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By PwC Deutschland | 20 June 2018

ECJ – Refusal to set-off EU-branch losses in Denmark not compatible with EU law

A Danish company may set off the final losses of its foreign EU-permanent establishment against its own taxable income, provided it can prove that the losses incurred are final and the company has exhausted the possibilities to deduct those losses in that Member State.

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With its judgment the ECJ saw an infringement of the freedom of establishment (Article 49 TFEU) insofar as the Danish authorities refused to allow the Danish Head Office to deduct from its taxable income the losses incurred by its Finnish permanent establishment (PE).

Background

The Danish company (Bevola) operated a PE in Finland which was closed down in 2009. Bevola maintained that the losses of the PE could not be utilised in Finland. The Danish tax authorities refused a set-off of these losses against the income of the head office because the company had not elected to apply the "international joint taxation" scheme. This scheme grouped together the joint income of the parent and all its subsidiaries and all its permanent establishments situated outside Denmark for tax purposes; the election was binding for a period of 10 years.

Danish regulation infringes freedom of establishment…

The ECJ ruled that Article 49 TFEU in fact precludes the Danish tax regulations under which it is on the one hand possible for a Danish company to deduct losses of its domestic branches, while this is not possible for losses of its foreign EU-branches, unless the group has opted for international joint taxation on the terms as set out above.

The Court took into consideration the decision of the ECJ in *Marks & Spencer*, in which UK law was found to be incompatible with EU law in the situation where a UK parent company could not deduct the final losses of its subsidiaries which were resident in other Member States although such a deduction would have been permissible under the UK group tax relief scheme had the losses been those of a UK subsidiary.

…but the difference in treatment could be justified by overriding reasons

Those overriding reasons could be situations which are not objectively comparable, overriding reasons in the public interest (maintaining the coherence of the tax system between Member States) but only if it is proportionate to that objective.

Although the principle of maintaining the coherence of the tax system constitutes a convincing justification for the difference in treatment the Court nevertheless held that the Danish regulations go beyond what is necessary to achieve the desired objectives.

With regard to the question of international group relief scheme being justified by the necessity of ensuring the balanced allocation of the power to impose taxes between Member States and by the necessity to safeguard the coherence of the Danish tax system, the Court took the view that the scheme was disproportionately onerous and subject to strict conditions as it requires all companies and all PEs in the group to participate and had to be adhered to for a minimum period of 10 years. The fact that participation in the scheme was optional did not stop it being excessively restrictive.

Deduction of losses of foreign PE may be possible….

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However, where there is no longer any possibility of deducting the losses of the non-resident PE in the Member State in which it is situated, the risk of a double deduction of losses no longer exists. The Court went on to say that alignment of Bevola's tax burden with its ability to pay tax is ensured better if it could, in that specific case, deduct from its taxable income the definitive losses attributable to the Finnish PE.

…only if those losses are definite

In order not to compromise the coherence of the Danish tax system, deduction of the losses under dispute could be set-off only if Bevola demonstrates that those losses are definitive. Generally, the losses attributable to a non-resident PE become definitive when, first, the company (in the case at hand: Bevola) has exhausted the possibilities of deducting those losses available under the law of the Member State in which the establishment is situated (here: Finland) and, second, it has ceased to receive any income from that PE, so that there is no longer any possibility of the losses being taken into account in that Member State.

It is for the national court to assess whether those conditions are satisfied in the case of Bevola's Finnish establishment.

Conclusion

In various EU Member States, there have been doubts as to the applicability of the *Marks & Spencer doctrine* and consequently whether companies resident in an EU Member State may deduct final losses incurred in non-resident subsidiaries. With this judgment, the ECJ has confirmed that the *Marks & Spencer doctrine* still applies and that it also extends to and includes final losses incurred by non-resident PEs.

The ECJ case reference is C-650/16 *Bevola und Jens W. Trock* judgment of June 12, 2018

Keywords

Final PE losses, international joint taxation