ec TAX REVIEW 2018–5

Editorial XL

Cross-Border Loss Compensation and EU Fundamental Freedoms: The 'Final Losses' Doctrine Is Still Alive!

Axel Cordewener*

In a recent judgment the Grand Chamber of Court of Justice of the European Union (CJEU) has given new impetus to its case law on the impact of the fundamental freedoms of the Treaty on the Functioning of the European Union (TFEU) on domestic tax systems as regards the cross-border relief of 'final losses' suffered abroad. The present contribution looks into the different phases of development of the relevant CJEU decisions and submits a first evaluation of the new judgment and its potential consequences.

1 The birth of the 'final losses' doctrine

In December 2005 the CJEU rendered its famous *Marks & Spencer* judgment on the question of whether, and in how far, the fundamental freedoms guaranteed by EU primary law required the UK to open up its domestic group relief system to cross-border situations and losses suffered by foreign subsidiaries in other Member States. Carefully weighing the taxpayer's internal market right of free establishment (today Article 49 TFEU) against national interests related to the protection of 'a balanced allocation of the power to impose taxes between the different Member States', the prevention of a dual use the same loss and of tax avoidance, the Court's Grand Chamber ruled that such foreign losses could basically be excluded from the domestic tax base, but that nevertheless under certain circumstances the primary principle of proportionality required to take them into account.[1] The latter exception applied where the parent company could demonstrate that its foreign subsidiary had 'exhausted the possibilities available in its State of residence' to offset the loss against profits not only for the current, but also for previous and future accounting periods, and that the loss could not be transferred to a third party for relief purposes, either.[2] This was the birth of the 'final losses' doctrine (or 'no possibilities' test).[3]

It is likewise well-known that the CJEU has afterwards extended this doctrine to losses incurred by foreign permanent establishments (PEs) located in the EU. In this respect the Court's *Lidl Belgium* judgment made clear that Member States are, in principle, entitled to apply the exemption method under a double tax treaty in a symmetrical way to both profits of losses of the PE and exclude them from the head office's domestic tax base.[4] However, by analogy the *Marks & Spencer* exception would apply where a loss could no longer be set off against profits in the Member State where the PE is established,[5] so that the head office of the taxpayer concerned could 'import' that loss into its Member State of residence in order to deduct it from domestic profits there.

2 Only limited 'clarifications' of the doctrine in subsequent case law

Once the 'final losses' doctrine had been accepted by the CJEU both for foreign subsidiaries and (tax-treaty exempt) PEs, taxpayers started to rely on it before national tax authorities and domestic courts. Naturally, given the fact that the EU fundamental freedoms function as non-discrimination rules applying to unequal treatment of cross-border and purely domestic situations, in cases involving foreign subsidiaries *a priori* this only makes sense where some sort of a domestic group taxation system exists that allows intra-group loss transfers (as *tertium comparationis*). Regarding foreign PEs, on the other hand, the issue should not arise where the head office's home Member State either applies the credit method to PE income or exempts only positive PE results (profits) from the domestic tax base, or where, exceptionally, no double tax treaty exists between the two Member States concerned (and the home Member State does not apply strict territoriality under its domestic law; see *infra* 4). As a consequence, some Member States were not affected and could

* Katholieke Universiteit Leuven; Of Counsel, Flick Gocke Schaumburg, Bonn. Email: axel.cordewener@kuleuven.be.

1 CJEU, 13 Dec. 2005, C-446/03, *Marks & Spencer plc* ECLI:EU:C:2005:763, paras 41 et seq.

2 CJEU, 13 Dec. 2005, C-446/03, *Marks & Spencer plc* ECLI:EU:C:2005:763, paras 55–56.

3 The CJEU usually refers to 'definitive losses' in this context, but the term 'final losses' appears to be more common in legal doctrine and will therefore be employed here.

4 CJEU, 15 May 2008, C-414/06, *Lidl Belgium GmbH & Co. KG* ECLI:EU:C:2008:278, paras 41 et seq.

5 CJEU, 15 May 2008, C-414/06, *Lidl Belgium GmbH & Co. KG* ECLI:EU:C:2008:278, paras 47–48.

slumber on peacefully, while there were rather intense discussions in many others.[6]

In the latter Member States, domestic courts were soon faced with numerous proceedings brought by taxpayers who relied on the 'final losses' doctrine in various circumstances, which prompted further references to the CJEU. For the taxpayers concerned, however, this turned out to be a rather cumbersome exercise: in some cases the Court decided that the doctrine could not be applied since the losses had either become (legally) 'final' in the Member State where they had arisen only due to that country's domestic legislation[7] or the taxpayer had not (or at least not yet to a sufficient degree) proven that the losses were already (factually) 'final',[8] and in some other cases the Court did not address the issue at all.[9] The legal uncertainty caused by this zigzag course of the CJEU was considerable, and at a certain point these developments even led Advocate General Kokott to believe that the CJEU had given up the *Marks & Spencer* doctrine altogether.[10]

3 The doctrine's 'funeral' in *Commission v. UK* and *Timac Agro*?

In 2015, however, the doctrine – at least so it seemed – received two severe blows. First, in the Grand Chamber of the CJEU dealt with the infringement case *Commission v. UK* concerning the amendments of the UK domestic legislation after the *Marks & Spencer* judgment. The UK had introduced an opening of the 'group relief' system towards 'final' losses of subsidiaries resident not only in other EU Member States but also the three additional States of the European Economic Area (Iceland, Liechtenstein and Norway), but with a very high hurdle for UK parent companies: they have to demonstrate the impossibility for the foreign subsidiary to obtain loss relief in its State of residence with respect to *future* accounting periods 'immediately after the end' of the subsidiary's accounting period (despite the fact that the general deadline under UK law for submitting the actual claim to have the foreign loss taken into account under the 'group relief' system only expires two years after the end of the accounting period in which the loss is incurred). Quite obviously it is very difficult to meet this strict condition in practice, since the taxpayer may simply not be able to look far enough into the future at this early point in time. As the Commission pointed out, the requirement is only likely to be met if either the subsidiary's State of residence does not provide for a loss carry-forward or the subsidiary was already put into liquidation in the relevant accounting period.[11]

Advocate General Kokott seized the occasion to reinforce the criticism uttered by herself[12] and some of her colleagues against the 'final losses' doctrine on previous occasions,[13] and explicitly called on the CJEU to reconsider the doctrine and abandon it.[14] The Court, however, paid lipservice to its *Marks & Spencer* judgment. Focusing on the proportionality of the amended UK legislation in the light of the 'no possibilities' test, the Court first disqualified the lack of a loss carry-forward mechanism in the subsidiary State as 'irrelevant' for the finality of the losses suffered there (mere 'legal finality'; see *supra* 2).[15] The CJEU then went on to explain that (factual) 'finality' requires that the foreign subsidiary 'no longer has any income in its Member State of residence', since so long as it 'continues to be in receipt of even minimal income, there is a possibility that the losses sustained may yet be offset by future profits made in the Member State in which it is resident'. In this respect the Court believed that it was indeed possible for a UK parent company to prove, within the strict time limit imposed by UK law, that its foreign subsidiary would not receive any further 'minimal income', not only where that subsidiary was put in liquidation during the accounting period in which the losses were sustained, but also if it 'ceased trading and sold or disposed of all its income producing assets' immediately after the end of that accounting period.[16] The amended UK legislation was therefore considered to be in line with EU law requirements.

While the aforementioned judgment, in its practical result, allowed Member States with a group relief or consolidation system to install domestic rules reducing the entry point of 'final losses' incurred by foreign

[6] *See* e.g. on the situation in Germany and on the continuation of the *Marks & Spencer* saga before the UK domestic courts Cordewener, EC Tax Rev. 58 (59 et seq.) (2011) and *ibid.*, Maastricht J. Eur. & Comparative L. 417 (420 et seq.) (2015).

[7] CJEU, 7 Nov. 2013, C-322/11, *K* ECLI:EU:C:2013:716, paras 73 et seq.

[8] *See* already CJEU, 15 May 2008, C-414/06, *Lidl Belgium GmbH & Co. KG* ECLI:EU:C:2008:278, paras 49–51, and subsequently CJEU, 21 Feb. 2013, C-123/11, *A Oy* ECLI:EU:C:2013:84, paras 52–54.

[9] *See* CJEU, 23 Oct. 2008, C-157/07 *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt GmbH* ECLI:EU:C:2008:588 (third prejudicial question not answered); 25 Feb. 2010, C-337/08 *X Holding BV* ECLI:EU:C:2010:89; 17 July 2014, C-48/13, *Nordea Bank Danmark A/S* ECLI:EU:C:2014:2087 (last semi-clause of prejudicial question not discussed). Previously also CJEU, 18 July 2007, C-231/05, *Oy AA* ECLI:EU:C:2007:439, after discussion by Advocate General Kokott, 12 Sept. 2006, ECLI:EU:2006:551, paras 70 et seq., and CJEU, 6 Nov. 2007, Case C-415/06, *Stahlwerk Ergste Westig GmbH* ECLI:EU:C:2007:651.

[10] *See* Advocate General Kokott, 19 July 2012, C-123/11, *A Oy* ECLI:EU:C:2012:488, paras 52 et seq.

[11] For details, *see* Cordewener, Maastricht J. Eur. & Comp. L. 417, 425 et seq. (2015).

[12] Advocate General Kokott, 19 July 2012, C-123/11, *A Oy* ECLI:EU:C:2012:488, paras 47 et seq.

[13] Advocate General Geelhoed, 23 Feb. 2006, C-374/04, *ACT Group Litigation* ECLI:EU:C:2006:139, para. 65; Advocate General Mengozzi, 21 Mar. 2013, C-322/11 *K* ECLI:EU:C:2013:183, paras 80 et seq.

[14] Advocate General Kokott, 23 Oct. 2014, C-172/13, *Commission v. UK* ECLI:EU:C:2014:2321, paras 42 et seq.

[15] CJEU, 3 Feb. 2015, C-172/13, *Commission v. UK* ECLI:EU:C:2015:2321, paras 25 et seq., 33.

[16] CJEU, 3 Feb. 2015, C-172/13, *Commission v. UK* ECLI:EU:C:2015:2321, paras 34–37.

subsidiaries to nothing but a tiny spot, the subsequent *Timac Agro* judgment appeared to go even further. The decision responds to a request for a preliminary ruling by which the Tax Court of Cologne had expressly asked the CJEU to clarify the *Marks & Spencer* doctrine. The case concerned a German corporation that had suffered losses in 1997 and 1998 through an Austrian PE and used them, on the basis of a unilateral German relief rule (as an exception to the general exemption of the PE results under the bilateral double tax treaty) to reduce its domestic tax base. When in 2005 the PE was sold to an Austrian subsidiary of the German corporation, another domestic provision in Germany was triggered that led to a full recapture of the previously deducted losses and an upwards adjustment of the head office's German tax base. However, in the years 1999 through 2005 the PE had accumulated further losses which (due to the abolition of the above unilateral relief rule) been treated by Germany as tax-treaty exempt, and which were now claimed by the German corporation to fall under the *Marks & Spencer* and *Lidl Belgium* exception (*supra* 1).

The CJEU first tackled the recapture issue and, basing itself on a hint in a similar direction in *Nordea Bank*,[17] analysed whether cross-border freedom of establishment was really being restricted through a discriminatory difference in treatment of two situations that are objectively comparable. In this respect the Court made the very general but nonetheless fundamental statement that, 'in principle, permanent establishments situated in a Member State other than the Member State concerned are not in a situation comparable to that of resident permanent establishments in relation to measures laid down by that Member State in order to prevent or mitigate the double taxation of a resident company's profits'.[18] In the Court's view, however, Germany had, 'by permitting the deduction of losses' of foreign PEs under its unilateral relief rule, 'equated' the tax position of the foreign PE with that of a domestic PE 'so far as concerns the deduction of losses'.[19] Since in so far the recapture mechanism indeed caused unequal treatment, it had to be justified by overriding reasons in the public interest, and in this respect the CJEU accepted the need to safeguard both 'the symmetry between the right to tax income and the right to deduct losses' and 'the coherence of the national tax system', together with 'the prevention of tax avoidance'.[20] In the framework of the proportionality test the Court then briefly addressed the *Marks & Spencer* doctrine by referring to its explanations in *Commission v. UK* as regards, on the one hand, the irrelevance of a lacking carry-forward mechanism in the Member State of the PE and, on the other hand, the relevance of 'even minimal income' that the foreign PE may still be receiving. Ultimately, it was left to the national court to determine whether the losses incurred in 1997 and 1998 could really be considered 'final'.[21]

In a second step the CJEU then turned to scrutinize the treatment of the PE losses incurred from 1999 onwards under the exemption method of the bilateral double tax treaty with Austria. And this part of the judgment is particularly short: the Court merely referred to its aforementioned statement concerning 'comparability of the situations' and concluded that, since Germany did not exercise 'any taxing powers' over the results (profits and losses) of Austrian PEs of German taxpayers, 'the situation of a permanent establishment situated in Austria is not comparable to that of a permanent establishment situated in Germany in relation to measures laid down by the Federal Republic of Germany in order to prevent or mitigate the double taxation of a resident company's profits'.[22]

This is where the judgment stops, but it is also the point where subsequently an intense debate started[23] about the question of whether *Lidl Belgium* had been overruled, so that the *Marks & Spencer* doctrine on 'final losses' could no longer be applied to tax-treaty exempt foreign PEs. In fact, it only took a few months until the first German tax court ruled in exactly that way.[24] And even worse: another few months later the German Federal Tax Court quashed an earlier judgment of the Tax Court of Nuremberg and, explicitly referring to the fact that the CJEU had already denied the objective comparability of tax-treaty exempt foreign PEs with domestic PEs, decided that the level of justification of a potential infringement of freedom of establishment – including the proportionality test as the correct systematic position of the 'final losses' test – had ceased to apply.[25] The Federal Tax Court even regarded this legal situation as so obvious that it refused to refer any further question to the CJEU,[26] and since its judgment was published in the Federal Tax Gazette, it is to be applied by all German tax authorities. And just for the sake of completeness, it may be added that only a few weeks later also the Tax

[17] *See* CJEU, 17 July 2014, C-48/13, *Nordea Bank Danmark A/S* ECLI:EU:C:2014:2087, paras 22 et seq.

[18] CJEU, 17 Dec. 2015, C-388/14, *Timac Agro Deutschland GmbH* ECLI:EU:C:2015:829, paras 26–27.

[19] CJEU, 17 Dec. 2015, C-388/14, *Timac Agro Deutschland GmbH* ECLI:EU:C:2015:829, para. 28.

[20] CJEU, 17 Dec. 2015, C-388/14, *Timac Agro Deutschland GmbH* ECLI:EU:C:2015:829, paras 29 et seq.

[21] CJEU, 17 Dec. 2015, C-388/14, *Timac Agro Deutschland GmbH* ECLI:EU:C:2015:829, paras 52 et seq.

[22] CJEU, 17 Dec. 2015, C-388/14, *Timac Agro Deutschland GmbH* ECLI:EU:C:2015:829, paras 63–65.

[23] On *Timac Agro* alone dozens of annotations and articles have been published in Germany.

[24] *See* Finanzgericht München, 31 Mai 2016, 7 V 3044/15, *Entscheidungen der Finanzgerichte (EFG)* 2016, 1232 = ECLI:DE:FGMUENC:2016:0531.7V3044.15.0A (not appealed).

[25] *See* Bundesfinanzhof, 22 Feb. 2017, I R 2/15, *Bundessteuerblatt (BStBl.)* II 2017, 709 (714–715) = ECLI:DE:BFH:2017:U.220217.IR2.15.0, and previously Finanzgericht Nürnberg, 27 Nov. 2014, 6 K 866/12, *EFG* 2015, 537 = ECLI:DE:FGNUERN:2014:1127.6K866.12.0A.

[26] Bundesfinanzhof, 22 Feb. 2017, I R 2/15, *BStBl.* II 2017, 709 (715) = ECLI:DE:BFH:2017:U.220217.IR2.15.0.

Court of Munster decided two cases in exactly the same vein.[27]

4 The 'resurrection' of the doctrine in *Bevola*

Largely unnoticed, however, a Danish case was already pending in Luxembourg when the German Federal Tax Court believed *Lidl Belgium* to be overruled, and that case has now been decided by the Grand Chamber of the CJEU on 12 June 2018.

4.1 The Issue

In *Bevola* the Court had to deal with the Danish corporate income tax system which, as a basic rule, applies a territorial regime to foreign PEs (and foreign real estate), in the sense that income from such foreign sources is not included in the tax base of resident taxpayers. An exception is provided for domestic groups of companies that are subject to the (mandatory) system of 'national joint taxation': the ultimate parent of the group can opt towards the special regime of 'international joint taxation', which leads to the inclusion of the results of all foreign subsidiaries and PEs (and of foreign real estate) for a fixed period of ten years. In 2009 the plaintiff, which formed part of a Danish group that had not exercised this option, had closed its Finnish PE and subsequently claimed that the losses incurred by that PE could no longer be taken into account in Finland and, therefore, should be deductible from its taxable income in Denmark. Since the Danish tax authorities refused this request, the company brought an action before the Danish courts, and the High Court of Eastern Denmark finally asked the CJEU for a preliminary ruling on the compatibility of the Danish tax system with Article 49 TFEU, in particular with a view to the potential applicability of the *Marks & Spencer* doctrine.

4.2 Input by the Advocate General

A first surprising development in the proceedings before the CJEU was the Opinion of Advocate General Campos Sánchez-Bordona who, before entering into a detailed analysis of the Court's case law, took a step backwards and pointed out that the doctrine paid heed to 'a sound principle of tax justice, which creates a link between the levying of tax and taxpaying capacity'. In this respect the Advocate General pointed out that, '(i)f tax is levied on the profits of a legal person in a particular tax year, it is logical that, when those profits are calculated, losses incurred by that person should not be excluded, for there will have been a commensurate reduction in taxpayer's economic capacity (more specifically, taxpaying capacity)'. And the Advocate General was convinced that this basic logic also applies 'in a cross-border context', since in his view the exhaustion of all possibilities to have losses of a foreign subsidiary taken into account in that subsidiary's State of residence has an impact on 'the parent company's economic capacity (…): it will definitively have been reduced'. According to the Advocate General, this was exactly the reason 'why the principle underlying the judgment in *Marks & Spencer* (it must be possible for account to be taken of definitive losses *somewhere*) ensures that there is a balance between the tax burden and the actual economic capacity of the taxpayer who has incurred those losses', and that is why he considered the *Marks & Spencer* doctrine as 'a valid starting point' in the present case.[28]

One may not necessarily agree with all aspects of the Advocate General's subsequent analysis, in particular the part where he draws an analogy between the treatment of foreign subsidiary and PE losses on the basis of *Marks & Spencer* and *Lidl Belgium*, on the one hand, and the treatment of subsidiaries and PEs under the Parent-Subsidiary Directive and the Anti-Tax Avoidance Directive.[29] However, one might subscribe to the idea that the argument based on a taxpayer's economic capacity ('taxpaying capacity') applies *a priori* to situations where no foreign subsidiary as a separate entity is involved, but a foreign PE (which, both in company law terms and in the sense of the terminology for secondary establishments used in Article 49 TFEU, will typically be a branch). And it may actually have been exactly this argument which induced the Grand Chamber of the CJEU to turn its *Bevola* judgment into a clear and systematic demonstration of the fact that the 'final losses' doctrine is still alive and kicking.

4.3 The CJEU's Grand Chamber judgment

4.3.1 Difference in Treatment

In a first step, the CJEU analyses whether the general Danish rule that excludes foreign PE income from the domestic tax base leads to a difference in treatment. Although the Court accepts that Denmark's decision 'not to exercise its powers of taxation over the permanent establishments abroad of Danish companies' was not necessarily disadvantageous and could even lead to tax advantages for the companies concerned, it pointed out that 'the case was different, however, in a situation such as Bevola's, in which, since the non-resident permanent establishment has ceased its activity, the losses incurred

[27] *See* Finanzgericht Münster, 28 Mar. 2017, 12 K 3541/14 G, F, *Deutsches Steuerrecht kurzgefasst (DStRK)* 2017, 347 = ECLI:DE:FGMS:2017:0328.12K3541.14G.F.00, and 28 Mar. 2017, 12 K 3545/14 *EFG* 2017, 1740 = ECLI:DE:FGMS:2017:0328.12K3545.14G.F.00.

[28] Advocate General Campos Sánchez-Bordona, 17 Jan. 2018, C-650/16, *A/S Bevola, Jens W. Trock ApS* ECLI:EU:C:2018:15, paras 37–39.

[29] *See* Advocate General Campos Sánchez-Bordona, 17 Jan. 2018, C-650/16, *A/S Bevola, Jens W. Trock ApS* ECLI:EU:C:2018:15, paras 53–54, referring to recital 9 of Council Directive 2011/96/EU of 30 Nov. 2011, *OJ* 2011 L 345/8, and to recital 4 and Art. 7 of Council Directive (EU) 2016/1164 of 12 July 2016, *OJ* 2016 L 193/1.

could not be deducted, and can no longer be deducted, in the Member State in which it is situated'. In such circumstance, the Danish company concerned 'suffers an unfavourable difference in treatment compared to a company possessing a permanent establishment in Denmark'.[30] According to the Court, this evaluation is not in any way influenced by the fact that Danish law, within the framework of the 'international joint taxation' regime, offered the possibility to include (positive and negative) income of, inter alia, foreign PEs. The Court emphasizes in this respect that the obligation to include the entire global income of the group for a (minimum) period of ten years were 'two strict conditions',[31] although one might have expected a reference to the *Gielen* judgment[32] to make this argument more convincing.

4.3.2 *Comparability of the Situations*

In a second step, the CJEU then turns to the question of whether Danish companies with foreign PEs and those with domestic PEs (branches) were in a comparable position. This is exactly the point on which views differed during the proceedings as regards the relevance of *Timac Agro* (*supra* 3), and again the Court takes a very systematic approach by stating that, 'the comparability of a cross-border situation with an internal situation must be examined having regard to the aim pursued by the national provisions at issue'. Against this background the Court explains that neither *Timac Agro* nor the previous judgment in *Nordea Bank* contradict this approach, since there had been no need to analyse the purpose of the national rules: in both cases the Member State concerned had 'applied the same tax treatment to permanent establishments abroad and those in national territory', so that this Member State 'recognises that, with regard to the detailed rules and conditions of that taxation, there is no objective difference between their situation which could justify a difference in treatment'. The Court vehemently rejects any categorical interpretation of both aforementioned judgments as 'meaning that, where national legislation treats two situations differently, they cannot be regarded as comparable'.[33]

What is striking in this respect is that the CJEU refers to *Nordea Bank* and *Timac Agro* several times, but never to a specific paragraph of these judgments. As regards *Timac Agro* this is particularly interesting since in that decision two different elements of the German legislation had been at stake, namely the unilateral recapture rule and the exemption method under the double tax treaty, and the explanations given by the Court in the latter context could actually be interpreted as establishing, as a general principle, that tax-treaty exempt foreign PE and domestic PEs are in incomparable situations (see *supra* 3). However, the *Bevola* judgment shows that there is no rule without exception.

This made clear by the Court when it turns to analyse the Danish domestic legislation which, by applying a territorial system to PEs, 'is intended to prevent double taxation of profits and, symmetrically, double deduction of losses of Danish companies possessing such permanent establishments'. However, it was only 'as regards measures laid down by a Member State in order to prevent or mitigate the double taxation of a resident company's profits' (i.e. of positive income) that, according to the Court's own interpretation of *Nordea Bank* and *Timac Agro*, foreign and domestic PEs are not in a comparable situation. As the CJEU now emphasizes in *Bevola*:

> as regards losses attributable to a non-resident permanent establishment which has ceased activity and whose losses could not, and no longer can, be deducted from its taxable profits in the Member State in which it carried on its activity, the situation of a resident company possessing such an establishment is not different from that of a resident company possessing a resident permanent establishment, from the point of view of the objective of double deduction of losses.

In fact, this is where the Court explicitly relies on the logic developed by Advocate General Campos Sánchez-Bordona (see *supra* 4.2) and explains that the prevention of 'double taxation of profits and double deduction of losses' of foreign PEs, as intended by the Danish rule, aims 'more generally to ensure that the taxation of a company possessing such an establishment is in line with its ability to pay'. Still, where that company has 'definitely incurred losses' in its foreign PE, 'its ability to pay tax is affected in the same way as that of a company whose resident permanent establishment has incurred losses', and in so far both situations are thus 'objectively comparable'.[34]

4.3.3 *Justification of the Restriction*

With these clarifications as to what, according to the CJEU, should be the correct interpretation of *Nordea Bank* and *Timac Agro*, it is likewise obvious that the Danish territorial rule now was considered a restriction on freedom of establishment and had to be justified. Yet, in this respect the Court shows considerable lenience and, first of all, accepted the Danish defence argument that the exclusion of losses incurred by foreign PEs was necessary in order to preserve 'the allocation of the powers to

[30] CJEU, 12 June 2018, C-650/16, *A/S Bevola, Jens W. Trock ApS* ECLI:EU:C:2018:424, paras 21–24.

[31] CJEU, 12 June 2018, C-650/16, *A/S Bevola, Jens W. Trock ApS* ECLI:EU:C:2018:424, paras 25–27. It is interesting to note, though, that the various language versions of the judgment differ on the qualification of the two conditions for applying the 'international joint taxation' regime: the German version, in particular, indicates that these conditions pose 'a heavy burden' ('eine schwere Bürde') for the Danish companies concerned.

[32] *See* CJEU, 18 Mar. 2010, C-440/08, *Gielen* ECLI:EU:C:2010:148, paras 49 et seq.

[33] CJEU, 12 June 2018, C-650/16, *A/S Bevola, Jens W. Trock ApS* ECLI:EU:C:2018:424, paras 32–35.

[34] CJEU, 12 June 2018, C-650/16, *A/S Bevola, Jens W. Trock ApS* ECLI:EU:C:2018:424, paras 36–40.

impose taxes between Member States', and to ensure 'the coherence of the tax system'. In particular as regards the latter argument the Court identifies a 'direct link' between a tax advantage and a corresponding tax burden: the advantage 'consists in the possibility, for a resident company possessing an establishment that is also resident, of setting the losses of that establishment off against its taxable result', and 'the direct corollary of that tax advantage is the inclusion in the resident company's taxable results of any profits made by the resident permanent establishment'. In the Court's opinion, that direct link is indeed 'necessary in the light of the objective of the national provisions … to ensure that the taxation of a company possessing a non-resident permanent establishment is in line with its ability to pay tax', since if that company could offset such losses 'without being taxed on the profits' made by the foreign PE, its 'ability to pay tax would be systematically underestimated'.[35] The CJEU goes even further and concedes an additional justification to the Danish government which the latter had not even explicitly relied upon (but which flows from the aim of the domestic rule as interpreted by the Court), and that is 'the prevention of the risk of the double use of losses'.[36]

4.3.4 *Proportionality*

Hence, like in most cases on fundamental freedoms nowadays, the outcome of the case ultimately depended on the question of whether the national measure respects the proportionality principle, i.e. whether it does not go beyond what is necessary to reach its aims. In this context the CJEU, first of all comes back to the already existing Danish system of 'international joint taxation' and rules out the basically conceivable alternative of using that system as a general entry door for foreign PE losses. The Court believes that, 'if a resident company were free to define the extent to which that joint taxation was applied', this would almost unavoidably result in situations of cherry-picking which would undermine all relevant national interests mentioned above (*supra* 4.3.3).[37]

Finally, however, the CJEU comes back to its *Marks & Spencer* doctrine, which was in the centre of the national court's prejudicial question. In this respect the Court first ascertains that, in a situation where 'there is no longer any possibility of deducting the losses of the non-resident permanent establishment in the Member State in which it is situated, the risk of double deduction of losses no longer exists'. What comes then is the Court's statement that, under such circumstance, the general Danish territoriality rule 'goes beyond what is necessary' for pursuing the above-mentioned objectives, and that 'alignment of the company's tax burden with its ability to pay tax is ensured better' if a resident company with a foreign PE 'is authorised, in that specific case, to deduct from its taxable results the definitive losses attributable to that establishment'.[38] In fact, the Court could hardly have expressed its commitment to *Marks & Spencer* any clearer.

The rest that follows concerns the technical details of how the 'final losses' exception is to be applied in practice. In this respect the CJEU explains that it is up to the resident company to demonstrate that the foreign losses it wishes to set off against its domestic results are 'definitive' in the sense of *Marks & Spencer* (*supra* 1) and *Commission v. UK* (*supra* 3). According to the Court, it:

> follows from that case-law, which max be applied by analogy to the losses of non-resident permanent establishments, that the losses attributable to a non-resident permanent establishment becomes definitive when, first the company possessing the establishment has exhausted all possibilities of deducting those losses available under the law of the Member State in which the establishment is situated and, second, it has ceased to receive any income from that establishment, so that there is no longer any possibility of the losses being taken into account in that Member State.

In the case of A/S Bevola and its Finnish PE, the CJEU left it to the domestic court whether these conditions were satisfied.[39]

5 The future of cross-border loss relief in the EU

Looking at the outcome of *Bevola* in light of the previous episodes of the 'final losses' saga, the interested observer is involuntary reminded of an event that left millions of soap opera fans in the mid-1980s seriously flabbergasted: at the end of the eighth season of 'Dallas', one of the main protagonists, Bobby Ewing, is run over by a car and dies, so that the complete ninth season takes place without him – until he reappears at the beginning of the tenth season, where he is happily taking a shower when being discovered by his beloved Pamela. The conversation between the two is almost as ingenious as this plot and, in a nutshell, boils down to: 'Honey, what's the matter? You look like you just saw a ghost.' (Bobby); 'I had a terrible nightmare!' (Pam – slightly hysterical); 'It's over. None of that happened!' (Bobby).

A more serious evaluation, however, leads to a certain degree of frustration, especially from a German perspective: it seems that the German Federal Tax Court which, against very strong resistance on the part of the German tax authorities, made quite some efforts to introduce the CJEU's judge-made *Marks & Spencer* and *Lidl Belgium*

[35] CJEU, 12 June 2018, C-650/16, *A/S Bevola, Jens W. Trock ApS* ECLI:EU:C:2018:424, paras 41–51.

[36] CJEU, 12 June 2018, C-650/16, *A/S Bevola, Jens W. Trock ApS* ECLI:EU:C:2018:424, para. 52.

[37] CJEU, 12 June 2018, C-650/16, *A/S Bevola, Jens W. Trock ApS* ECLI:EU:C:2018:424, paras 54–56.

[38] CJEU, 12 June 2018, C-650/16, *A/S Bevola, Jens W. Trock ApS* ECLI:EU:C:2018:424, paras 57–59.

[39] CJEU, 12 June 2018, C-650/16, *A/S Bevola, Jens W. Trock ApS* ECLI:EU:C:2018:424, paras 60–65.

principles into the national tax system,[40] was led astray by the Court's *Timac Agro* judgment and gave up on 'final losses' too early. The bright side of it is that several appeals are still pending before the Federal Tax Court,[41] which will give the national judges sufficient opportunity to reinstall the doctrine and then to look into technicalities (e.g. are the condition for 'final losses' fulfilled, and how are such losses to be calculated and introduced into the domestic tax base?). In this respect it should not make a decisive difference that, in *Bevola*, Denmark's tax jurisdiction was already reduced under domestic law (no tax liability of resident taxpayers on foreign PE income) while, as *Lidl Belgium* and *Timac Agro* have shown, Germany basically assumes broad tax jurisdiction under its domestic law (unlimited tax liability of resident taxpayers in their global income) but carves out foreign PEs under bilateral double tax treaties using the exemption method. Member States like Denmark and Germany will, therefore, have to adjust their domestic legislation, and it will be interesting to see whether the strict procedural requirements for proving `finality´ which the CJEU accepted in *Commission v. UK* (*supra* 3) for foreign subsidiaries will likewise be introduced for foreign PEs.

Moreover, the *Bevola* case also sends a signal beyond the treatment of foreign PEs, in particular since the principles applied by the CJEU to the latter were explicitly derived from the area of foreign subsidiaries and transferred 'by analogy'. In this respect it may be interesting to note that two Swedish cases are currently pending before the Court concerning the treatment of losses suffered by foreign subsidiaries and the influence of certain restructuring measures within the group on the qualification of these losses as 'final' in the sense of *Marks & Spencer*.[42] Furthermore, the 'final losses' doctrine may also have an influence on certain inbound cases.[43]

And last but not least, there is still the big project of harmonizing the corporate tax base in the EU, which has been split up by the Commission in October 2016 into a proposal only covering the Common Corporate Tax Base (CCTB)[44] and an additional proposal including cross-border consolidation (CCCTB).[45] The former has recently received strong support by a 'German-French Common Position Paper' that was published on 19 June 2018,[46] i.e. only a week after *Bevola* was decided. Unfortunately, the Position Paper not only focuses exclusively on the CCTB proposal, but it even states in paragraph 4 that '(b)oth countries do not support introducing provisions on cross-border loss relief (Article 42 of the CCTB Directive), as they should be discussed at a second stage, as part of the negotiation on the CCCTB Directive'. In other words, even the limited rule on (cross-border) 'Loss relief and recapture' concerning both foreign subsidiaries and PEs is rejected. At least for 'final losses' that would lead to a situation that is obviously not in line with EU primary law. Should that not make Member States reconsider their reluctance against cross-border consolidation and start working on constructive solutions in that direction, together with the European Commission? From the taxpayers' perspective that would be a more than welcome spill-over effect of the *Marks & Spencer* saga.

Prof. Dr Axel Cordewener

[40] *See* Cordewener, EC Tax Rev. 58 (59 et seq.) (2011).

[41] The appeal by the tax authorities in case I R 17/16 (against Finanzgericht Hamburg, 6 Aug. 2014, 2 K 355/02, *EFG* 2014, 2084) was put on hold until *Bevola* was decided by the CJEU. Further appeals are, in particular, I R 48/17 and I R 49/17, both against the judgments of Finanzgericht Münster of 28 Mar. 2017 (*supra* n. 27).

[42] *See* cases C-607/17, *Memira Holding AB*, and C-608/17, *Holmen AB*.

[43] *See* with respect to the Danish rules on 'joint national taxation' Advocate General Campos Sánchez-Bordona, 21 Feb. 2018, C-28/17, *NN A/S* ECLI:EU:C:2018:86, paras 82–83, and CJEU, 4 July 2018, C-28/17, *NN A/S* ECLI:EU:C:2018:526, para. 35.

[44] COM(2016) 685 final of 25 Oct. 2016.

[45] COM(2016) 683 final of 25 Oct. 2016.

[46] https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Topics/Europe/Articles/2018-06-20-Meseberg.html (last visited 12 July 2018).