG Maduro, *ibid.*, point 28.

holistic approach of the ECJ to the EC Treaty and the fundamental freedoms. The approach had in fact also been adopted in previous cases, with respect to tax treatment of foreign income (De Groot, Lenz, Manninen),[9] costs in relation to a subsidiary abroad (Bosal)[10] and exit taxes (Lasteryie du Saillant),[11] but the 'disrespect' of the allocation of taxing rights based on the territoriality principle did not have the same dimension as in Marks & Spencer.

In *Marks & Spencer*, the Opinion's reasoning focuses on the benefits of the Union's citizens inherent to the internal market: the latter 'constitutes the transnational dimension of European citizenship'.[12] To clearly determine the beneficiaries of the rule seems an evident condition to the correct interpretation of the fundamental freedoms rules (even if the ECJ case law is not consistent).[13] The same is true for the right comparator. In the Opinion, it is claimed that the right comparator includes resident parent companies according to whether they reside in it or move within the Community (i.e., resident parent companies with resident subsidiaries versus resident parent companies with non-resident subsidiaries).[14]

1.2 *A Precedent or an Exception?*

Even if this is correct under a formal analysis of the facts, a deeper insight will show us that treating parent companies alike in their State of residence in respect of cross-border losses will not eliminate the aforementioned restrictions and is far from ensuring neutrality in the exercise of the freedom of establishment.[15] In fact, to determine whether non-deductibility of losses of foreign companies in the parent company Member State is a disadvantage[16] or, even admitting that it is a disadvantage, to determine whether the latter is caused by the parent company Member State[17] is more than disputable, as is shown by subsequent case law such as Krankenheim Ruhesitz am Wannsee and K.[18] In the latter cases, the ECJ considered that any disadvantages in the residence State were not attributable to that State.[19]

It is consequently controversial that parent companies are the right comparator in cases regarding cross-border losses. Overseeing the allocation of taxing rights between the residence and the source States may well be the reason why the State of residence of the parent company will not be able to eliminate restrictions resulting from a different treatment of domestic and cross-border losses.

Moreover, Marks & Spencer and the subsequent cases on cross-border losses rely on a unilateral perspective, when assessing which State causes the restrictions: by stating that restrictions are caused by the resident Member State, the Court overcomes the allocation of taxing rights. In substance, this perspective was not observed in Krankenheim Ruhesitz am Wannsee and K, where the ECJ took into account the legislation in the source State (although the formal analysis still relies on the restriction of the Member States).

At the same time, in *Marks & Spencer*, both the Opinion and the Court accepted justifications based on an internal market (cohesion) perspective: whether losses are or not deductible in the source State (allocation of taxing rights), whether there is a risk of double deduction or whether there is a risk of tax avoidance by cherry picking where to deduct the losses.[20] Subsequent case law by the Court relying on justifications attached to the 'internal market cohesion perspective' such as the outbound dividends cases has raised many questions, demonstrating that adopting

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[9] ECJ 12 Dec. 2002, C-385/00, *F.W.L.De Groot v. Staatssecretaris van Financiën*, [2002] ECR I-11819, para. 77: 'it is settled case-law that all of the Treaty provisions relating to the freedom of movement for persons are intended to facilitate the pursuit by Community nationals of occupational activities of all kinds throughout the Community, and preclude measures which might place Community nationals at a disadvantage when they wish to pursue an economic activity in the territory of another Member State (Case C-370/90 *Singh* [1992] ECR I-4265, paragraph 16, *Terhoeve*, paragraph 37, Case C-190/98 *Graf* [2000] ECR I-493, paragraph 21, and Case C-302/98 *Sehrer* [2000] ECR I-4585, paragraph 32)'; ECJ 15 Jul. 2004, C-315/02, *Anneliese Lenz v. Finanzlandesdirektion für Tirol*, [2004] ECR I-07063, para. 20; ECJ C-319/02, 7 Sep. 2004, Petri Manninen, [2004] ECR I-07477, para. 22 and also from the perspective of 'companies established in other Member States in that it constitutes an obstacle to their raising capital in Finland' para. 23.

[10] ECJ C-168/01, 18 Sep. 2003, *Bosal Holding BV v. Staatssecretaris van Financiën*, [2003] ECR I-09409, para. 27.

[11] ECJ 11 Mar. 2004, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie*, [2004] ECR I-02409, paras 39–40.

[12] Opinion AG Poiares Maduro, *supra* n. 1, point 34.

[13] Adopting a different approach to 'comparison' see, e.g., ECJ 25 Feb. 2010, C-337/08, *X Holding BV v. Staatssecretaris van Financiën*, [2010] ECR I-01215, para. 38; ECJ 22 Dec. 2008, C-282/07, *État Belge – SPF Finances v. Truck Center SA*, [2008] ECR I-10767, focusing on the Member States' tax role and not on the taxpayers' rights, paras 41–42.

[14] Opinion of AG Maduro, *supra* n. 1, point 34.

[15] Contrary to what was expected by the AG Poiares Maduro Opinion, *supra* n. 1, points 49, 51.

[16] As assumed in the AG Poiares Maduro Opinion, *supra* n. 1, point 41 without considering the tax situation of the subsidiary in concrete and of the group as a whole.

[17] As the AG Poiares Maduro Opinion, *supra*, n. 1, suggests in point 40.

[18] ECJ, 23 Oct. 2008, Case C-157/07, *Finanzamt für Körperschaften III in Berlin v. Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt GmbH*, [2008] ECR I-08061; ECJ, 7 Nov. 2013, Case C-322/11*, K*.

[19] *Krankenheim Ruhesitz*, *ibid*., paras 49–52. *K.*, *ibid*., paras 75–77. See Michael Lang, 'Has the Case Law of the ECJ …', *supra* n. 2, 531–532.

[20] AG Poiares Maduro Opinion, *supra* n. 1, points 72–75.

the internal market perspective when justifying unilateral restrictions, leads to more questions than answers.[21]

Although the Opinion does not mention the allocation of taxing rights[22] as a justification for the restriction – in fact, it focuses on the transfer of losses which risks jeopardizing the aim of the (UK) group system[23] –, its inclusion as a justification by the ECJ announces the failure of Marks & Spencer (see section 2.1 below).

In turn, avoidance as a justification for not allowing the deduction of cross-border losses in the parent company's Member State was recognized by the AG and the ECJ as a risk that should not be underestimated. But here again, contrary to settled case law on abuse,[24] it is not required that the parent company's State of residence demonstrate avoidance in the concrete case. Both the methodology and the arguments and decisions followed by the Court and the AG Opinions in the subsequent related cases are less clear than in Marks & Spencer.

It is therefore widely recognized that the ECJ is not at ease with its Marks & Spencer decision.[25] The above-mentioned controversial issues and especially the justifications put forward by the Court and analysed below (see section 2), demonstrate that Marks & Spencer is not the rule (a precedent) but an exception.[26]

1.3 *The Original Sin in Marks & Spencer: Territoriality, Extraterritoriality and Transfer of the Taxable Base*

In the *Marks & Spencer* case, overcoming the principle of non-discrimination meant overcoming the consistent application of the international tax principle of territoriality (or symmetry) as applied to the taxable base and as it had been settled in the *Futura* case.[27] Passionate reactions among tax lawyers were raised by such a bold overcoming of territoriality and allocation of taxing rights. If a Member State does not tax the profits incurred abroad it does not have to allow deduction of costs or losses (unity of the taxable base). This has also been explained by the economic allegiance principle and the prohibition of extraterritorial taxes:[28] non-residents are only taxed on the profits incurred at source and jurisdictions cannot tax if neither source of income nor residence of the taxpayer takes place in its territory. The (limited) partnership metaphor (see below section 3.1) explains why tax losses are deductible in the territory where a company operates and within certain limits.

Although it is easy to recognize that *Futura* does not serve the purpose of setting up the internal market, in the Marks & Spencer Opinion, it is hardly explained why *Futura* expressed the needs of power coordination and the facts in Marks & Spencer do not reveal that need.[29] In fact, in both cases the 'transfer of losses between companies forming part of the same group' refers to the transfer of losses between companies under distinct jurisdictions.[30]

AG Poiares Maduro recognized that the need to ensure cohesion of the tax system may justify restrictive rules,[31] but considered that this could not be performed to the detriment of integration of tax systems within the context of the internal market.[32] From an EU law perspective, the principle of territoriality seems connected to international taxation relying on national sovereignty and therefore inadequate for the internal market. The intuition by a Court proudly not specialized in tax law was to a certain extent correct.

However, it was not realized that profits or losses have to be consistently assessed under the laws of one jurisdiction or another; they are *the* taxable base, and therefore from a legal perspective, deduction of losses only secondarily is a problem of national sovereignty or cohesion. The taxable base is a dogma in Tax Law (a systematic element of the legal Typus or *Tatbestand*), that had been already touched by the ECJ in cases involving

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21 See ECJ 14 Dec. 2006, C-170/05, *Denkavit Internationaal BV and Denkavit France SARL v. Ministre de l'Économie, des Finances et de l'Industrie*, 2006 I-11949; ECJ 8 Nov. 2007, *Amurta SGPS v. Inspecteur van de Belastingdienst/Amsterdam*, 2007 I-09569.

22 See Opinion AG Poiares Maduro, *supra* n. 1, points 71–76, especially 71 and 76.

23 *Ibid.*, point 74.

24 For example, ECJ 12 Sep. 2006, C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, [2006] ECR I-07995.

25 See e.g.: *X Holding*, *supra* n. 13; Krankenheim Ruhesitz am Wannsee, *supra* n. 18; *K.*, *supra* n. 18; and also the reasoning put forward by AG Kokott when asking the ECJ to overrule Marks & Spencer: See Opinion of Advocate General Kokott delivered on 19 Jul. 2012, Case C-123/11A Oy. See moreover the Opinion of Advocate General Mengozzi in *K.*, *supra*, n. 18, points 87 and 88.

26 See Opinion of Advocate General Kokott, *supra* n. 25, points 1–3.

27 ECJ 15 May 1997, C-250/95, *Futura Participations SA and Singer v. Administration des contributions*, [1997] ECR I-02471, para. 22.

28 Klaus Vogel, *Einleitung, Doppelbesteuerungsabkommen* (hrs. Vogel, Lehner), Beck, München, 2008, 5. Auflage, mno 11.

29 AG Poiares Maduro Opinion, *supra* n. 1, points 61–62.

30 This is overseen in points 62–64.

31 Going back to Bachmann: AG Poiares Maduro Opinion, *supra* n. 1, point 65.

32 AG Poiares Maduro, *ibid.*, point 66.

both resident individual taxpayers, such as de Groot,[33] and resident companies, such as Bosal,[34] regarding cross-border transfer of costs.

In cross-border situations, this unity of the taxable base was seen by tax lawyers as a symmetric treatment of profits and losses.[35] Costs incurred abroad and deductible in the residence Member State implied overcoming the symmetry of the taxable base, especially in case a Member State applied the territorial regime (*de Groot, Bosal*).

Deduction of costs in the source Member State incurred by a non-resident without a permanent establishment State means overcoming the traditional role of the source country in respect of the aforementioned non-residents (taxation by withholding tax on gross income).

Deductibility of foreign losses in the Marks & Spencer situation implied a detachment (or transfer) of the taxable base itself from the source State to the residence State. Even if it is not clear,[36] deductibility of losses incurred in the source State and not deductible there seem to imply deductibility of losses as determined according to the tax law in that source State – that is why both the AG and the ECJ foresaw the risk of trafficking losses. In AG Kokott's Opinion on *Commission v. The United Kingdom*, the case law on exit taxes is referred to as having overruled Marks & Spencer. Perhaps more aware of the distortive effects caused by case-law promoting consideration of cross-border losses in the country of residence of the parent company, the ECJ restrained from transferring the taxable base from the exiting State to the incoming State, in the exit tax cases on companies.

For example, in *National Grid Indus:*

> The transfer of the place of effective management of a company of one Member State to another Member State cannot mean that the Member State of origin has to abandon its right to tax a capital gain which arose within the ambit of its powers of taxation before the transfer (see, to that effect, Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, paragraph 59). The Court has thus held that, in accordance with the principle of fiscal territoriality linked to a temporal component, namely the taxpayer's residence for tax purposes within national territory during the period in which the capital gains arise, a Member State is entitled to charge tax on those gains at the time when the taxpayer leaves the country (see *N*, paragraph 46). Such a measure is intended to prevent situations capable of jeopardizing the right of the Member State of origin to exercise its powers of taxation in relation to activities carried on in its territory, and may therefore be justified on grounds connected with the preservation of the allocation of powers of taxation between the Member States (see *Marks & Spencer*, paragraph 46; *Oy AA*, paragraph 54; and Case C-311/08 *SGI* [2010] ECR I-487, paragraph 60).[37]

According to the AG Opinion on Marks & Spencer, the assessment of whether non-deductibility of cross-border losses was a restriction should be guided by a neutrality purpose. Contrary to the expectations of the AG Opinion, the parent company residence country cannot guarantee a neutral result even if it allows for deductibility of losses incurred abroad, since neutrality would depend on full harmonization of corporate tax bases and consolidation (and even then neutrality would not be complete due to the application of transfer pricing rules in the relation with companies or branches of the same group located in third countries).[38]

2 Justifications operating in the cohesion of the internal market framework

2.1 *Allocation of Taxing Rights, Double DIP and the Risk of Tax Avoidance*

The Marks & Spencer decision can also be considered a landmark case as regards the justifications. In that judgment, the Court accepted for the first time that 'the preservation of the allocation of the power to impose taxes between Member States' could serve as an imperative reason in the public interest justifying the restriction to the fundamental freedoms. In this perspective, the Marks & Spencer decision can be seen as marking a turning point in the evolution of the discussion on the justifications from a taxpayer-centred to a State-centred approach.

The different meanings that can be given to the concept of 'cohesion' reflect this difference in perspective. Prior to Marks & Spencer, the cohesion of the tax system argument – as it was developed for example in *Bachmann* or *Commission v. Belgium*[39] – was essentially based on the

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33 ECJ, *De Groot*, *supra* n. 9.

34 ECJ, *Bosal*, *supra* n. 10.

35 See the critiques on De Groot, Bosal and Marks & Spencer in Ben Terra/Peter Wattel, *European Tax Law,* Kluwer, The Netherlands, 2012, 6th ed., mnos 733–737.

36 See, e.g., AG Opinion in *A Oy* (Case C-123/11), paras 73 et seq. Michael Lang, 'Has the Case Law …', *supra* n. 2, 535–536.

37 ECJ 29 Nov. 2011, C-371/10 *National Grid Indus BV v. Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam*, [2011] ECR I-12273, para. 46.

38 Michael Lang, 'Has the Case Law …', *supra* n. 2, 530.

39 Case C-204/90 *Bachmann v. Belgium*, *supra* n. 31 and Case C-300/90, *Commission v. Belgium* [1992].

effect of the domestic tax measures at stake on the personal situation of the individual taxpayer: it was rather an issue of identifying whether he or she had suffered a real tax disadvantage, i.e., an increased tax liability that was not compensated by a lesser tax burden at a prior or later stage.

In Marks & Spencer, and then in the subsequent case law, the issue of cohesion (or coherence) is taken to another level, i.e., the allocation of taxing powers between Member states concerning a particular transnational situation. In that perspective, the individual taxpayer's position is used as a mere illustration of the results of the application of domestic or conventional tax rules in the cross-border context. The discussion of the acceptability of justifications by the court turns into a fundamental question of the rationale behind international tax allocation rules and the legitimacy of the Member states' tax claims.

Such a renewed approach to the cohesion justification, accepted by the Court under the words 'preservation of the allocation of the power to impose taxes between Member States', is certainly one of the most remarkable aspects of the Marks & Spencer decision. However, as mentioned above, it is not to be found as such in the opinion of the Advocate General Maduro. It is true that he pointed out, citing AG Kokott, that 'conception of fiscal cohesion rests on over-rigid criteria which are not always germane, regard being had to the objective pursued by the rules at issue',[40] and he proposed 'to revert to the criterion of the aim of the legislation at issue', on the ground that 'cohesion must first and foremost be adjudged in light of the aim and logic of the tax regime at issue'. However, Advocate General Maduro in assessing the purpose of the UK group tax relief regime, carefully avoided to acknowledge that the territorial dimension of the regime, and its limitation to UK companies, was inherent to the rationale of the system. According to Maduro:

> *It should be recalled that the aim of the United Kingdom scheme of group relief is to ensure fiscal neutrality of the effects of the creation of a group of companies. Such creation must not entail any specific disadvantage under the general rules of corporation tax. The means of arriving at that situation is to permit the circulation of losses within a group. Nor, however, is it permissible for a supplementary advantage to arise for the group. That accounts for the prohibition on making use twice of the losses surrendered. That scheme thus establishes a correlation within the group between the transfer of losses within the group and the impossibility of using those same losses for tax purposes. Losses are transferred from one company for the benefit of another company in exchange for which the surrendering company loses the right to use those losses again for corporation tax purposes. The advantage conferred on the claimant is supposedly neutralised by the tax to be charged to the surrendering company.*[41]

In light of that objective, Maduro recognized the right of the United Kingdom to limit the benefit of the scheme in order to avoid situations where groups of companies would be put in a more favourable position than single companies, i.e., to prevent double deduction of losses. Such a case would constitute a breach of the neutrality sought by the UK legislator and potentially justify the adoption of measures restricting the freedom of establishment.

But AG Maduro very explicitly dismissed the argument according to which allowing transfer of losses between domestic parent companies and foreign EU subsidiaries would be per se contrary to the objective of the relief and/or would necessarily entail the risk of double use of losses. According to the AG:

> *the Member State concerned cannot merely prohibit any transfer of losses on the sole ground that it is impossible to tax foreign subsidiaries. If it acts in that way the restriction applied goes well beyond what is necessary in order to protect the cohesion of its group system. In fact it results in the addition of objectives foreign to its rationale, whether that involves protection of the revenue of the Member State concerned or the favouring of groups carrying on all their economic activity in its territory. Such objectives would in any event be contrary to Community law.*[42]

The wording used is clear: the restriction to the freedom of establishment cannot be merely justified by the international allocation of taxing powers between Member States or in an hypothetical principle of symmetry between the right to tax profits than the obligation to take losses into account. Oddly enough, it appears that despite the AG's explicit *mise en garde,* the Court reopened the door in the *Marks & Spencer* judgment to justifications it had rejected in this previous case law, such as the protection of tax revenues or the favouring of domestic economic activities, not contradicting him, but also, according to some commentators, her previous case-law.[43] While AG Maduro insisted on 'the need to establish an equilibrium in the allocation of competences as between

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[40] Opinion of the AG Poiares Maduro *supra* n. 1, para. 71.

[41] Opinion of the AG Poiares Maduro, *ibid.*, para. 72.

[42] Opinion of the AG Poiares Maduro, *ibid.*, para. 75.

[43] Melchior Wathelet, 'Tax Sovereignty of the Member States and the European Court of Justice: New Trends or Confirmation?', In Hinnekens/Hinnekens (eds), A vision of taxes within and without European borders, p. 927, referring to ECJ, 18 Nov. 1999, X Ab-YAB, Case C-200/98. See also M. Lang, The *Marks & Spencer* Case – *The Open Issues Following the ECJ's Final Word*, European Taxation, February 2006, p. 67.

the Member States and the Community',[44] the ECJ focused instead on 'the preservation of the allocation of the power to impose taxes between Member States', which entailed 'the symmetry between the right to tax profits and the right to deduct losses'.[45] The Court combined this latter justification with two others (the double taking into account of losses and the prevention of tax avoidance) in order to allow the exclusion of foreign subsidiaries from the group relief scheme, except in specific circumstances. This line of reasoning was followed in the cases *Oy AA* and *Rewe Zentralsfinanz* which also dealt with the tax treatment of losses.[46] Progressively, the preservation of the allocation of taxing powers became an – almost – autonomous ground of justification in the ECJ's direct tax case law, potentially applicable to any cross-border situations.[47]

One could wonder whether that sort of justification really serves the purpose of the achievement of the internal market. It is not unsurprising that the use of this notion has been challenged by Advocate General Kokott in her opinion preceding the *Nordea* case, who sees in it 'simply an expression of other recognised grounds of justification, specifically with regard to the delimitation of Member States' fiscal sovereignty'.[48] This seems particularly to be the case as regards the specific issue of the cross-border tax treatment of losses. Maduro, in his opinion in Marks & Spencer, did not need any reference to the preservation of the allocation of taxing powers between Member States to admit that in certain circumstances cross-border loss relief could be disallowed. He merely considered that when group losses had benefited from equivalent treatment in the State of residence of the subsidiaries, the United Kingdom was in a position, in the light of the objective of the group relief scheme, to oppose the transnational transfer of these losses.[49] Ten years after the decision Marks & Spencer, the time has maybe come for the Court to reassess whether it really brings an added-value or whether it sheds only more confusion to an already complex and protean case law.

2.2 *Exhausting the Possibilities of Taking Losses into Account*

From a more practical perspective, the core issue to be solved in order to benefit from the Marks & Spencer case law concerns the tax treatment of the losses incurred in the State of residence of the subsidiaries. The question when the loss of a subsidiary has to be considered definitive, opening the possibility to transfer in the state of the parent company, is indeed distinct from the question whether the loss has effectively been deducted in the State of residence of the subsidiary. It appeared indeed from the Marks & Spencer decision that a difference can be made between the losses that have not been taken into account due to purely factual circumstances, such as the discontinuance of trading operations in the Member States concerned and the losses that the subsidiary has not been entitled to deduct due to restrictions in the domestic tax legislation of the State of residence (terms of limitation, anti-avoidance rules, …). This difference could entail rather bizarre consequences, such as favouring from a tax perspective the termination of an economic activity instead of its continuation.[50] In its recent ruling in *Commission v. UK* (Marks and Spencer 2), the ECJ admitted the compatibility of the UK legislation adopted in order to implement the *Marks & Spencer* decision with article 49 TFEU. That legislation provided that the assessment as to whether the losses sustained by a non-resident subsidiary may be characterized as definitive had to be made by reference to the situation obtaining 'immediately after the end' of the accounting period in which the losses were sustained. In its judgment, the ECJ issued two important clarifications. First, the country of residence of the parent company does not have to extend cross-border loss relief if the subsidiary is resident in a country that does not allow losses carry forward. Second, losses may be considered as definitive 'only if that subsidiary no longer has any income in its Member State of residence', otherwise there is always 'the possibility that the losses sustained may yet be offset

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44 Opinion of the AG Poiares Maduro, *supra* n. 1, para. 6.

45 Case C-446/03, Marks & Spencer *supra* n. 1, para. 45.

46 Case C-231/05, *Oy AA* [2007], para. 51; Case C-347/04, *Rewe ZentralFinanz* [2007], para. 41.

47 See ECJ Case 414/06, 15 May 2008, *Lidl Belgium GmbH & Co. KG v. Finanzamt Heilbronn* [2008], ECR I-03601; *X Holding*, *supra* n. 13, para. 31; Case C-418/07, *Société Papillon v. Ministère du Budget*, des Comptes publics et de la Fonction publique, [2008], ECR I-08947, paras 37–40; Case C-371/10 National Grid Indus, *supra* n. 37, para. 45; Case C-18/11, Philips Electronics UK [2012] ECR, para. 23; Case 123/11, A Oy, *supra* n. 36; Case C-322/11, *K. supra* n. 18, para. 51; Case C-350/11, *Argenta Spaarbank* [2013], para. 50; Case C-48/13, *Nordea Bank Danmark* A/S [2014], para. 27.

48 Opinion of the AG Kokott delivered on 13 Mar. 2014, Case C-48/13, *Nordea Bank Danmark* A/S [2014], para. 42.

49 On the notion of equivalent losses, M. Lang, *EC Tax Review*, 2005/2, pp. 98–99.

50 I. Richelle, 'Marks and Spencer: A Landmark Decision', in Haslehner/Kofler/Rust (eds), Landmark Decisions in Direct Tax Jurisprudence, Kluwer Law International, Alpen aan den Rijn, forthcoming 2015.

by future profits made in the Member State in which it is resident'.[51] Moreover, it appears from the Court's decision that cross-border loss relief cannot be limited to situations where the subsidiary has been wound up before the end of the accounting period in which the losses are sustained.

3 Why cross-border deduction of losses will not eliminate non-discrimination

3.1 *Why Marks & Spencer Will Never Achieve Neutrality: What is a Loss?*

The nature of losses is often overlooked in tax scholarship. It is naturally masked by the legal consequence of the loss. Losses should be viewed more properly as tax losses. Tax losses do not necessarily correspond to losses in the colloquial sense. The sole importance of tax losses is their deductibility against income, which is, of course, a decision taken by a sovereign tax jurisdiction in its legislative capacity. Therefore, the key issues in analysing losses would be their status as deductible, the attachment to a taxpayer (the one who may deduct), the timing of their deductibility (i.e., also determinative of their value) and the various limitations on their deductibility (a whole or a part) due to abuse or potential abuse.

It is natural therefore that losses are often analysed similarly to deductible business expenses. First, because they literally arise from such deductible business expenses, as a loss is at the end of the day the excess of expenses over revenue. Second, their deductibility analysis is quite similar to that of business expenses. In the purely domestic setting, this may be trivial: corporate groups, originally designed and incentivized to operate as such for the purpose of being entrepreneurial and take risks beyond the inefficient levels of natural human behaviour, are doing what they are designed to do. Consequently, they lose some and win some.

Tax law as a reflection of society tolerates losses as an essential part of doing business. In effect tax law guarantees the deductibility of expenses regardless of whether they eventually generated income or not so long as the taxpayer who took the expenses achieved the overall societal goal of business success in the form of income. In quite simple terms, a jurisdiction is partnering with a taxpayer in both the upside and the downside, but only to the extent of success in the overall role of such taxpayer in society. No jurisdiction is willing to refund overall losses, for example, despite the support for such a regime among economists who believe in the efficiency benefits of such a choice.[52]

The (limited) partnership metaphor can explain many of the legal choices taken by jurisdictions in their design of their tax losses rules. For example, the non-refundability of overall losses may be explained by the view that a failing taxpayer has failed to materialize its societal role and use and hence should not be further incentivized by society. Similarly, the timing of losses attempts to correspond to some finality of an investment with a view to prevent abusive behaviour. Finally, jurisdictions refuse to permit the transfer of losses or their 'sale' among taxpayers directly or indirectly since that would frustrate the nature of the partnerships the government has with each of these taxpayers separately. The arrangement is not viewed as collective since the incentives are for more risk taking in a competitive rather than a collective environment.

This scheme is particularly complex in the context of corporate groups due to the artificiality of the business arrangements, yet the undeniable success of modern corporations in taking risks and reaping profits for accommodating societies required tax jurisdictions to be particularly tolerant of complex corporate structures. In the context of tax losses it required viewing the group rather than each corporation separately as the 'revenue partner' of the government. Tax jurisdictions viewing the group as the risk taking decision-makers began permitting group-wide loss relief mechanisms such as consolidation, etc…, very much like the UK in our case.

Once businesses crossed borders the picture became however much more complex. The belief in the benefits of cross-border trade made tax jurisdictions support it yet new conflicts arose from the competing tax claims of the now more than one jurisdiction involved. An expense made abroad may be deductible against profits made abroad and as such feature in the conflict between source and residence jurisdictions. Yet, until such expense materializes as a tax loss it still have a promise to serve income generation that would satisfy both the source and the residence jurisdictions, whatever way they decide to divide income among them. Once a loss materializes, something dramatic happens: the partnership between the source country and the taxpayer is clearly shattered and the latter jurisdiction exits the scene, since it would not (and that is acceptable as a matter of convention in our international tax regime) refund such a loss. The current international tax regime is built on competition and very loose coordination that never extends to these

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51 Case C-172/13, Commission v. UK, paras. 33-36. See also Case C-322/11, K, supra., n.18.

52 It is often claimed that complete symmetry would be most efficient being completely neutral, yet such outcome depends on the details of the legal regime, and, moreover, similar consequences may be achieved via other legal mechanisms. The most notable economic literature on the matter assumes a flat tax, for example. See, e.g., Evsey D. Domar & Richard A. Musgrave, Proportional Income Taxation and Risk Taking, 58 Quat. J. Econ. 388 (1944), or Joseph E. Stiglitz, The Effects of Income, Wealth and Capital Gains Taxation on Risk-Taking, 83 Quat. J. Econ. 263 (1969). See also Mark Campisano & Roberta Romano, Recouping Losses: The Case for Full Loss Offsets, 76 Nw. U. L. Rev. 709 (1981).

circumstances. Therefore, the sole question left is whether the investor's (residence or parent) jurisdiction should consider permitting the loss or not. A matching approach or one based on territoriality, reflected in *Futura*, for example, is understandable against this background, yet it does not take into account the unique features of the EU and the single market. A simple approach of fair division of tax bases or revenue may also be unsatisfactory since the single market has not yet evolved to the point of coordination and revenue sharing.[53]

But, as explained above losses are different from business expenses in the finality of the understanding that the relevant business enterprise would not generate income to the partnering state. Note that annual or other temporal losses may also be analysed in the same way, yet they present less of a problem due to the general acceptance that they may not be true loses but simply a consequences of the choice of the fiscal year. As such, it is conventional to follow the rules at source, since such losses (under this view) may generate income soon and then the problem disappears. This view is not intellectually pure since all losses eventually result from the choice of a time perspective and we never use lifetime accounting in taxation, especially when for corporations that may be indefinite. Nonetheless, this is not an issue in Marks & Spencer when the group had a clearly terminated and failing enterprise abroad. In this context, what may be the purpose of the partnership between the taxpayer and the tax jurisdiction – the UK in our case? The accurate question from a single market perspective is whether the partnership between the UK and Marks & Spencer was extended to the latter's other European investments. Note that the question in this case is opposite to the European law state aid rules, which forbid incentives to invest abroad on the grounds of fair competition. This commentary elaborates on the unique case of final losses.

3.2 *Identification of Tax Losses Dependent upon the Taxable Base More or Less Complex Rules*

The question of final losses taken by the parent residence state lies therefore first on the determination of tax losses. This, in turn, requires determination of deductibility, timing, personal scope and qualification under limitations. All of these differ immensely among states, including within the EU. These differences make the difficult question even more difficult since the potential abuse or tax avoidance considerations may become serious. These differences have been the focus of many of the loss cases decided by the ECJ, yet note that the problem goes beyond abuse, and indeed, the rules seem not to require proof of abuse at this point.

Nonetheless, it should be mentioned that the abuse potential may be viewed, when combined with the difficulty of fairly allocating the tax base to tilt the scale toward non-deductibility, or a *Futura* type reversal.

One should particularly be attentive to the timing of losses that significantly vary among jurisdictions. As already mentioned, a tax loss is eventually a matter of timing. A completely defunct enterprise cannot use a loss anyway. Marks & Spencer fought for the loss only because it could then reduce its UK taxes that were levied on positive income made by Marks & Spencer. We discuss the implications of this below.

3.3 *No Legal Link between the Member State That Is Asked to Eliminate the Restriction and the Less Favourable Treatment that Cross-Border Losses May Be Subject To*

The bottom line of Marks & Spencer is to permit a parent company to deduct a loss generated from a failed business abroad in the same manner that it is permitted to deduct a loss from a failed domestic business. It is clear that the terms of the partnership between the taxpayer and the (home) tax jurisdiction is very different in both cases. In the domestic setting the government tolerates multi-entity groups so long as the overall risk taking activity is beneficial to the government and under its fiscal control. In the cross-border setting, the terms are different since the government then wishes to increase domestic growth potential based on successful trade with the risk of losing some control. The loss of control is mitigated by the conventional international tax regime and its operative norms. Against this background, it is easy to see that the home jurisdiction (UK in our case) loses also control over both the loss generating activity and the determination of the loss (although it may control this a bit by limiting the scope of foreign losses based on accounting rules, etc.).

It is first and foremost the source legal regime that controls the loss generating activity rather than the home jurisdictions. This may be tolerated, as mentioned, so long as the rules of the game are stable and acceptable. No country expected to permit deduction of losses under asymmetric rules, i.e., when they would not be permitted to tax income if the investment ended up being successful. Further, it is safe to say that the Marks & Spencer outcome was not in line with the legitimate expectations of countries under the international tax regime rules that govern division of revenue and symmetry. The frustration of the UK from this outcome is understandable. As such,

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[53] The complexity of the matter is exacerbated by the combination of loss offset and consolidation regimes together with the proliferation of hybrid tax planning (particularly hybrid entities), as demonstrated by the Dual Consolidated Losses saga involving the United States and the UK. See, e.g., Peter H. Blessing, Dual Consolidated Losses, Tax Notes, Vol. 99, No. 8, 26 May 2003.

Marks & Spencer clashes with the norms of the international tax regime. Yet again this is expected since the latter promotes competition and the single market necessarily requires internal cooperation in the removal of obstacles even when obstacles would result in better outcome for some Member States and are expected otherwise. Reconciliation of the two and negating the expectations of tax jurisdictions is a tall order for European tax law. It seems clear that simply setting international tax rules aside with unclear guidance is very problematic. Some scholars have proposed therefore alternative solutions, including a recent support of recapture rules by Michael Lang.

3.4 *Would Recapture Work?*

The idea behind the recapture rule is to follow the logic of Marks & Spencer and, at the same time, to fix the problematic lack of clarity resulting from the decision. Therefore, the idea is that within the single market countries are required to operate under the same metaphoric partnership agreements with their taxpayers regardless of the place of investment. This means that foreign losses are to be deductible regardless of source, but future income would require the recapture of such losses upon generation of income

This proposal is a manifestation of the nature of tax losses as temporal creatures. Recapture serves this nature in the same manner as the Marks & Spencer solution, yet with rejection of the notion of 'final' losses that is unclear and creates incentives for the 'source' jurisdiction not to permit the loss. Recapture simply guarantees the benefit of the tax loss, very much in line with economic literature's preference for refundibility.

Alas, recapture faces the same difficulties that refundability presents and is unlikely to have better results than Marks & Spencer. It does not resolve the fundamental dual character of the single market as non-harmonized creature with no tax policy but with obstacles removing mechanisms. It does not resolve the asymmetry faced by parent jurisdictions that are going to absorb losses at the same time when they would never tax income if it were generated. But, most importantly, it would open the door for much more abuse and would interfere with domestic tax policies in a manner that seems to be disproportional.

In fact, for multinational enterprises, their deductions in the home jurisdictions are likely to be the most valuable. These are often high tax jurisdictions and jurisdictions where they generate significant income. Recapture would guarantee the best tax treatment for any losses made. Such home jurisdictions would now face a dilemma. On the one hand it helps the so-called competitiveness of their regimes yet on the other hand it is likely to erode their domestic tax base. They may end up responding by changing their domestic consolidation rules, domestic loss limitation regimes and even reverse the trend toward territoriality and exemption in favour of the more protective credit and Controlled Foreign Corporation (CFC) regimes, none of which seem beneficial to Europe as a whole. Source jurisdictions would have nothing to lose by restricting loss absorption rules so long as these are not harmonized and that they are not particularly low tax rate jurisdictions or higher rate than the relevant home regimes.[54] Similarly, recapture would be much too complex without an effective exchange of information mechanism in place. Finally, it is unlikely to expect more clarity in the identification of future profits to be recaptured in comparison to finality of tax losses. At least the finality test does not face ongoing concerns about tax rate changes, timing rule changes, etc.

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54 In a particularly low tax rate jurisdiction that would go against its investment attraction policies and in a high tax rate jurisdiction it would risk a particularly high effective tax rate.

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