Loss relief limits

International Tax | Large Corporate



01 March 2015

Bill Dodwell considers the latest verdict from the European Court of Justice on cross-border loss relief

Seasoned observers of the European Court of Justice in Luxembourg point out that there was a high-water mark in deciding cases in favour of taxpayers.

The original Marks & Spencer cross-border loss relief case belonged to the period when the CJEU seemed to be trying to build a form of tax harmonisation. That judgment was given in 2005 and, since then, companies in many EU states have sought to argue that they should be able to get some form of cross-border loss relief.

Some of the more imaginative claims came from Scandinavia, where the system for offsetting profits against losses required that the profit be contributed to the loss-maker. Lidl sought loss relief for its Luxembourg branch – even though by the time its claim had been litigated the losses had already been used. The CJEU regarded these as allowing companies to choose where they wished to be taxed – which went beyond the loss relief ruling.

The CJEU's Advocate General, Juliane Kokott, has been waging a one-woman campaign against loss relief. In recent opinions she asked the court to declare that the original decision in favour of Marks & Spencer was wrong. Yet the CJEU has steadfastly refused to accept her invitation.

The latest iteration came in *Commission v United Kingdom* (C172/13) where the Commission argued that the UK's enactment in 2006 of rules allowing cross-border loss relief in limited circumstances was flawed. Informed by complaints, the Commission argued that by imposing a requirement that the taxpayer show at the end of the accounting period that there was no possibility of using the losses, it was virtually impossible to claim loss relief. It also argued that the UK should have enacted law to allow loss relief for periods before 2006.

Interestingly, the UK told the court: 'The relevant provisions do not make cross-border relief conditional upon the non-resident subsidiary having been put into liquidation before the end of the accounting period in which the losses were sustained. Evidence of an intention to wind up a loss-making subsidiary and initiation of the liquidation process soon after the end of the accounting period would be factors to be taken into account. The intention to wind up the subsidiary is taken into account, along with all other relevant facts as at the end of the accounting period in which the losses were sustained, in determining whether the above condition is satisfied, that is to say, in checking that there is no possibility of the losses being taken into account.'

The court sat as a grand chamber (13 judges) and firmly rejected the Commission's complaint. They did so on the basis that the Commission had failed to show that it was necessary to put the overseas company into liquidation before the end of the relevant accounting period – using the UK's evidence. The court also ruled that the Commission had not established that claims could not be made for periods before 2006 – and indeed there are still several hundred open cases with HMRC.

However, claimants will be disappointed to find that the court has in effect ruled against two situations which are part of some of the filed claims. The first concerns claims where the overseas country does not allow carry forward of losses. There are two situations here: some countries disallow losses on a change of structure, or of ownership. Others impose a limit on the number of years for which losses may be carried forward. The CJEU said: 'It is settled law that losses sustained by a non-resident subsidiary cannot be characterised as definitive … by dint of the fact that the member state in which the subsidiary is resident precludes all possibility of losses being carried forward.' There is no obligation to provide loss relief in this situation.

The second area concerns claims where the scale of the losses is so enormous that it appears impossible in practice ever to use them. Here, the CJEU ruled: '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.' This seems to cut out claims based on the scale of losses.

Where does this leave claimants? There are still some open issues likely to require further litigation concerning group structure. HMRC have argued to date that only claimants that satisfy the fact pattern of Marks & Spencer, namely a UK parent company, meet the test. More recent cases, such as Philips Electronics and Felixstowe Docks, suggest a broader view is needed.

However, it now seems very clear that cross-border loss relief is only a terminal loss relief when the business has ceased completely and has been put into liquidation. Perhaps this is fair. As the court puts it, the difference in treatment between resident and non-resident companies '… may be justified by three overriding reasons in the public interest, taken together, that is to say, by the need to preserve the balanced allocation of powers of taxation between the member states, the need to prevent the double use of losses and the need to combat tax avoidance'.

We’re back to those original ‘branch or subsidiary’ letters I remember writing to companies venturing overseas for the first time.