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Is there such a Thing as Definitive Losses? And if so, when?

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Two cases recently discussed by the European Court of Justice provide a welcome opportunity to use this space for a quick review of the status of foreign loss relief under EU law. The first is the decision in *Commission v UK* (C-172/13, ECLI:EU:C:2015:50), delivered by the Grand Chamber of the Court of Justice on 3 February, and resulted in a victory of the UK government over the Commission's claim that its legislation's interpretation of the Court's case law had been overly restrictive. In the second, *X AB v Skatteverket* (C-686/13, ECLI:EU:C:2015:31), Advocate General Kokott has delivered her Opinion on 22 January, concluding that Member States are not compelled to allow currency losses in connection with a foreign shareholding to be deducted.

Both cases concern what might be referred to as 'foreign losses', and in both cases the signs are set to limit the availability of cross-border relief within the EU. Yet this conclusion is not inevitable, as the reasoning used by both the Court and its AG might not apply in all other cases and circumstances, as I will try to outline in this and my next blog post.

Is the 'Marks & Spencer exception' clinically dead?

The Court rejected the Commission's claim that the UK tax rules, which impose strict conditions for the deduction of a foreign subsidiary's 'definitive losses' – in particular, the requirement to prove *immediately after the accounting period in which the losses were sustained* that loss relief by any other means is definitely unavailable – made it *virtually impossible* to obtain cross-border group relief as required by the Court's earlier case law following its key judgement in *Marks & Spencer* (C-446/03, ECLI:EU:C:2005:763). It thus appears to uphold the UK government's (and legislator's) interpretation of that judgement. According to this interpretation, a claim for loss relief must be brought immediately after it had been realised and the assessment of whether such loss is 'definitive' would have to be established at that time. This is certainly bad news for those UK companies that decided to try and continue to operate through foreign subsidiaries despite initial losses, only to realise after several years that the would have to wind down their foreign subsidiaries. In that case, any losses other then those sustained in the last accounting period prior to the liquidation of the foreign subsidiaries would be unavailable for group relief even if there is no other way to get relief. It is questionable whether such result is in the best interest of the internal market, whose objective is to encourage cross-border economic activity. Before one can jump to the conclusion that the obligation to provide foreign loss relief is thus so severely limited as to render it effectively meaningless and declare *Marks & Spencer* to be clinically dead, it serves to inspect the Court decision more closely and pay heed not only to its result, but also to the judges' reasoning.

What the Court said

First of all, the Court decided not to accept its AG's renewed invitation to formally overrule *Marks & Spencer*, which therefore continues to form a part of the doctrine of EU law. It appears almost inconceivable that the Court will deviate from this formal affirmation by its Grand Chamber in the foreseeable future. Even more so after the doctrine had been questioned repeatedly by several of its AGs prior to this case (See the opinions in *A Oy* (C-123/11, ECLI:EU:C:2012:488) and *K* (C-322/11, ECLI:EU:C:2013:183)). This is of little value, however, if the Member States remain free to apply it in such a restrictive manner as to make its benefit virtually unattainable to taxpayers.

The Court furthermore accepted the UK government's defence that its rules did not actually make it *virtually impossible* to obtain relief, since the mere intention to liquidate a foreign subsidiary would be taken into account in a case-by-case assessment of the possibility for recovery of losses after they have been suffered. The Court bases this acceptance on two elements: First, it strongly rejects the Commission's claim that the UK legislation required the liquidation of a foreign subsidiary before the end of the accounting period in which it sustained a loss, as the relevant provision explicitly refers to 'immediately after the end' of the accounting period, not 'before the end'. That is certainly correct, but really not the point. Secondly, the Court pointed to a concrete example of a company that had benefited from the rule challenged by the Commission, to prove that its application was not actually impossible. Clearly, that is also correct, but similarly seems to be missing the point of the challenge. One example alone can hardly be considered proof of an effective implementation of the Court's own doctrine, nor in itself refute the claim that attaining its benefits is *virtually impossible*.

What the Court did *not* say

While the Court decided in favour of the UK government, it actually managed to avoid providing a clear answer to what one can only assume will form the substantive question in a future case very soon: whether it is disproportionate to deny relief for losses sustained by a foreign subsidiary two (or more) years before even the intention to liquidate it has materialised, even if the subsidiary was subsequently actually liquidated and there was actually no other way to obtain such relief. This is not a question about whether a certain loss is definitive, but when that assessment of definiteness is to be made.

The UK defended itself successfully by arguing that the intention to liquidate would have to be taken into account in the assessment, which however must be made by the end of each accounting period for the respective sustained losses. Consequently, as long as there is still hope (ex ante) to recover losses through future profits, one cannot claim relief in the residence state of the parent company, even if it becomes clear (ex post) that no such future profits ever materialised.

The Court probably did not feel compelled to address the more difficult question since it could deny the Commission's claim without doing so. The Court makes it very clear in its answer to the second question that the onus of proof was on the Commission in this case, so that the Court would not engage in a full-scale review of the law applied in the UK beyond the claims made by the Commission. This should be no surprise. Although it may result in an unsatisfactory outcome in a case like this, it is the nature of the procedure that determines the standard of review applied by the Court. It is crucial, however, to be aware of this and not to conclude from a judgement in favour of a Member State made in the context of an infringement procedure that that Member State's law is

actually in full compliance with EU law, as it is well possible that the Commission's action failed because of its failure to proof a violation of EU law whether or not it existed.

The future of foreign loss relief in the EU

The main novelty of the case appears to be the Courts rephrasing of the original *Marks & Spencer* exception. In paragraph 36 of its judgement, the Court explains that losses of a foreign subsidiary could only be characterised as **definitive if 'that subsidiary no longer has any income in its Member State of residence'**, as even minimal income could result in a loss offset in that Member State. Although this interpretation is consistent with previous judgements, it has never been spelt out so clearly, despite the fact that the Court cites its judgement in case *A Oy* (C-123/11, ECLI:EU:C:2013:84) in its support. In that case, the Court had left it open for the referring court to decide whether the company had indeed exhausted all possibilities of taking losses into account in the subsidiary's residence state, without more concrete guidance as to how that 'exhaustion of possibilities' should or could be proven. It appears now from this judgement that the only possible proof would indeed be an already completed liquidation of such subsidiary, as a company in liquidation may clearly still earn income. If that were the case, and Member States were also free to limit foreign loss relief to the last accounting period prior to a company entering liquidation by a restrictive time limitation to bring the claim based on EU law, the Court would indeed allow limiting relief to losses that are incurred in the liquidation procedure itself, but no losses that triggered such liquidation despite the (ex post) impossibility of income after that point in time. It remains to be seen, however, whether this is indeed the way in which the Court is going to apply the rule from now on.

Two other consequences are also conceivable: First, the Court could draw the line where the UK government supposedly did, taking into account the intention to put a subsidiary in liquidation and assume its earlier losses to be *definitive*. In my opinion, this result would be the least desirable, as it would create an incentive to liquidate subsidiaries in the presence of uncertainty regarding the company's future prospects; (EU) tax law would thus distort business decisions. This is arguably exactly the opposite of the Court's intention in *Marks & Spencer*, where it seemingly created a rule that would ensure, in principle, that definitive losses would be taken into account somewhere, whatever the prospects of the company at any given point in time. This neutrality of tax consequences in relation to a genuine business decision – whether to continue pursuing a business in another Member State or not – would be lost by such interpretation of the Freedom of Establishment.

Second, it is also possible (if somewhat less likely) to reduce the decision to its procedurally based reasoning: the mere fact that the Commission was unable to prove the *virtual impossibility* of obtaining loss relief under UK law does not necessarily mean that the provisions were compatible with EU law; it might simply mean that the Commission bet on the wrong horse and should instead have argued that obtaining loss relief was *too difficult* to be considered proportionate. Notably, AG Kokott had effectively recharacterised the Commission's claim in such a way in her Opinion on the case, but the Court refused to do the same.

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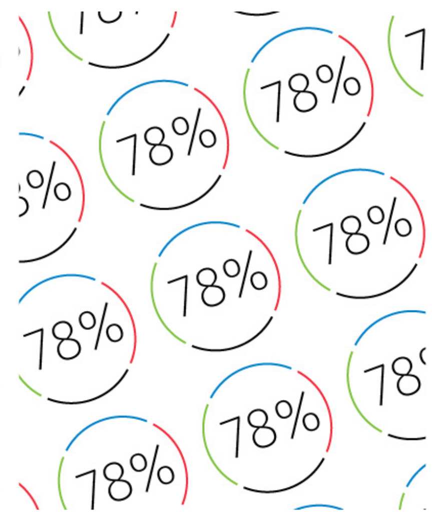

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