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By PwC Deutschland | 28 April 2023

Update: ECJ - Final losses of UK branch not deductible for German parent company

In its decision of 22 September 2022, the European Court of Justice upheld the German rule that the final losses of a permanent establishment (PE) located in the United Kingdom are not deductible for the German head office (parent company). This practice is not contrary to the principle of freedom of establishment. There is no obligation under EU law to take such losses into account because Germany as the state of residence has waived its power to tax the profits (and losses) of its UK PE under the UK/German double tax treaty.

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Background

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. The German tax authorities refused an offset of the UK losses as final losses against the taxable income of the head office.

With its request for a preliminary ruling the Supreme Tax Court had asked the ECJ 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. In his Opinion, the Advocate General (GAG) 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.

More details on the case and the opinion of the Advocate General (GA) to be found in **our blog post of 27 May 2022**.

ECJ decision

The ECJ held that

"Articles 49 and 54 TFEU (regarding the principle for freedom of establishment) must be interpreted as not precluding a tax system of a Member State under which a company resident in that Member State may not deduct from its taxable profits the final losses incurred by its permanent establishment situated in another Member State where the Member State of residence (here: Germany) has waived its power to tax the profits of that permanent establishment under a double taxation convention."

The ECJ went on to say that - since Germany has waived its power to tax the profits made and losses incurred by such a permanent establishment situated in another Member State - a resident company which has such an establishment is not in a situation comparable to that of a resident company which has a permanent establishment situated in Germany in the light of the objective of preventing the double taxation of profits and, on the other hand, to avoid utilizing the losses twice.

According to the ECJ, this ruling is not in contrast to the judgment of 12 June 2018 in *Bevola and Trock* (case C-650/16) since in the latter decision Denmark had unilaterally (i.e., by national law) waived its power to exert its taxing rights over the profits (and losses) incurred in another Member State.

Update (28 April 2023):

Following the ECJ judgment, the Supreme Tax Court now delivered its final decision in the case of dispute which was the subject of the reference for a preliminary ruling. German resident companies cannot offset losses from a branch located in another EU country from their domestic taxable income if, under the relevant double tax treaty (here: between the UK and Germany), there is no German right of taxation for the

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foreign branch income. This also applies if the losses abroad cannot any longer be utilized for tax purposes (because the UK-branch was not profitable and thus closed) and are therefore "final" (so-called final losses). The Supreme Tax Court went on to confirm that this is not in violation of EU law. The concept for the right to tax branch profits under treaty provisions applies to a net amount; it therefore follows that simultaneously branch losses are also to be excluded from the basis of German taxation.

Source:

The ECJ case reference is **C?538/20**, *W (Déductibilité des pertes définitives d'un établissement stable non-résident)* judgment of 22 September 2022.

Note: Read more about the judgment from our experts in the PwC EUDTG Newsalert from 22 September 2022, which may be downloaded from the **EU Direct Tax Group website**.

Keywords

Final PE losses, foreign branch losses