The Danish Group Taxation Regime and EU Law – Clarification under way?

Kluwer International Tax Blog
August 18, 2015

Jakob Bundgaard (CORIT advisory)

Please refer to this post as: Jakob Bundgaard, 'The Danish Group Taxation Regime and EU Law – Clarification under way?', Kluwer International Tax Blog, August 18 2015, http://kluwertaxblog.com/2015/08/18/the-danish-group-taxation-regime-and-eu-law-clarification-under-way/

Written by Associate Professor, PhD Anders N. Laursen, Department of Law, Aarhus University and Technical Advisor to CORIT Advisory

On June 4th 2015 the High Court of Eastern Denmark decided to refer a case to the European Court of Justice (ECJ) concerning the Danish mandatory group taxation regime. Also in June 2015, the Commission issued a formal notice to the Danish government concerning the implementation of *Philips Electronics*. The eventual outcome is interesting not only due to the possible implications for the mandatory group taxation regime itself but also because the ECJ might give some insights on the question of comparability in general.

Under Danish tax law all Danish resident companies are subject to the mandatory group taxation regime. The mandatory group taxation regime also encompasses any foreign group companies' permanent establishments (PEs) and real estate situated in Denmark. The mandatory group taxation regime entails that a tax loss from one company can be used to offset income by the other companies in the group. This also holds true for tax losses incurred by a PE situated in Denmark (PEs situated abroad are at a starting point not subject to the group taxation regime). If, however, a tax loss is incurred by a PE this loss may not be utilized within the group if the loss can be deducted by the foreign company to which the PE belongs. As most countries tax their resident companies on their worldwide income this is often the case. Hence, the Danish mandatory group taxation regime frequently prevents a tax loss incurred by PE situated in Denmark from being utilized by the other companies of the group taxation scheme.

At a first glance this rule seems to be contrary to the ECJs judgement in *Philips Electronics*. In this case, the ECJ found that an almost identical provision under British tax law constituted a restriction on the freedom of establishment. This has led many Danish commentators to claim that this part of the Danish mandatory group taxation regime is not in line with EU law. The Danish Ministry of Taxation, on the other hand, claims that the Danish rules differ from their British counterpart on one crucial point, which has to do with comparability.

In *Philips Electronics* the ECJ compared the possibility of transferring losses incurred by a PE situated in the UK to the transfer of losses incurred by a UK resident subsidiary of a foreign parent company. The ECJ found, that only in the former situation, the British rules imposed certain condition on the possibility of transferring losses. In the latter situation, on the other hand, the transfer of losses sustained in the UK was not subject to any equivalent condition. Thus, the rules under British law were tantamount to different treatment of objectively comparable situations. As the differential treatment could not be justified, the British rules were not in compliance with EU law.

Under Danish tax law, if a resident subsidiary of a foreign parent incurs a tax loss, that tax loss cannot be utilized by the company itself if it is possible to transfer the loss to a foreign group company e.g. due to a foreign group taxation regime or similar foreign provisions. This also entails that if the company is part of a Danish mandatory group taxation scheme, the tax loss cannot, under the same circumstances, be utilized by another company within the group. Hence, a loss incurred by a Danish resident company, that can be utilized abroad, cannot be used to offset income by another company under a Danish mandatory group taxation scheme. Similar, any loss incurred by a PE situated in Denmark, cannot be utilized within the Danish mandatory group taxation scheme, if the loss can be utilized by the head office abroad. On these grounds, the Danish Ministry of Taxation argues, under the mandatory group taxation regime, a tax loss incurred by PE is treated no differently than a tax loss incurred by a subsidiary of a foreign parent. As there is no differential treatment of objectively comparable situations, there is no breach of EU law. As such, the Danish rules differ from those under scrutiny in *Philips Electronics*.

For several reasons the ECJs opinion on these arguments is expected with great interest.

First of all the ECJs decision could have a great impact on the Danish mandatory group taxation regime overall.

Secondly, the case referred to the ECJ by the High Court of Eastern Denmark is further complicated by its specific facts and circumstances. The case concerns a Swedish company's PE situated in Denmark. The PE incurred a loss that could not be utilized by another group company in Denmark under the mandatory group taxation scheme, because the loss could *in principle* be utilized by the head office in Sweden due to the fact that Sweden tax resident companies on their worldwide income. However, in the specific situation, under Swedish tax law no loss could be computed. Hence, under Swedish law, no loss existed and, naturally, no loss could be deducted by the Swedish company. If the ECJ is to acknowledge the arguments put forward by the Danish Ministry of Taxation – it is not an infringement of the Fundamental Freedoms that the loss cannot be utilized in Denmark, because a subsidiary would under the same circumstances also be prevented from utilizing a similar loss – this will entail that such tax losses are lost in a kind of 'tax limbo'. This would seem difficult to reconcile with the notion of an internal marked. On the other hand, however, the ECJ has in the past accepted the unfavorable tax treatment of a tax payer in a cross boarder situation if this is due to an 'exercise in parallel' of taxing rights of the member states involved. The case at hand might give the ECJ an opportunity to further elaborate on this point of view.

Thirdly, the case may offer insight to the general view of the ECJ on the matter of comparability. It has for several years now been policy of the Danish Ministry of Taxation to remedy national tax provisions that infringe the Fundamental Freedoms by expanding their scope of application. Numerous examples exist: It is well known from the ECJ's case law, e.g. *Cadbury Schweppes* and *Lankhorst-Hohorst*, that CFC provisions and Thin Cap regulations can indeed infringe the Fundamental Freedoms of the Treaty. The Danish 'solution' to these potential infringements has been to expand the scope of these anti avoidance provisions to also cover purely domestic situations. Hence, CFC rules under Danish law apply to foreign and resident subsidiaries alike as do the Thin Cap provisions. As such, the Danish Ministry of Taxation claims, no differential treatment between domestic and cross boarder establishments exist, and, consequently, there is no breach of EU law. This case could give the ECJ an opportunity to once again go in search of the 'holy grail' of EU tax law: the prohibition of non-discriminatory restrictions