

Cross-Border Loss Relief: whether UK laws on Cross-Border Loss Relief have any bearing to non-EU states and country like Tanzania

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TEU	Treaty of the European Union
EU	European Union
TFEU	Treaty on the Functioning of the European Union
ECJ	European Court of Justice
PE	Permanent Establishment
OECD	Organization for Economic Cooperation and Development
DTC	Double Tax Conventions
MS	Member States of the European Union
EC	European Commission
EEA	European Economic Area
A.G.	Advocate General
ICTA	Income and Corporation Taxes Act (UK)
ITA	Income Tax Act (Tanzania)
JALA	Judicature and Application of Law Act (Tanzania)
<i>i.e.</i>	That is
<i>eg</i>	Example
<i>etc</i>	et cetera
para.	Paragraph
p.	page
pp.	Pages
Art.	Article

1. Introduction

This research paper is written by an outsider looking into the European Union (EU)¹ law and direct taxation system in Europe. It could very well even be looked at from any observant/researcher outside the EU and the European Economic Area (EEA). The EU law contains some unique principles of taxation which aim at harmonization of direct taxation². The subject of the paper has relevance to the Tanzania legal system. Tanzania has both historical and economical connection with Europe and UK in particular. First the EU has been a great support of Tanzania's economy and has been a model to the East African Community of which, Tanzania is a member³. As for UK, it was the first country that actually penned down most of the laws in Tanzania before independence including tax laws and after independence, Tanzania, had the first Income Tax Ordinance based on English common law system. So the law was in operation until it was repealed and replaced by the Income Tax Act of 1973 which has been updated and amended periodically to the current tax legislation of 2006. To date the country still uses common law as source of law⁴. Tanzania's sources of law are numerous including the constitution, statutes, customary law, Islamic laws, case law and precedents. In this particular topic the paper refers to the foreign law and precedents as the entry point. The case laws sought as source may be derived from the domestic courts or from foreign courts as provided by *Section 2(3) of the Judicature and Application of Laws Act Cap 358 of the Laws of Tanzania (JALA)*. The law states that, foreign written laws are derived specifically from common law countries, e.g., England as well as Courts of Justice and courts of Justice of Peace in England. Tanzania is a sovereign and independent state with its own laws and regulations. It's been 50 years since independence and the current situation as far as corporate taxation is concerned, is not as fully exhausted and explored as the case is in UK, to date the country is struggling to develop its foreign direct investment sector. The application of foreign laws is one way for the country to adapt to the changes taking place in the world. The UK legal system is one of the oldest that Tanzania considers when looking for judicial guidance in the wording of JALA 'only so far as the circumstances of Tanzania and its inhabitants permit..'. The tax treatment of losses in UK, therefore, is one topic that could have critical effect to Tanzania's growth in international business.

1.1. Statement of the Problem

The problem to be examined in this research is on the tax treatment of losses in cross border situations as addressed in the European cases and the adaptation or implementation of the final decision of the European Court of Justice (ECJ) by different European states to their respective national laws as required by the EU law⁵. The main issue was on the transfer of losses between different independent companies, belonging to the same group, located in different jurisdictions. The transfer of losses across

¹ EU is established by the Treaty of the EU of 1992 and the Treaty on the Functioning of the EU 2009, EU also covers the European Economic Area (EEA) http://europa.eu/about-eu/basic-information/index_en.htm

²Art. 5 Of TEU establishing an internal market, *also*, EU has been successful with indirect taxes by enacting VAT Directives (2006/112/EC) which are incorporated in national VAT rules of MS.

³ http://ec.europa.eu/europeaid/where/acp/country-cooperation/tanzania/tanzania_en.htm

⁴ E-document "A Guide to Tanzanian Legal System and Legal Research"

<http://www.nyulawglobal.org/globalex/tanzania.htm>

⁵ Marjaana Helminen, (2011), "EU Tax Law – Direct Taxation" IBFD, online books (chapter 1.2.4.)

borders, as the paper will further elaborate, raised a conflict between the European Union's (EU) goal for internal market and principles of international taxation especially the *principle of territoriality*. The specific scenario was in the case C-446/03 *Marks & Spencer plc vs. David Halsey* (His Majesty's Inspector of Taxes) (*Marks & Spencer*) which involved the transfer of losses from foreign subsidiaries (in France, Belgium and Germany) to parent company (in the UK). The problem analyzed in this paper lies on those circumstances in the case and to find out then, whether this is possible? If so, to what extent and to which effect?, as the title of the topic further questions whether the definitive treatment of losses could also have an effect to other states such as Tanzania which follows common law system (as the UK) and also where different European companies carry out their business activities. The multinational companies often opt for equalization mechanism of their profits and losses to ease their tax burden especially when they are closely related, e.g., parent company and its subsidiary where the subsidiary is largely owned and controlled by the parent company. Hence the loss carry-over or loss carry-forward or loss carry-back are usually favorable.

1.2. Purpose of the Research

First, the paper looks to a large extent at European's analysis of cross border losses through case law study. ECJ Decision has been the overriding concern to states as it creates a conflict with the application of territoriality and source principles which grants them the power to impose tax in exclusion of other states. The ECJ's decision in *Marks & Spencer* affirms the transfer of losses across borders from parent companies to its subsidiaries and branches in other states, in an effort to implement its freedom of establishment principle found in *Article 49 of the TFEU*. However this decision was received differently by member states, for it dislocate the right of states to impose taxes e.g., UK had enacted even stricter rules after the decision was passed⁶, making it impossible for companies to take advantage of the ruling. UK's *Marks and Spencer* case has not been settled by the national courts due to the uncertainties found in the ECJ decision centering on the 'no possibilities test' which was first introduced in this case⁷. Therefore the paper aims to look at the current situation with regards to current and final losses and examines how states have embraced the ECJ decision. The states that have indeed provided some remarkable feedback on the issue are Sweden, Netherlands, Finland, Germany and UK⁸.

Secondly, the decision of ECJ has *indirect* effect to other states. The decisions of the ECJ are binding to EU member states (MS) and those located in the EEA⁹. Despite that fact, the paper aims to show that there is a lesson from the practice and experience of the ECJ

⁶ With effect from 1 April 2006 the UK legislator introduced amended rules on cross border loss relief qualifying losses incurred in an EEA subsidiary to be set off against revenue of a UK parent Company provided that the parent company holds at least 75% of the subsidiary, also '*an unnecessarily restrictive interpretation of the condition that there should be no possibility of use of the loss in the state of the subsidiary*' (paragraph 7 of Schedule 18A of the Income and Corporation Taxes Act (ICTA) 1988); on 18th September 2008 the European Commission formerly asked (Art. 258 TFEU) the UK to implement the ECJ decision properly. After the ECJ judgment in 2005 the case went to UK national courts, and it is still ongoing, on October 2011 the court gave its decision in favor of Marks and Spencer

⁷ the latest judgment of 14 October 2011 in *Case 2011 WL 5903155*, the High Court of Appeal dismissed appeals made by *Marks & Spencer* and Tax Authorities against the decision made in 21 June 2010

⁸ The national courts of the respective countries have had opportunity to interpret the ECJ decision.

⁹ This is by virtue of Article 260 of TFEU where MS are required to comply with the judgment of the Court.

that can be useful to other states. The lesson could be on the general principles applicable to losses and loss relief in cross border situations upheld in the case law of the ECJ. As introduced, Tanzania, which has very little experience on corporate taxation ever since its independence in 1961 (with its foreign direct investment only growing recently), can learn from the UK take on cross border relief situation. This is true for the fact that both countries follow the common law system (UK being the oldest) and that Tanzania can make reference to foreign laws as its source of law. This subject will become useful in coming years when Tanzania is predicted to have developed its investment sector.

1.3. Outline

The paper has four main parts. The first part is the introduction establishing the relevance of the topic. The second part will focus on the tax treatment of business income and losses of domestic and foreign companies, looking at the basic information on the setting off of losses and the loss relief mechanisms as well as to elaborate on the tax subject and tax object principles, a brief introduction to European group taxation systems will also be provided. The third part will look, for all intents and purposes, at the EU law, case law study of the ECJ and will show how Finland, Sweden, Germany and the Netherlands have dealt/are dealing with the issue in the light of the ECJ decision in *Marks & Spencer*, including the process of implementation of the final decisions providing country to country analysis (at the same time observing the chronological order of the cases). The cases for the study are listed in the literature review and the cases feature both domestic and cross border situations. The research will also look at four different kinds of group loss relief such as *Group Relief* in UK, *Fiscal Unity* in the Netherlands, *Group Contribution* in Sweden and Finland, and Loss Relief '*Organschaft*' in Germany. The last part will provide the take on cross-border losses by non-EU states and the conclusion of the research.

1.4. Research Methodology and Literature Review

Essentially, before we see what effect the ECJ decision has on Tanzania, the paper will first analyze the application of the ECJ decision in Europe and see how far Member States have implemented or interpreted the court's decision in their domestic laws. The first step in this direction is to look at *Marks and Spencer* case and then on to different case laws which were decided after the *Marks and Spencer* such as case C-231/05 *Oy AA*, case C-414/06 *Lidl Belgium*, as well as pending cases *Oy A* and case C-18/11 *Phillips Electronics*. Documentary research, *Global Tax News*, *International Tax News*, *Tax Notes International*, newsletters will also be used to see the current situation in the states, the paper will also use the domestic legislations such as UK's (ICTA) and Tanzania's Income Tax Acts (ITA) and for Sweden, Finland and German I will use different articles and online books; the *Country Surveys*, *European Taxation*, *EU Tax Law series* from the IBFD database as secondary source material to analyze their domestic law situation. In looking at the basics the paper will provide the general and legal framework of the treatment of losses by different states and examine why cross border loss relief has brought much attention, thus by using books such as; Roy Rohatgi, 2002, '*Basic International Taxation*', Ben J. M. Terra, Peter J. Wattel, 2012, '*European Tax Law*', Marjaana Helminen, 2011, '*EU Tax Law – Direct Taxation*', Dennis Webber, 2011, '*European Direct Taxation: Case law and Regulations*', Dennis Weber, Bruno da Silva, 2011, '*From Marks & Spencer to X Holding: the Future of Cross-Border Group Taxation*'.

Michael Lang, (et al), 2010, "ECJ Recent Developments in Direct Taxation 2009' Series on International Tax Law, Univ. Prof. Dr. Michael Lang (Editor) Volume 64. also COM (2006) 824, 19 December, 2006, 'Tax Treatment of Losses in Cross-Border Situations'. International Tax Notes, online publications on European Taxation by IBFD, such as the publication by Michael Langs (2006) titled ' *The Marks & Spencer Case – The Open Issues Following ECJ Final Word*' in an effort to analyze the cross border loss relief situation in Europe.

2. General Tax Treatment of Losses

2.1. Corporate Taxation

2.1.1. Profits and Losses of a Domestic Company

Here the basics about profits and losses will be provided to get an insight on the topic from European countries and Tanzania will be looked at extensively in Chapter 5. The countries under study, UK, Finland, Sweden, Germany, and The Netherlands follow the classical system of taxation¹⁰ where companies are subject to corporate income tax on the business profits and the shareholders are taxed on the distributed profits as dividends. UK employed the imputation system by awarding the shareholders tax credit on the tax paid by the corporation¹¹. On the other hand companies also incur losses; the shareholders could also have incurred losses when share get low values, this will be discussed lightly as the paper deals with negative corporate business income. In this situation the *Marks & Spencer* case stated that profits and losses are the two sides of the same coin¹², hence losses must also be taken into account and relief should be granted thus upholding the symmetry principle. It follows that companies that are liable to corporate tax can apply or claim relief when they have made a loss. When a company makes a profit or a gain (positive income) it is taxed on that income, on the other hand, when the company makes a loss (negative income) on trading stock, disposal of an asset or payment of interest from a loan it is able to deduct it from its taxable income and later offset the losses against its profits. The profits can be those earned in previous year in which case the losses can be carried back or profits in future years in this case the losses can be carried forward for set off.¹³

Each sovereign state has its own rules for direct taxation, and a lack of harmonization as the case is for the European countries' relation to the European Union, the rules for set off of losses vary from country to country this is provided in the *European Tax Handbook of 2011*. It was observed that companies in some countries like UK, Sweden, Germany, and Tanzania can set off losses against income from the same source. Sweden allows set off of losses in the same accounting year or immediately when losses were incurred and any surplus of losses may be carried forward indefinitely. Loss carry-forward is also indefinite in Germany and UK under specific conditions. In Germany the loss carry forward can be forfeited if 50% of the ownership in the loss making company

¹⁰ Van Boeijen-Ostaszewska, O., (ed), (2011), 'European Tax Handbook 2011', 22edition, IBFD, Amsterdam, The Netherlands

¹¹ Van Boeijen-Ostaszewska, (2011), *European Tax handbook*, p.905

¹² Case C-446/03 *Marks & Spencer* Para. 43 also Michael Lang (2006), 'The Marks & Spencer Case – The Open Issues Following ECJ Final Word' p. 57

¹³ Roy Rohatgi, (2002), " Basic International Taxation", Kluwer Law International, The Hague, Netherlands page 181

is lost. In UK the loss carry forward is maintained as long as the company remains within the charge of corporate tax. The Netherlands allows losses to be carried forward for 9 years with 70% shares held by that company. Loss carry forward is 10 years in Finland and this right can be forfeited if more than 50% of the shares of the loss making company are sold during the loss year. As for loss carry-back, UK and Germany allow for 1 year, with Germany inserting a limit of Euro 511500 and excess losses are allowed to be carried forward. Loss carry back is 3 years for Netherlands while Finland and Sweden does not allow loss carry-back¹⁴.

The loss relief is essential and employed by companies to balance their tax liability between losses and profits endured during the course of business. The company that has made a loss makes a use of the loss by deducting it from the taxable income, thus reducing its total tax liability. The set off against future or previous profit is a way states ensure that the taxpayer has paid its tax liability to its required legal amount¹⁵. This principle of taxation if not well executed often cost states a lot of revenue, as we will later see in the case law study and so the states have been especially cautious when companies uses the loss relief to lower their tax liability or gain tax advantage, such as *possible double use of losses*. For instance in a domestic situation a parent company with a Permanent Establishment (PE) or a subsidiary, to which the parent company has a substantial ownership, the losses incurred by either of the two will have a tax effect in the parent company and can possibly be deducted from taxable income by these companies. In case of PE located in another state, in which case it is still one company, the PE falls under the legal jurisdiction of that other State as provided in Article 5 of the OECD Model. Hence losses incurred by the PE in that other state can be taken into account in the state of the parent company as well.

2.1.2. Profits and Losses of a Foreign Company (cross-border)

The question is whether a foreign company business profits and losses can be considered when calculating the tax liability of a resident company? This part refers to those companies that are independent entities regulated by one state but they (tax subject) and/or income (tax object) have economic connection with more than that one state. Frankly the answer should be never because these states are sovereign and independent. They have a primary right to tax their own tax subjects but it is in the principles of taxation that states are at liberty to take into account, or not, foreign elements¹⁶. States that use residence to tie their tax payer to national tax law, such as the states under this study, tax their residents on their world wide income¹⁷. They use principle of residency to establish liability to national taxation wherever they are. On the other hand taxation also implies that each tax subject is taxed individually, both at a domestic level and at a cross border level, the source principle also used by the states under study. In the circumstances of the *Marks & Spencer* case the national courts justified the restriction to tax corporate income of a taxpayer located in another state on the ground of protecting the balance of allocation of power to impose taxes between MS¹⁸. So in most cases foreign companies do come within the tax jurisdiction of other

¹⁴ Van Boeijen-Ostaszewska, (2011), *European Tax Handbook*, pp. 238, 804 - 805

¹⁵ Ben Terra, et al, (2012) "European Tax Law", Kluwer, pp. 1020-1021

¹⁶ Jerome Monsego, 2011, "Taxaton of Foreign Business Income within the European Internal Markert", Intellecta Infolog, Goteborg, Sweden, p.147

¹⁷ European Tax Handbook 2011, pp238, 303, 615, 801, 905

¹⁸ Case C-446/03 *Marks & Spencer* Para 45 - 46

states either by principle of residence (worldwide taxation) and source (non-resident companies). In the case law study the national courts have reasoned with the ECJ on the facts concerning foreign subjects which can consequently be eliminated by national laws of states in which case the ECJ held the national laws to be incompatible with the aims of EU and its fundamental freedoms. The ECJ has held several times that MS must exercise their taxing powers, by virtue of territoriality and source principle, consistent with their obligations under the EU laws¹⁹.

Another factor, which implicates a foreign company, and can be avoided, is the possible *double taxation*; this can be eliminated by the methods available in their national laws or the rules in the double taxation conventions (DTC) to account for the foreign income. The main methods are credit and exemption. In the credit method the foreign tax paid by the resident taxpayer is credited against the home state tax or exempt. This foreign source income should have accounted for the profits and losses and the result is the one credited, Finland, Sweden and UK apply the credit method. In the exemption method the profits of foreign branch and the losses are completely eliminated²⁰. Moreover the exemption method is applied differently for instance Germany apply the exemption method without the loss deduction, called the base exemption as elaborated by Prof Terra in this case the foreign branch result is eliminated all together from the taxable income of the company. While Netherlands apply the exemption method only to the extent of temporary losses, the losses will be deducted but will later be reincorporated in the profits of the following year of income²¹.

The principle of international tax law followed by these countries are in conflict with the EU law, which aims at harmonizing direct taxation laws of MS to achieve internal market²². In this case the national laws of MS of the EU do not fully enjoy the liberty recognized by international law (of establishing their territorial rights) when it comes to the taxation of foreign companies' business income. The ECJ has held that MS tax rules are subordinated to the EU law especially to the fundamental freedoms²³.

2.1.3. Taxation of a Group of Companies

This arrangement is considered as an achievement to the EU internal market and compatible to the EU law. Group taxation systems took the centre attention in case law of the ECJ and national laws. In principle states do not have group taxation and have required separate filing of income by entities liable to corporate taxation²⁴. In few exceptional circumstances to the general principle of tax subject, the income of foreign company is incorporated in the taxable income of the group. Here a group of companies can consolidate their losses and profits so that only one company is liable to corporate tax while others are allowed to apply a system where losses of one company can be deducted from the profits of another company in the group. The need for balancing of profit and losses made it possible for MS to include special provisions to allow the group

¹⁹ See case 270/83 Avoir Fiscal para 24, case 250/95 Futura para 19, case 141 AMIP para 19, case 446/03 Marks & Spencer para 29 see also Marjaana Helminen, (2011), chapter 1.2.1.

²⁰ Ben Terra, (2012), pp. 1020-1021

²¹ Ben Terra, (2012), page 1021

²² Art. 3 of the TEU

²³ Jerome Monsego, (2011), p.24

²⁴ European Tax Handbook 2011,

of companies' arrangement for taxation purposes²⁵. Group of companies basically consists of independent entities closely related. Often they are characterized by a parent company which directly or indirectly owns other companies, these become its subsidiaries and these companies will form a group, sometimes the group can also include a holding company. The losses incurred by any of its establishments can be claimed in a group. The different group treatment towards loss relief is referred to as 'group relief' in UK (Chapter 3), *Group Contribution* in Finland and Sweden (Chapter 4.1), *Organschaft* in Germany (Chapter 4.2), 'Fiscale eenheid' or *Fiscal Unity* in Netherlands (Chapter 4.3), others are Consolidated Tax Return in the USA²⁶. Each of these group relief methods offers, severally, advantages to taxation such as relieving of the group's loss lock-up, withholding taxes on inter-company dividends, interest and royalties, intercompany arm's length pricing requirement, separate filing of returns²⁷. Moreover in each of these schemes, companies, in their respective countries, must qualify for group relief; the shareholding in the subsidiaries by the parent must be evident. Here as well the rules for shareholding qualification vary with the States. Some states do have them under very specific rules for instance, Finland and Sweden requires that the shareholding of the parent company to its subsidiary should be greater or equal to 90%, UK is 75%, while Germany is 50%.

Many states provide group relief but on strict rules and often in pure domestic situations²⁸. First, in domestic situation, relief of losses within one company (PE) is automatically available in all 27 EU MS while in a group of companies (parent and subsidiary) is available under specific rules in most member states and the states concerned in this paper (i.e. Germany, Netherlands, Finland, Sweden and UK) have these specific rules which will be analyzed in later chapters and observe their remarkable differences. On the other hand the cross-border loss relief within one company (PE)²⁹ is available in most cases in Netherlands, Finland, Sweden and the UK while in a group of companies (parent and subsidiary) is not available in most states with the exception of Denmark, Italy and Austria. This was the situation in 2006³⁰ even after the ECJ decision in *Marks & Spencer*, in 2009 cross-border loss relief was still limited despite the fact the group relief system was allowed for final losses³¹, the situation has not improved and the states uphold the exception in *Marks & Spencer* case (each country taking different interpretation as it will be looked at in following chapters). In European Union, the basic difference in providing for relief in domestic and cross-border situations raises the issue of a possible conflict with the Treaty on the Functioning of the European Union (TFEU) which aims to achieve an internal market without frontiers or obstacles to the free movement of goods, services, persons and capital irrespective of national borders. The

²⁵ Marjaana Helminen, (2009), "EU Tax Law – Direct Taxation" IBFD, Amsterdam, The Netherlands, p.88

²⁶ See definition of 'Group Treatment' IBFD international Tax Glossary, page 201

²⁷ Ben Terra, et al (2012)

²⁸ Marjaana Helminen (2009) also European Tax Hand Book 2011 '*cross-border losses are limited*'

²⁹ Facts from *Lidl Belgium* case, where the Lidl Belgium company resident of Germany wanted to deduct losses of its PE in Luxemborg from its taxable income in Germany, also From European Tax handbook 2011 '*From 2006 a UK resident Company may claim group relief of a non-resident subsidiary resident in EEA countries (EU MS, Iceland, Liechtenstein and Norway) or the relevant losses of PE in the EEA where all scope for claiming non-UK relief for the losses has been exhausted*' p.909

³⁰ COM2006 Tax Treatment of Losses in Cross-Border Situations

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2006:0824:FIN:EN:PDF>

http://ec.europa.eu/taxation_customs/resources/documents/sec_2006_1690_en.pdf

³¹ Marjaana Helminen, (2009) p.89

Treaty on European Union (TEU) identified some tax to the EU market such as the different in tax treatment of resident and non-resident taxpayers as well as different tax treatment of domestic and foreign investment and income³². In that regard, the ECJ has been called up to decide a few cases on whether particular MS tax group regimes were in breach with the freedom of establishment set forth in Article 49 of the TFEU³³.

2.2. ECJ on Direct Taxes

The ECJ works to ensure that rule of law is observed and the interpretation and application of the Treaty of the European Union (TEU) is carried out accordingly and that MS have properly implemented their obligation under the treaty³⁴. ECJ has competence to determine cases where the fundamental freedoms of the Union law have come into question. National courts of the MS are obliged to interpret the national laws as far as possible in conformity with Community law. There is a doctrine of *Direct Effect* that the presence of a conflict between the two laws, the national courts is instructed to disregard the national provision as held in the *Costa v ENEL* case. In such the national courts are bound to the decisions of the ECJ³⁵.

The court has a role towards the functioning of the internal market, the ECJ faces one problem with national courts; the harmonization of direct taxes in Europe has been one of the biggest challenges towards the goals of the EU. The fact is that the area of direct taxation has been left under the competence of Member States (MS). Frankly, the states have been designing their own tax laws towards business income of individuals and corporations. Many of these are members of the OECD and adhere to international tax law norms. Another fact is that of sovereignty were each country is free to determine its tax laws and have the power to impose income tax on its subjects (taxpayers). These states have split into different jurisdictions and observe rules of residency, source and territorial taxation. The states have also found ways in limiting their power by providing tax reliefs to eliminate double taxation. Further states have also entered into double taxation conventions DTC with other states to eliminate international double taxation and tax avoidance.

As a result, the states in Europe have been found to fall short of the EU's internal market expectations regarding the fundamental freedoms contained within even with adaptation of group taxation systems³⁶. This can be seen in the case law study of the ECJ on the area of cross-border loss relief. This paper will analyze the influence of ECJ on the national tax laws of UK, from the landmark case i.e. *Marks & Spencer* and then will see how other MS have interpreted the case, such as Finland, Sweden, Germany, and The

³² Terra, (2012), page 3, also Article 26(2) of TFEU

³³ Dennis Weber, Bruno da Silva, (2011), 'From Marks & Spencer to X Holding: The Future of Cross-Border Taxation', EUCOTAX Series on European Taxation, Kluwer Law International, The Hague, The Netherlands, page 1

³⁴ Art. 13 of TEU establishing the EU institutions and the ECJ, also Article 260 of the TFEU providing the role of ECJ

³⁵ See case 6/64 *Costa v ENEL* '... the EEC Treaty has created its own legal system which, on the entry into force of the Treaty, became an integral part of the legal systems of the Member States and which their courts are bound to apply' also Mattias Dahlberg, (2005), 'Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital', EUCOTAX Series on European Taxation, Kluwer Law International, The Hague, The Netherlands, page 13-33 also Art. 5 of TEU

³⁶ Marjaana Helminen, (2009) p 89

Netherlands. The finding will maybe lead us to a conclusive answer to whether the MS's interpretation of ECJ case law on cross border losses can have any bearing to non-EU countries such as Tanzania in the country's development of international business.

3. Cross-Border Issues addressed by the ECJ

3.1. UK

3.1.1. Domestic Law

Section 6 (1) and 11(1) of UK tax laws, the Income and Corporation Taxes Act 1998 (ICTA), provide for a charge of corporation tax on profits of companies resident in the UK as well as non-resident who conduct business in UK through a branch or agency (PE). Section 8(1) of ICTA, UK charge its residents companies in respect of their world wide income and non-residents companies are taxed to the extent of the profits attributed to their PE operating in the UK.

Under DTC between the United Kingdom and, in particular, Belgium, Germany and France, the foreign subsidiaries of resident companies, as non-resident companies, fall within the scope of United Kingdom corporation tax in respect of their trading activities only if those activities are conducted in the United Kingdom through a permanent establishment within the meaning of those Conventions³⁷.

3.1.2. Group Taxation

Principally there are no provisions for any form of income consolidation. Each member in a group structure is separately assessed to corporate taxation³⁸. However there are provisions covering transfer of assets and losses in the group. Hence a group of company with taxable profits may claim relief against losses arising in the group. The kind of relief applied in UK is called group relief; it allows resident companies in a group to offset their losses against the profits. Group relief allows the resident companies, referring to residents and PE of foreign companies, in a group to offset their profits and losses among themselves. The group relief has also been extended to UK PE of nonresident Company³⁹ and to overseas PE of a UK Company in specified conditions that all scope for claiming relief for the losses of the non UK resident has been exhausted⁴⁰. Hence Section 402 of ICTA provides that amounts eligible for relief from corporation tax may be surrendered by a surrendering company (the company that made the loss) and a claim to those amounts made by another company, the claimant company may be allowed. The surrendering company and the claimant company have to be in the same group for the group relief to be possible. The trading losses may be set off against profits of the claimant company in the corresponding accounting year. As far as nonresidents are concerned, the laws as from 2006 require that the losses of a UK branch of a non-resident may be surrendered to another group company for set off against the UK taxable profits.⁴¹

3.1.3. Marks & Spencer Case, ruling of 13th December 2005

Facts of the case are as follows the dispute arose between Marks & Spencer PLC (Marks & Spencer), a UK company and UK Tax Authority. The UK Tax Authority rejected Marks

³⁷ Case C-446/03 *Marks & Spencer* para 6

³⁸ European Tax Handbook 2011, pp. 908, 909

³⁹ See A.G J. Kokott's opinion in *Phillips Electronics* case (pending)

⁴⁰ European Tax Handbook 2011 p.909

⁴¹ Section 403 of ICTA also C-446/03 *Marks & Spencer* para 12-17, same in the AG decision in *Phillips Electronics* case

& Spencer claim for a tax relief on losses incurred by its subsidiaries abroad. Marks & Spencer is a registered company operating in the UK, and its subsidiaries are in Belgium, Germany and France. In year 2001 the company divested itself of Continental European activity and by that time the France subsidiary was sold to third parties while the other two subsidiaries located in Belgium and Germany ceased their trading operations. Marks & Spencer then claimed group relief in UK with respect of losses incurred in Belgium, Germany and France for the four accounting periods from 31st March 1998 to 31st March 2001. Moreover each of the subsidiaries operated in the states they were registered and they did not have PE in UK and had never traded there. Consequently the Tax Authority rejected the claim for group relief on the ground that group relief could only be granted for losses recorded in the UK. Marks & Spencer appealed against the decision before the High Court of England and Wales, and the court stayed the proceedings and referred the case to the ECJ for preliminary ruling⁴².

The issue in the case was raised in the question *'whether Article 43 EC and 48 EC preclude the provisions of a Member State, which prevent a resident parent company from deducting from its taxable profits losses incurred in another Member states by a subsidiary established in that Member State although they allow it to deduct losses incurred by a resident subsidiary'*.⁴³

The court held that *'As Community law now stands, Articles 43 EC and 48 EC do not preclude provisions of a Member State which generally prevent a resident parent company from deducting from its taxable profits losses incurred in another Member State by a subsidiary established in that Member State although they allow it to deduct losses incurred by a resident subsidiary. However, it is contrary to Articles 43 EC and 48 EC to prevent the resident parent company from doing so where the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods and where there are no possibilities for those losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party'*

This ruling had several shortcomings and raised a series of arguments from the UK tax authorities concerning the status of the foreign subsidiaries, since the Court found that the UK law was a restriction to the freedom of establishment. The justifications put forward by the UK Tax Authority and accepted by the ECJ were 'The balance allocation of the powers to impose tax among Member States, Tax avoidance and Prevention of double use of losses' as viable taken together. The justifications caused a series of different question in an effort to comprehend the basis of the judgment. First the balance of MS tax power has been irrelevant for this case and to the attainment of the freedom of establishment (see next part 3.1.3.1) but it was important for the Court to consider the risk of tax avoidance and double use of losses (part 3.1.3.2.). In the ruling the ECJ introduced the 'no possibility test' to counter check the proportionality of the national measure to find out whether it has gone beyond what is necessary to achieve the objective pursued in which case the ECJ held that the national law cannot be applied where it could be demonstrated to the tax authorities that the non-resident subsidiary

⁴² C-446/03, *Marks and Spencer*, Para 2-26

⁴³ C-446/03, Para 27

had exhausted all possibilities of taking into account of its losses (part 3.1.3.3.). The justifications were later on used in following cases separately (*Oy AA* case) and as for the no possibilities test the ECJ did not offer any instruction on how this was to be taken into effect hence this is no doubt the reason that even after the ruling, the case on group relief continued to occupy the UK Courts and Tribunals. In the UK High Court in case 2006 WL901125 the issue was whether the losses had been used abroad, in this case it was to be determined whether the France subsidiary's losses could be used by the purchaser and in Belgium and Germany it was to be determined the losses could be taken into account in UK if they become final i.e. if liquidation was completed. The court held that the conditions for allowing loss deduction were fulfilled when the claim for relief was made. In 20th February 2006 Marks & Spencer appealed to the Court of appeal to on the conditions set for loss carry forward and to evaluate the finality of the losses in Belgium and German. The amendments that were required to the ICTA, as an implementation of the ECJ ruling in the national laws, stated that '*... there should be no possibility of use of the loss in the state of the subsidiary is met is set immediately after the end of the accounting period in which the loss arises*'⁴⁴ were considered to have been too strict and improperly implemented to the aim of the EU⁴⁵. These restrictions were illustrated in the formal request sent by the European Commission to implement the ECJ decision properly, the reasoned opinion contained the said restriction where contained in para. 7 of the Schedule 18A of ICTA that the no possibilities test was 'unnecessarily and restrictively' interpreted.

3.1.3.1. On Allocation of Powers to Impose Tax between Member States

This is one area in the cross border loss relief that seemed to be the centre of concern to the tax administration when dealing with principle freedoms of EU. In the research of the paper the power to impose tax should have had no influence on the judgment of the Court. This ground is obvious for the states to justify their national laws. The preservation of powers to tax is one of the crucial factors for member states, the EU law provide the member states with the liberty to draft their own tax law as EU does not impose taxation, its role is to see the states limit their power in situations where the tax subject and tax object have a connection with more than one MS⁴⁶. It does not provide for residence state or the source state since the internal market thrives for absence of tax obstacles. The ECJ has developed, in case law, the competence of member states to define the criteria for allocating their taxation powers. UK uses its territorial rights to tax its residents and hence there is no issue that UK will take into account the company resident in another MS. The subsidiary will be accountable in the state it was established, therefore one would consider the reasoning of the Court to allow group relief rules of a country that allowed transfer of losses from a resident subsidiary to a resident parent, to be extended to allow the transfer of losses from non-resident subsidiary to a resident parent disruptive to the power of taxation between MS. Will it be possible for a state to tax a resident of another state on income that has no economic attachment to its jurisdiction? The UK tax law does not include the foreign subsidiaries nor it should; the subsidiaries were separate legal entities established outside the scope

⁴⁴ Part 1, paragraph 7(4), of Schedule 18A ICTA 1988

⁴⁵ Phillip Baker, (2010), 'UK Forthcoming cases: Marks & Spencer (Group Relief)II and Phillips Electronics UK Limited' "ECJ – Recent Developments in Direct Taxation 2009", Series on International Tax Law, Vol 64, Linde Verlag Wien, Wien, Scheydgasse, page 251 also Commission's press release of 18 September 2008 IP 08/1365 <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1365&type=HTML>

⁴⁶ Marjaana Helminen, 2011

of UK jurisdiction. Hence by requiring UK to take the losses of these subsidiaries, the Court is allocating UK powers to exercise tax jurisdiction that does not exist⁴⁷. Even the ECJ could not dispute, so at the end the MS power to impose taxes is still intact whether the internal market allows it or not. At the end the ECJ introduced the no possibilities test as an exception to the general rule of tax subject and where there are non-final losses.

The allocation of tax power between member states was raised in cross-border cases where the group of companies involved a *non-resident member*. Since the profits and losses are to be allocated to one country, the challenge was upon the ECJ to determine the state to account for the losses in order to be consistent with the symmetry principle. The view for this case the subsidiary losses and profits will be accounted in its resident state. The symmetry principle is to followed as in Germany in the *Lidl Belgium* case and *Oy AA* cases, which will be analyzed in later chapters.

3.1.3.2. On Tax Avoidance and Double Use of losses 'double dip'

Tax Avoidance, there is a possibility that the taxpayer would take an advantage of the group relief and choose the most favorable regime to relieve the losses. Even though the taxpayers are allowed to choose the most favorable system in which to conduct the business,⁴⁸ the Court decided to use the justification together with the need to preserve MS power to impose taxes and risk that losses could be used twice or 'double dip'. Double Dip refers to an alternative technique for reducing source and residence taxation. The technique takes advantage of tax rules in both states in one calculating year. It often arises in states which permit grouping of income and losses of commonly owned company⁴⁹. For instance in the case of *Marks and Spencer* the UK tax authority argued that the losses can be used in the state of the subsidiary and in the state of the parent company. It follows that were UK treated parent companies equally with regard to resident and non-resident subsidiaries, the result would be that the losses of a non-resident subsidiary could in principle be set off in both the UK and the resident state of the subsidiary. Another factor that could raise the risk is when the two companies are closely related in such a way that a parent company with significant connection with the subsidiary (has invested or hold shares) can claim loss deduction when the subsidiary incurred losses. The subsidiary company as well can claim loss deduct in respect of the losses incurred in its resident state⁵⁰.

3.1.3.3. On Current and Final Losses and the 'no possibility test'

The issue of current and final losses was mentioned in the case but was resolved by the 'no possibilities test' as far as final losses were concerned which left out the tax relief for current losses. In the *Marks and Spencer* case, group relief scheme does not have to be extended to non-resident subsidiaries except in respect of definitive foreign subsidiary losses which will never be set off in the subsidiary. The final losses were those losses incurred as a result of a sale to third parties and/or when the subsidiaries ceased its trading activities. However the court has not provided whether the definitive losses

⁴⁷ Bruno da Silva (2011), ' From Marks & Spencer to X Holding', p.5

⁴⁸ Advocates General's opinion in *Oy AA* para 62

⁴⁹ Victor Thuronyi, (1998), 'The Law Design and Drafting: Chapter 18 *International Aspects of Income Tax*', International Monetary Fund, Washington DC, USA

⁵⁰ Jerome Monsego, (2011), p.147

quality is the only condition to allow Group Relief rules that allow transfer of losses from a resident subsidiary to a resident parent to be extended to allow the transfer of losses from a non-resident subsidiary to a resident parent. The ECJ ruling left question in the pending case of *A Oy*⁵¹ regarding mergers, whether they are also considered as final losses. In this case the parent company merged by absorption of the subsidiary registered in Sweden. The subsidiary had only trading losses. The result of the merger was a single company that did not have a PE in Sweden. In this case loss became definitive for they could not be deducted in Sweden as a result of a merger. In *Marks & Spencer* the losses were final due to sale and liquidation⁵². The ruling of the case might have similar reasoning to *Marks & Spencer* case, the only difference will be on the application of the national laws in accounting for the losses as according to Finnish tax laws, and whether Finnish tax law would allow such merger. This will be discussed when looking at the cross-border relief in Finland and Sweden in part 4.3 and 4.4 respectively.

3.1.4. *Phillips Electronics UK Case (pending)*

3.1.4.1. Advocate General J. Kokott's contribution on 19th April 2012: Looking at Current Situation.

Article 252 of TFEU provide the status of the Advocate General in assisting the Court, they are responsible for delivering reasoned submissions on cases in open court. The advocate general has same status as the judges of the ECJ. Article 253 of TFEU provide that '*the Judges and Advocate Generals are chosen from persons whose independence is beyond doubt and who possess the qualification required for appointment to the highest Judicial office in their respective countries..*' Moreover the written opinion of the Advocate General, for its quality and reasoning, is often considered in delivering the final ruling of the ECJ⁵³. In the pending case of *Phillips Electronic*⁵⁴, the Advocate General Kokott's submission will be considered as the current situation in the treatment of losses in the UK.

The facts of the case were as, UK Company, Philips Electronics, claimed a group relief for losses incurred by another company in UK a resident branch of Netherlands Company (UK Branch). The UK Company wanted the losses to be surrendered to it and thus have the losses deducted for the basis of assessment for its corporation tax. The Netherlands Company, LG PD Holding, is the parent company and this established its entitlement to the group relief. The tax authority disputed the claim for surrender of the losses for group relief on the ground that the losses to e surrendered are taken into account in principle in the Netherlands' taxation of the parent company and that the conditions in Section 403(D)(1)(c) of ICTA were not satisfied. The taxpayer contested that the conditions in the UK group relief provisions were contrary to the freedom of establishment.

⁵¹ Case C-123/11 A Oy (pending)

⁵² Case C-446/03 para 21

⁵³ Mattias Dahlberg, (2005), page 16, also Electronic article 'The Advocates-General in the Court of Justice of the European Union' <http://humanrightshouse.org/Articles/16051.html>

⁵⁴ Case C-18/11 Philips electronics (pending)
<http://curia.europa.eu/juris/document/document.jsf?text=&docid=121725&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=839235#Footnote31>

Those conditions provide that foreign companies may surrender the losses of a UK-resident permanent establishment only where they cannot be used for the purposes of any foreign tax. Such a condition does not apply to companies resident in the United Kingdom.

The issue was whether the provisions Section 403(D)(1)(c) of ICTA restrict the freedom of establishment. Under those provisions a surrender of domestic losses of the PE of a foreign company by way of group relief is not possible where the losses for the purpose of foreign taxation are allowable against non-UK profits.

The Advocate General concluded that the UK law that prevented the surrender of losses incurred in UK by a resident PE of a nonresident company to a resident company by way of group relief and where the losses could not be deductible against the non-domestic profits of the company was a restriction to the freedom of establishment. She continues stating that national law could not be justified on the grounds used in *Marks & Spencer* case i.e. of preservation of the allocation of taxing powers between MS or prevention of double use of losses.

From the submission of this case it's clear that UK laws still restrict freedom of establishment and that the provisions of law do not favor cross-border losses (even though the case involved only one jurisdiction, the reason for denial of the group relief was that the losses might still be attached to the non-resident parent company) that favor resident companies more than the non-residents. The conditions found in Section 403(D)(1)(c) of ICTA apply only to the foreign companies with branches in UK and the losses that may be used by their resident state but does not to the residents companies.

The UK considers the two companies not in comparable situation. First the company, claiming the losses, is registered in UK while the surrendering company is the UK Branch of non-resident (LG PD Netherlands hence, the tax liabilities of the two companies are not comparable as the UK Company is taxable on its worldwide income while the Branch of the non-resident Company is taxable in the UK to the extent of the profits attributable to it. However the Advocate General observe in para 33, that the Court found in *Marks & Spencer* that in each specific situation it is necessary to consider whether the fact that a tax advantage is available solely to resident taxpayers is based on objective elements. Consequently, a restriction exists where there is no objective difference in the situation, with regard to the tax levy in question, which would justify different treatment between the various categories of taxpayer. Hence in domestic taxation the status of both the UK Company and the UK Branch are comparable to the domestic tax paid. The UK Company pays tax on the income earned in UK and get credited for the foreign income paid, while the UK Branch pays tax on the profits attributable to it. In this case both the profits and losses of the UK Company and UK Branch will be accounted for in UK⁵⁵.

The Justification put forward in the *Marks & Spencer* are repeated here, Advocate General referred to the uncertainty that originated from that case. The allocation of power is considered the core factor for states to protect their taxing right in relation to the activities carried on in their territory. In this case the allocation of power is resolved by DTC. Under Article 7 of the UK-Netherlands double taxation convention, the United

⁵⁵ C-18/11 Philips Electronic, Para 33-35 of the Opinion of Advocate General, 19th April 2012

Kingdom has the power to tax both the income of domestic companies and the income of UK-resident permanent establishments of foreign companies. It's the opinion of the Advocate general that the powers of the UK under the DTC are not impaired by the fact that the losses can be surrendered in the Netherlands. The losses incurred are those connected to the activity carried on in the UK, just as the profits attributable to the PE are taxable in UK. This is true when looking at previous case of *Lidl Belgium*. So UK cannot use this justification to prevent losses being surrendered by UK Branch.

On the double use of losses, the UK Tax Authority saw that to surrender the losses of the UK Branch to the UK Company will enable the losses to be deducted by both Netherlands and UK. However it has established that UK has the primary right to tax the income of the UK Branch, and the losses cannot be used anywhere but UK by following the principle of Symmetry in *Lidl Belgium* case and in *Marks & Spencer* case where the court maintain that profits and losses are two sides of the same coin⁵⁶.

I see reason on the submission of Advocate General and that UK has no justifiable grounds to dispute the claim of losses of UK branch of non-resident. Should the ECJ go with the same conclusion, UK will be forced to amend its tax laws or remove the provision as being in contradiction to freedom of establishment. The Marks & Spencer case is still under discussion by the UK courts and maybe this case is a way to urge the immediate action on changing the group relief provisions that are contrary to the freedom of establishment.

To recap as the law stands today in UK, companies in a group can claim group relief on losses arising in other group companies. Losses can be surrendered upwards, downwards, sideways in corresponding accounting period with 75% group structure. Group relief has been extended to UK PE of non resident company and to overseas PE of UK in specified circumstance such as that where the losses could not be principally be taken into account twice or where the all scope for claiming non-UK relief for losses has been exhausted and that the subsidiary is located in any of the EEA countries, EU MS, Iceland, Liechtenstein and Norway⁵⁷.

⁵⁶ C-18/11 Philips Electronic, Para 52 of the Opinion of Advocate General, 19th April 2012

⁵⁷ European Tax Handbook 2011, p.909 also UK Corporate Taxation Country survey, IBFD 2012

4. How EU States take on Cross-Border losses

4.1. Finland

(The Finnish system of group contribution has a lot in common with the Swedish system of group taxation and the two countries have faced similar problems in situation with cross-border aspects)

4.1.1. Domestic Laws

Companies registered in Finland are considered as resident taxpayers and the company profits are liable to state taxation. The residents are taxed on their worldwide income and nonresidents are liable to tax on the profits derived within Finland through a PE⁵⁸.

Credit method is applied to business profits attributable to PE. The credit method also limits the ability to deduct losses of a foreign PE against domestic income⁵⁹. The country reporter for Finland continued elaborating on the shortcoming of this rule is when the parent company of the foreign PE makes a loss, in this case losses of the Finnish parent company cannot be offset against the profits of the foreign PE.

4.1.2. Group Taxation

Finland allows a special group regime, called *group contribution* which is regulated under the Act on Group Contribution. In group contribution scheme, companies belonging to a same group have the ability to balance their profits and losses. The group contribution may be made by one company to another where the recipient may be a parent company, a subsidiary company or a sister company⁶⁰.

In group contribution profits can be transferred from a profit making company to another company in the group which carries losses. The contributions are considered as tax deductible expenses of the contributing company⁶¹. The main reason for the special scheme is to prevent tax disadvantages that would otherwise arise when doing business with other close related companies. For these companies to qualify into a group to access the benefits there are several conditions. There has to be a direct or indirect holding of at least 90% between the two companies. A group contribution is treated as taxable income of the recipient and as a tax-deduct of the contributing company. The Act on Group Contribution requires that both companies to be residents in Finland. The group contribution operates in a domestic situation, in which case if there is a foreign company the contribution will not be taken into account⁶², this was at issue in the *Oy AA* case⁶³. Some of the arguments were raised from the *Marks & Spencer* case which had

⁵⁸Seppo Penttila, 2009 'Tax Aspects of Groups of Companies – Finnish Experience', Stockholm Institute for Scandinavian Law.

⁵⁹ Kristiina Aima, IFA Cahiers 2011 - Volume 96B. Key Practical Issues to Eliminate Double Taxation of Business Income

⁶⁰ Michael Lang, Joseph Schuch (2006), 'ECJ Recent Developments in Direct Taxation' Kluwer International, The Hague, The Netherlands page 98

⁶¹ Bruno da Silva, (2011), 'From Marks & Spencer to X Holding: A Critical Overview and Some Open Issues' in Dennis Weber, Bruno da Silva, page 10

⁶² Michael Lang(ed) (2006) page 98 also Seppo Penttila 2009, page 293-298

⁶³ Case C-231/05 *Oy AA* judgement of 18 July 2007

opposite facts, whereas instead of transfer of losses the current case deal with transfer of profits.

The facts of the case are, AA Ltd was a company established in the UK and indirectly, through two other companies, held 100% of the shares in Oy AA. AA Ltd business ran at a loss in 2003 while Oy AA did not, (it was profitable) Oy AA then opt to make intra-group- financial transfer in favour of AA Ltd. Oy AA then applied to the Central Tax Commission for a preliminary decision as to whether the transfer sought constituted an intra-group financial transfer according to Article 3 of the Act on Group Contribution and could therefore be regarded as a tax deductible expense of Oy AA for the period 2004 and 2005. The Central Tax Commission refused the intra-group financial transfer on the ground that the deductible intra-group financial transfer and the corresponding taxable income had to fall under Finnish Taxation system⁶⁴.

The issue was whether a legislation, which provided that a subsidiary established in Finland can deduct from its taxable income an intra-group financial transfer which it makes in favor of its parent company only if that parent company is established in Finland, was a restriction to the freedom of establishment⁶⁵.

The court held that legislation was not in restriction of freedom of establishment and that subsidiary in Finland may not deduct an intra-group financial transfer which it makes in favor of its parent company unless that company has its establishment in Finland⁶⁶.

The case illustrated another problem where a domestic situation (such as the Finnish scheme) is extended to an international situation. This is a challenge in cross border activities and especially to EU fundamental freedoms. Frankly, the scheme at issue promotes interests of the group of companies situated in Finland or non residents with establishments in Finland. However the ECJ did find that the scheme was a restriction to the freedom of establishment since MS in the EU have a right to exercise their business activities in other MS such as Finland through a branch, subsidiary or agency according to Article 43 of EC (Article 49 of the TFEU), the legislation limit the subsidiaries of other MS parent companies into enjoying the same benefits awarded to subsidiaries of Finnish parent companies⁶⁷.

The Court applied the justifications to restrict the freedom of establishment as employed in the *Marks & Spencer* case. The court used two of the justification with exclusion of risk of double use of losses, since in the case, the profits were being transferred and not the losses⁶⁸.

Current Situation in Finland Sweden

Finland dealt with another dispute yet to be decided by the ECJ, *A Oy* case⁶⁹, which dealt with the cross-border loss importation by way of merger.

⁶⁴C-231/05 Oy AA, Para 11-16

⁶⁵ C-231/05 Oy AA, Para 17

⁶⁶ C-231/05 Oy AA, Para 68

⁶⁷C-231/05 Oy AA, Para 32

⁶⁸ Bruno da Silva (2011), page 11

⁶⁹ Case C-123/11 (A Oy) pending

The facts of the case involve a Finnish parent company holding a Swedish subsidiary which terminated its activities in 2007/2008. The subsidiary was left with trading losses. The two companies entered into a merger where the parent company absorbed the subsidiary company. The resulting company did not have a PE in Sweden. Hence the losses would not be set off in Sweden and will be considered definitive within the meaning of the *Marks & Spencer* case. Following the UK decision in *Marks & Spencer* and then the *Phillips Electronic* case the ECJ will have another opportunity to explore the 'no possibility' test as regards the merger. The ECJ will have to elaborate what other kind of losses incurred by a company can be termed definitive and whether the circumstances in the case at hand consider the importation of losses after a merger definitive even though the subsidiary in Sweden was not liquidated.

Finland

Group Contribution can be made between the parent company and its subsidiary but may also be made between two Finnish subsidiaries of a joint parent company. As far as nonresidents are concerned the Supreme Administrative Court has considered nonresidents subsidiaries or even nonresidents parent companies to qualify when determining the minimum ownership on the basis of non-discrimination provisions of the applicable DTC, however the payment of Group contribution to a non-resident subsidiary or to a non-resident company is not tax deductible⁷⁰. Sweden has made a much better improvement in comparison when it comes to nonresidents.

Sweden

On 11 March 2009 the Swedish Supreme Administrative Court applied the ECJ's case law on group taxation from the *Marks & Spencer* case. The *Gambro* case no 73222-06 involved a Swedish parent Company with a subsidiary in the Netherlands and Italy. The Swedish company contemplated sending group contribution to the subsidiaries in liquidation and in return to get a tax deduction. The subsidiary in Italy faced time bar for carryover of its losses. The Board accepted the tax deduction of both contributions in accordance with the ECJ's judgment in *Marks & Spencer*. It held that a resident company may deduct a group contribution paid to its subsidiary resident in another EU MS even though all of the requirements were not fulfilled (a group of companies liable to Swedish corporate tax and 90% hold in the other company) provided that the subsidiary could not use the losses in its state of residence⁷¹.

As from 2010 to present, the Swedish rules on cross-border losses allowed a resident parent company to deduct final losses of its subsidiary located in another EEA state. The conditions imposed on this were more strict and precise, that the parent company has to hold 90% of the shares of the foreign subsidiary and that the subsidiary has been dissolved through liquidation. The final loss is calculated both before and after the liquidation according to the rules in the country of residence as well as according to the Swedish law⁷².

⁷⁰ European Tax HandBook 2011, Finland 'Corporate Taxation' Country Surveys, IBFD, 2012

⁷¹ Cecile Brokelind, (2009), ' *Gambro AB. The Swedish Supreme Administrative Court applies ECJ's caselaw on cross border Group Taxation in 10 decisions on the Swedish Group Contribution Regime*', Direct taxation, Case law,

⁷²European Tax HandBook 2011, Sweden 'Corporate Taxation' Country Surveys, IBFD, 2012

4.2. Germany

4.2.1. Domestic Laws

Germany's laws tax its residents on their worldwide income and provide unilateral foreign credit against the domestic tax liability. In avoidance of international double taxation and in most of its DTC, the tax authority employed the exemption of branch profit from German Tax. The profits and the losses deducted by the host state are exempted from the taxable income of a resident company with a foreign source income. The law here provides the tax symmetry principle where the taxation of profits and deduction of profit should be taken in one state as well as the that exemption of profits and exemption of losses should also be taken together as the two sides of the same coin⁷³.

4.2.2. Group Taxation

The group relief is known as *Organschaft*. The group relief allows members of a group to set off losses against the profits in other members of the group. The group is treated as single unity and that their profits and losses are pooled into the hands of the controlling company. The controlling company becomes liable for corporate taxes and the losses of each company maybe set off against profits of the group. Cross-border grouping is possible only when the controlling company maintains a PE in Germany. In this case the profit or losses allocated to the PE are taxed accordingly⁷⁴.

In 2006, after the *Marks & Spencer* case in the UK, a taxpayer, Lidl Belgium with a registered office in Germany, sought to deduct losses incurred by its PE situated in Luxemburg. The Finanzamt disallowed the deduction of the losses on the basis of the exemption of income relating to that PE, i.e. its corresponding income is not a subject of taxation in Germany. The *Lidl Belgium* case⁷⁵ corresponds to the *Marks & Spencer* case on the Symmetry of taxation argument used in the justification of the DTC provision to the taxpayer's claim that the provisions of the tax law prevent freedom of establishment.

Facts of the case are Lidl Belgium is a member of Lidl Schwarc group and carries on business as distributor of goods. Lidl Belgium further developed and established itself in Luxemburg and created a PE there. During the 1999 accounting period Lidl Belgium's PE in Luxemburg incurred a loss. When calculating its revenue for tax purposes Lidl Belgium sought to deduct that loss from the amount of its tax base. The Finanzamt disallowed the deduction of the loss stating the exemption of income relating to that PE by virtue of the provision on the double tax convention⁷⁶.

The issue was *'..whether Articles 43 EC and 56 EC preclude a national tax regime which does not allow a resident company, for the purposes of determining its profits and calculating its taxable income, to deduct losses incurred in another Member State by a*

⁷³ Wolfgang Kessler, Rolf Eicke, 'Lidl Belgium: Revisiting Marks and Spencer on the Branch Level', Tax Notes International, Volume 49, Number 13, March 31, 2008

⁷⁴ Germany – Corporate Taxation: Country Surveys, IBFD, March 2012,

⁷⁵ Case C-414/06 Lidl Belgium vs Finanzamt judgement of 15 May 2008

⁷⁶ Case C-414/06 Lidl Belgium, Para 8-11

*permanent establishment belonging to it, when that tax regime does allow losses incurred by a resident permanent establishment to deduct those losses.*⁷⁷

In short the national court was asking whether the country of the parent company (Germany) must take into account losses of foreign branch (in Luxemburg) even though the applicable double taxation convention provide for an exemption of the branch profits in that country.

The ECJ held that Article 43 EC does not preclude a situation in which a company established in a Member State cannot deduct from its tax base losses relating to a permanent establishment belonging to it and situated in another Member State, to the extent that, by virtue of a double taxation convention, the income of that establishment is taxed in the latter Member State where those losses can be taken into account in the taxation of the income of that permanent establishment in future accounting periods.

In this ruling, the court substantially concurred with the *Marks & Spencer* case ruling on the restriction to the freedom of establishment. The court took into consideration two of the justification; the concern for balancing of allocated power to taxation between MS in order to safeguard the symmetry and the avoidance of double use of losses. The court did not consider the tax avoidance justification since the case involved a single company. The court considered the proportionality case in the *Marks & Spencer* in appraising the Germany legal system for being proportionate since the losses at the level of the head office could not have been possible to be deducted. (ref to the DTC)⁷⁸

Current Situation in Germany

In work to harmonize the rules on cross border losses the EU took into account the laws in Germany of allowing cross border losses and found that they are less favorable to the other residents in the EU who have not registered seat in Germany but are seeking the fiscal unity advantage with Germany registered companies. In 2008 the Commission initiated infringement procedures against Germany arguing that the country's existing provisions violated the freedom of establishment in the Treaty of the European Union by prohibiting losses incurred by companies in EU to be offset in German⁷⁹. The situation did not change in 30th September, 2010, the Commission announced that it had sent a formal request to Germany to amend its group taxation regime which were considered discriminatory. The group taxation regime did not allow companies registered under the laws of other MS but with a place of effective management in German hence liable to unlimited taxation but allowed other companies incorporated under German laws.

Yet in 2011, cross border grouping was only possible if the controlling company maintains PE in Germany where the profits or losses is allocated to the PE and taxed accordingly⁸⁰. The resident companies of other EU MS were not included. Thus on 22 March 2012, in Brussels, The Commission decided to refer Germany to the European

⁷⁷ Case C-414/06 Lidl Belgium, Para 14

⁷⁸ Denis Weber (2011), p. 18

⁷⁹ http://www.lowtax.net/asp/story/front/Germany_Plans_Cross_Border_Loss_Relief_48632.html

⁸⁰ European Tax Handbook 2011, Germany 'Corporate taxation' Country Surveys, IBFD 2012

Court of Justice for excluding certain non-resident companies from the benefits of its corporation tax fiscal unity regime (Organschaft)⁸¹.

4.3. Netherlands

4.3.1. Domestic Laws

Corporation tax law follows that resident corporation are taxed fully (dividends and its shareholders) and as residents they are also subject to worldwide tax. Nonresidents are subject to tax only to the income derived from Netherlands' sources. Losses sustained may be carried back to be set off against profits of previous years and carried forward for 9years.

According to its DTC the Netherlands grants relief from double taxation by exempting the foreign income paid by its resident taxpayer from its corporate tax liability.

4.3.2. Group Relief

The Netherlands provide relief to group of company in a scheme known as Fiscal Unity. In this scheme, one company (parent company) which holds, legally and economically, at least 95% of the shares of another taxable person (the subsidiary), the two, can request tax be levied on them as if they were a single taxable person. The effect is that tax will be levied on the parent company because the activities and the assets of the subsidiary form part of the activities and assets of the parent company⁸².

The parent company of the fiscal unity files a consolidated tax return. The fiscal unity allows the offset of losses of one company against profits of another company in the group in the particular year and a tax free transfer of assets and liabilities and dividends to companies belonging to it. A fiscal unity is dissolved if requirements are no longer met or at the request of the taxpayer, in which the losses incurred by the fiscal unity remain with the parent company⁸³.

However the fiscal unity applies to taxable persons resident in Netherland. The only exception involved the nonresident which conduct business in the Netherlands through a PE⁸⁴. The nonresident can then join the fiscal unity with other resident subsidiaries established there.

This rule was in dispute in the *X Holding* case⁸⁵, in which the taxpayer sought to include a subsidiary established in Belgium into the fiscal unity. Although the ECJ found the rule to be in restriction to the freedom of establishment, the Court ruled in favor of the state in safeguarding the allocation of powers to state to impose taxes. The reasoning followed that the parent company is at liberty to include or exclude a subsidiary in the fiscal unity and that acceptance of the possibility to include nonresidents subsidiaries in

⁸¹<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/12/283&format=HTML&aged=0&language=en&guiLanguage=en>

⁸² Article 15 of the 1969 Law also para 5 of the C-337/08 *X Holding BV*

⁸³ Netherlands, Corporate Taxation, IBFD

http://online.ibfd.org/ludwig.lub.lu.se/kbase/#topic=doc&url=/collections/gtha/html/gtha_nl_s_002.html&q=netherlands+netherland&WT.z_nav=search&hash=gtha_nl_s_2.

⁸⁴Article 15 (3) (a) and (b) and (4) of the 1969 Law

⁸⁵ Case C-337/08 *X Holding BV vs Staatsecretaris van Financien*, Judgement of 25th February 2010

the fiscal unity would offer the parent company the opportunity to choose freely in which EU member states the subsidiary's losses would be taken into account⁸⁶.

The facts of the *X-Holding* case are as follows, the X Holding is established in the Netherlands, it is the sole shareholder of company F set up in Belgium. The company is registered under Belgian laws and not liable to corporation tax in the Netherlands. X Holding in the Netherlands and Company F in Belgium applied for the fiscal unity under Article 15 (1) of the 1969 Law. The Netherlands Tax Inspectors rejected that application on the ground that Company F was not established in the Netherlands.

The initial procedures before the tax courts/authorities to settle this issue was influenced by the ECJ case law on *Marks & Spencer*. The Court had previously settled a similar matter involving a foreign subsidiary. Hence the issue in this case was whether the national laws that allow parent company and its subsidiaries to opt for the fiscal unity but which prevent the parent company and its nonresident subsidiary to opt for the same scheme because the profits of that nonresident subsidiary are not subject to fiscal legislation in the Netherlands are restrictions to the freedom of establishment contained in Article 49 of the TFEU.

The Court held that the national rules were not incompatible with the EU law. The court considered the basis of the restriction of the rule which affords residents companies tax advantages in joining the fiscal unity but exclude the non residents; the court found the justification for this is on the ground of safeguarding the allocation of powers to impose taxes between states. The court employed the proportionality principle it used in *Marks & Spencer* case, where it looked at the fiscal unity and the measure to limit nonresident's subsidiaries into joining the fiscal unity, at the end the court reasoned that tax rules of the subsidiary state have to be applied in respect of subsidiary's profits and losses.

However after this decision of the ECJ the situation in the Netherlands was described as unsettling and the ECJ received numerous critics on this decision which was declared incorrect⁸⁷. It is in this paper interest to find out whether different approach would have been taken were the ECJ considered the fiscal unity in the Netherlands as a group taxation advantage different from the group relief in the UK, the *Organshaft* in the Germany or group contribution in Finland and Sweden. The ECJ took notice of the loss compensation without further exploring the advantages it has in cross-border business. the fiscal unity allow losses to be transferred to a profitable company in the group, hence the two companies merge into one and taxed as a single taxpayer. Second ECJ should have taken notice of the system of double relief in connection with losses of foreign PE (or Subsidiaries) in which the system allows immediate deduction of losses with the recapture if and to the extent that the PE makes profits (when the subsidiary makes profit). This system ensures there is no double deduction of losses. From the decision the ECJ seem not to want to broaden the scope of cross-border loss relief beyond *Marks & Spencer*, in which the only exception for losses of the subsidiary to be deducted in the parent state is that the possibility to offset those losses in the

⁸⁶ Para 31-33 of C-337/08 X Holding BV

⁸⁷ Denis Weber, (2011), "Eight Points Why the X Holding Judgement Is Incorrect" in Denis Weber, Bruno da Silva, *From Marks & Spencer to X Holding: The Future of Cross Border Group Taxation*, page25

subsidiary state has been exhausted. In this fact the X Holding case law contains no remarkable development from *Marks & Spencer, Oy AA* or *Lidl Belgium* cases.

Current Situation in the Netherlands,

On 7th January 2011, the Dutch Supreme Court rendered its final decision in the X Holding case. The decision upheld the Dutch law on fiscal unity to be available to entities which are established in the Netherlands and nonresidents in so far as they have PE in Netherlands.

Despite that victory to tax authorities, The Commission had issued a request to the Netherlands in 16th June 2011 for the state to amend its legislations on fiscal unity. The Dutch laws (Article 15.3.c of the Dutch Corporation Tax Law) did not allow two Dutch subsidiaries held by foreign parent companies to form a fiscal unity. In this the parent companies in other MS cannot benefit from the fiscal unity regime with their subsidiaries in the Netherlands which is contrary to the EU laws⁸⁸.

The Netherlands, like Germany and UK, and following the case law of the ECJ and Advocates General's Opinion on the *Phillips Electronics* case, would probably be advised to change its cross border rules where non residents are concerned to be compatible with the EU. As to date the Netherlands still upholds the *X Holding* decision and that fiscal unity cannot be formed with a nonresident subsidiary⁸⁹. The situation is consistent with the circumstance were losses are not final, were circumstances to change, anytime in the future, then it could be possible that national court could apply the ECJ's decision from the *Marks & Spencer* case.

In the conclusion of this chapter, the efforts of EU to harmonize direct taxation must take another direction since the tax treatment of companies established in EU still depend largely on national laws of MS which as the paper illustrated contained very different and unique rules of taxation most of which are often in conflict with the EU law. The EU has to strengthen the formation of European Company (SE) which it had started in 2004⁹⁰ or the CCCBT. As for the SE, Art. 10 of the SE Regulation provides that *company can be treated in every member state as if it was a public limited company formed within the law of the MS in which it has its registered office*, this makes sense and it will be a huge relief for ECJ to have to deal with different tax laws.

⁸⁸<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/719&format=HTML&aged=0&language=en&guiLanguage=en>

⁸⁹ European Tax HandBook 2011 p. 620, also The Netherlands, "Corporate Taxation" Country Surveys, 2012

⁹⁰ Marjaana Helminen, 2011, IBFD

5. How Non-EU States Take on Cross Border Losses

The paper managed to show the effect of UK cross border case law to other EU MS. On other hand the general principle applicable to cross border treatment of losses can be applicable to other nations i.e. the symmetry principle and the need to preserve power of imposing tax among states and not at all in the procedure followed in Europe. Most states have some common features of taxation. In the study are the states that follow the classical norms of international tax law with some guidance of the OECD Model of which the states are also signatories. The principles of EU of harmonization do not apply. In this case the states will be more concerned with observing their separate jurisdictions to which each state exercises its own power to taxation with and limit this power through the DTC and other multilateral agreements.

The concern of this paper is on the experience of the EU MS and in situation where the EU states engage in cross border activities with non-EU states. In the case study of the ECJ we saw that many rules of the MS especially UK, Germany and Netherlands were declared incompatible with the EU laws, and the Commission requested these states to amend their laws to be in conformity with the fundamental freedoms contained in the TEU. This will have no effect to the third parties⁹¹. In case no. 1256/07 *Tenneco*⁹², where a Swedish company held by an American company intended to send a group contribution to a sister company in Denmark whose losses could be face loss carry-over time bar in 2 years. The Swedish Court (RR) did not apply the Marks & Spencer ruling, on the ground the Swedish company was held by a non-EU states and Art 49 of TFEU could not apply.

5.1. Tanzania

5.1.1. Sources of Law

The laws of Tanzania are derived from The Constitution of United Republic, Statutes (principal and subsidiary legislations), case law, Received Laws, Customary and Islamic Laws, International law (Treaties and Conventions).

Under the source 'Received Laws' provided under Section 2(3) of the Judicature and Application of Laws Act Chapter 358 of the Laws of Tanzania [R.E. 2002] (JALA) The act provides that the received laws include Common Law, Doctrine of Equity, Statutes of general Application of England applicable before the 22nd of July 1920, which is deemed to be the reception date for English law in Tanzania.

The Tanzanian Income Tax Act Chapter 332 of the laws [R.E. 2006](ITA) has to a significant extent been influenced by the English principles of taxation and has been drafted to observe the main areas of taxation. The current statute has been revised in 2006 and has been amended in conformity with the Finance Act with the major areas of taxation including corporate taxation covered in the ITA.

⁹¹ Art. 49 of the TFEU on freedom of establishment of MS of the EU and Art 54 TFEU referring to application of the treaty to companies formed under the laws of MS

⁹² Cecile Brokelind, (2006) p.45

International Law has also influenced taxation in Tanzania by avoiding the problem of international double taxation and tax evasion. Tanzania has signed treaties with few EU states such as Denmark, Sweden, Finland, Italy, Norway and other are in negotiations.

5.1.2. Corporate Taxation and Cross border Losses.

Section 53 of ITA provides for taxation of corporation separate from its shareholders. Companies are taxed on their business income and the shareholders are taxed on the dividends received in the form of withholding tax⁹³. Corporation registered in Tanzania are considered residents and taxed on their worldwide income⁹⁴. Non residents companies are taxable to the extent of the profits derived in Tanzania through a PE⁹⁵. Entities calculate their income and losses from business from domestic sources separately from income or losses that have foreign losses⁹⁶.

The losses incurred in the course of business of a corporation are deductible, in calculation of assets and liabilities, the gains of a corporation maybe reduced by its losses⁹⁷. Foreign losses may be claimed and can be used against gains of the foreign source⁹⁸.

5.1.3. Group taxation

Companies can arrange in a group. The taxation applies to resident companies where a dividend distributed by a resident corporation to another resident corporation is exempted from income tax where the corporation receiving the dividend holds 25% or more of the shares in the corporation distributing the dividend. In case there is a loss as in fall of value of shares of the subsidiaries the deduction will not be allowed though this is not mentioned in the law⁹⁹.

The cross border relief is available to a PE of resident parent and PE of a nonresident parent. The profits and losses of the PE are calculated in respect of those business activities conducted and derived by sources in Tanzania¹⁰⁰.

Like many EU states including UK, the national laws do not contain cross border loss relief for a group of companies (parent and subsidiaries). This could be for the same reasons, stated by national Tax Authorities in UK, of preservation of power of taxation, prevent tax avoidance and double dip. The Tax authorities of Tanzania are no strangers to these concerns especially on the problem of tax avoidance. They are aware that, taxpayers have many devices to tax planning since most of the tax avoidance is tolerable¹⁰¹.

⁹³ Section 54 (1) (a) of ITA

⁹⁴ Section 66(4) of ITA

⁹⁵ Section 70 of ITA

⁹⁶ Section 67 (1) of ITA

⁹⁷ Section 36 (2) of ITA

⁹⁸ Section 36 (4) of ITA

⁹⁹ Section 54 (2) of ITA

¹⁰⁰ Section 71(2) ITA

¹⁰¹ Courts and scholars have often referred to UK case of IRC v Duke of Westminster 1936, AC 1, also see Kbuta Ongwamuhana, (2011), " Tax Compliance in Tanzania" Mkuki na Nyota, Dar es Salaam Tanzania, p.13.

6. Conclusion

'Cross border losses' is one area of taxation, among other topics, that has required the competence of national laws, international tax law and EU law for the taxpayers to fully exhaust its benefits as far as corporate income taxes go. It's no disputed matter that taxpayers preferred the utilization of losses through the available loss relief methods. The laws designed by the states have only been to serve the purpose of easing the taxpayers' liability to taxation. However, in a world that is continuously growing, the business world is also growing and proving more accessible and interconnected. The business structures are growing complex and cover several jurisdictions. The topic that this paper researched had been very challenging, given the various case law theories and arguments involved. It was especially difficult to follow the reasoning of the ECJ when finding out the presence of a restriction to a freedom of establishment. The most complicated area was to find comparable situations between residents and nonresidents taxpayer which are otherwise not at all comparable in international tax norms. At the end the paper found out that it was in an attempt of the ECJ to extend tax benefits of loss relief to other MS that are also in the same market, the benefits which would otherwise not be available in the absence of the internal market. However these benefits are conclusively available were the losses incurred are in a more domestic situation. From the case *Marks & Spencer* the court had to introduce the 'no possibilities' test which has not helped in settling the matter as the UK courts have yet to provide a final decision. The paper finds that it will be highly unlikely for other states, which do not have group taxation in their national laws, to want to explore the group relief since most of the cases' judgments are received with criticism while other cases are pending. However in the spirit of international trade the Court and other organizations will come up with a better solution to handle the issue of cross border losses.

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Appendix

Judicature and Application of Laws Act

2.-(1) Save as provided hereinafter or in any other written law, expressed, the High Court shall have full jurisdiction in civil and criminal matters.

(2) For the avoidance of doubt it is hereby declared that the jurisdiction of the High Court shall extend to the territorial waters.

(3) Subject to the provisions of this Act, the jurisdiction of the High Court shall be exercised in conformity with the written laws which are in force in Tanzania on the date on which this Act comes into operation (including the laws applied by this Act) or which may hereafter be applied or enacted and, subject thereto and so far as the same shall not extend or apply, shall be exercised in conformity with the substance of the common law, the doctrines of equity and the statutes of general application in force in England on the twenty-second day of July, 1920, and with the powers vested in and according to the procedure and practice observed by and before Courts of Justice and justices of the Peace in England according to their respective jurisdictions and authorities at that date, save in so far as the said common law, doctrines of equity and statutes of general application and the said powers, procedure and practice may, at any time before the date on which this Act comes into operation, have been modified, amended or replaced by other provision in lieu thereof by or under the authority of any Order of Her Majesty in Council, or by any Proclamation issued, or any Act or Acts passed in and for Tanzania, or may hereafter be modified, amended or replaced by other provision in lieu thereof by or under any such Act or Acts of the Parliament of Tanzania:
Provided always that the said common law, doctrines of equity and statutes of general application shall be in force in Tanzania only so far as the circumstances of Tanzania and its inhabitants permit, and subject to such qualifications as local circumstances may render.