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By PwC Deutschland | 27 May 2022

ECJ: Refusal to allow the utilization of foreign branch final losses in breach of freedom of establishment ?

Following the request for a preliminary ruling from the German Supreme Tax Court, the European Court of Justice (ECJ) is called to decide whether a German parent company has the right to deduct from its taxable income losses incurred by its UK branch, which had ceased activity and thus could no longer utilize its accumulated tax losses in the UK. In his Opinion, the Advocate General has suggested that the German rules denying the import of losses of foreign branches are not contrary to the EU principles of freedom of establishment.

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Background

The request for a preliminary ruling from the German Supreme Tax Court opens yet another chapter on the everlasting question, whether and if so to what extent a resident parent company my utilize final losses of its foreign permanent establishment (branch) with respect to an existing double taxation agreement (DTA).

The issue arises as to whether the approach taken by the ECJ in the judgment ***Bevola and Jens W. Trock*** (points 37 and 38 of the judgment) with respect to the objective comparability of both situations of residents and non-residents can be transposed to the present situation in the case of dispute, where the exemption of profits and losses of the foreign branch from German tax is by virtue of the German/UK DTA and not from a unilateral provision of national law.

The plaintiff is a German resident company (head office) that maintained a permanent establishment (branch) in the UK since 2004. The branch was not profitable and thus closed some years later. As a result of the closure, the losses incurred by the branch were no longer available in the UK and the German head office sought to offset the UK losses as final losses against its own taxable income in Germany, which the local tax authorities denied.

For the referring court, the case is not clear-cut, given the case-law of the ECJ. The latter had, in the opinion of the Supreme Tax Court, not yet given a sufficiently clear answer to the question whether final losses incurred in another Member State by a non-resident permanent establishment must be considered in the Member State of the parent company in cases where a bilateral DTA provides for the income of the foreign branch to be taxed in the foreign country.

Opinion of the Advocate General

In his Opinion the Advocate General (AG) concludes that EU Member States may deny a resident company the deduction of cross-border "final" losses. He went on to suggest that such a prohibition of deduction does not constitute a restriction of the freedom of establishment in individual cases; there is no obligation under EU law to take such losses into account.

The AG further stated that, as regards the deductibility of losses, the situation of the UK branch was not objectively comparable to that of German branches of German head offices and, therefore, the German rules denying the import of losses of foreign branches are not contrary to the EU principle of freedom of establishment (Opinion, points 27 through 30). The “objective of taxation on the basis of ability to pay tax”, as referred to in the judgment *Bevola and Jens W. Trock*, is a general and abstract principle of taxation. For the GA it seems not appropriate to add an additional meaning to the exemption method under DTA apart from the purpose of avoiding double taxation and the avoidance of a double offset of losses.

Source:

The ECJ case reference is **C-538/20** *W (Déductibilité des pertes définitives d’un établissement stable non-résident)* opinion of 10 March 2022.

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Keywords

final losses, foreign branch losses, head office