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Editorial

Should We Cut 'Final' Losses?

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1 Will 'Final Losses' Be Alive Much Longer?

Cross-border utilization and the Court's 'final loss' doctrine has always been a heavily debated matter of EU direct tax law. Quite recently, Axel Cordewener wrote in our Editorial that the 'The "Final Losses" Doctrine Is Still Alive!',[1] after the Grand Chamber decision in *Bevola*[2] had (seemingly) resolved the uncertainties previously created by *Timac Agro*.[3] Doubts remained, however, and the German Bundesfinanzhof clearly wants to have them resolved. In its reference in Case C-538/20, *W AG*,[4] the Bundesfinanzhof has asked a number of precisely worded and reasoned questions that will (hopefully) compel the Court to put its cards on the table: Simplified, the Bundesfinanhof wants to know if the 'final loss' doctrine applies in a case of a treaty-exempt foreign permanent establishment. Only if that question is answered to the affirmative, the Bundesfinanzhof asks for further clarification on other points regarding the existence and determination of 'final losses'. In what is expected to become a landmark decision, AG Anthony Collins lodged his Opinion on 10 March 2022.[5] Quite surprisingly, he concludes that, for lack of comparability, there is no discrimination between domestic and cross-border situations, and hence no need to take into account 'final' foreign losses. However, *in eventu*, his Opinions also provides powerful analysis not only on the elusive concept of 'finality' of losses, but also on the question under which Member State's law such losses are to be determined.

2 Is There Even a Discrimination Between Treaty-Exempt Foreign and Taxable Domestic Permanent Establishments?

At the core of the Court's line of cases on cross-border loss relief lies the question of comparability between cross-border and domestic situations. The Court set the stage in its 2005 Grand Chamber decision in *Marks & Spencer*[6] on the *vertical* comparison between domestic and cross-border situations: Does the freedom of establishment require the UK to take into account losses of foreign subsidiaries (over whose undistributed profits it does not exercise taxing jurisdiction) if it does so for domestic subsidiaries (whose profits are taxed in the UK) through a system of group relief? Considering loss-relief mainly as a 'cash advantage' (through the 'speeding up of relief of losses of the loss-making entities'[7]) that was denied in cross-border situations, the Court quickly concluded the existence of a restriction on freedom of establishment. It also rejected the argument that the situations of foreign and domestic subsidiaries are not comparable: While the Court obviously accepted that the UK's regime complies with the Union-recognized principle of territoriality,[8] it nevertheless held that 'the fact that it does not tax the profits of the non-resident subsidiaries of a parent company established on its territory does not in itself justify restricting group relief to losses incurred by resident companies'.[9] This rather superficial assumption of comparability in case of a fragmentation of the tax base over multiple jurisdictions has been labelled as the 'original sin'[10] and has been heavily criticized.[11]

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1 Axel Cordewener, *Cross-Border Loss Compensation and EU Fundamental Freedoms: 'The "Final Losses" Doctrine Is Still Alive!'*, 27 EC Tax Rev. 230–236 (2018).

2 CJEU (Grand Chamber), 12 Jun. 2018, Case C-650/16, *Bevola*, EU:C:2018:424, para. 38.

3 CJEU, 17 Dec. 2015, Case C-388/14, *Timac Agro*, sEU:C:2015:829.

4 For the reference *see* German Bundesfinanzhof, 6 Nov. 2019, I R 32/18.

5 Opinion AG Collins, 10 Mar. 2022, Case C-538/20, *W AG*, EU:C:2022:184.

6 CJEU (Grand Chamber), 13 Dec. 2005, Case C-446/03, *Marks & Spencer*, EU:C:2005:763.

7 CJEU (Grand Chamber), 13 Dec. 2005, Case C-446/03, *Marks & Spencer*, EU:C:2005:763, para. 32.

8 CJEU (Grand Chamber), 13 Dec. 2005, Case C-446/03, *Marks & Spencer* EU:C:2005:763, para. 39, referring to CJEU, 15 May 1997, Case C-250/95, *Futura Participations*, EU:C:1997:239, para. 22.

9 CJEU (Grand Chamber), 13 Dec. 2005, Case C-446/03, *Marks & Spencer*, EU:C:2005:763, para. 40.

10 *See* Yariv Brauner, Ana Paula Dourado & Edoardo Traversa, *Ten Years of Marks & Spencer*, 43 Intertax 306–314 (308).

11 Also, e.g., in the Opinion AG Kokott, 23 Oct. 2014, Case C-172/13, *Commission v. UK (Marks & Spencer II)*, EU:C:2014:2321, paras 23–29.

However, both the Court and the European Free Trade Association (EFTA)-Court have not yet wavered and explicitly or implicitly upheld that line of comparison also in subsequent cases involving group relief (*Commission v. UK*[12]), group contributions (*Oy AA,*[13] *Yara,*[14] *Holmen*[15]), tax consolidation (*X Holding*[16]), and cross-border mergers (A *Oy*,[17] *Memira*[18]).

What followed soon after *Marks & Spencer* was the Court's first decision on losses of foreign permanent establishments, *Lidl Belgium*,[19] which dealt with Germany's symmetrical base exemption of profits and losses of a Luxembourg branch, i.e., the exact same issue later raised in *Timac Agro* and now in *W AG*. Not surprisingly, in *Lidl Belgium* the Court equated a treat permanent establishment with an 'autonomous entity'[20] and decided the case along the path charted by *Marks & Spencer*. That seemed consistent: Conceptually, the denial of cross-border group relief and the exemption of a permanent establishment's losses raise the same issues, since the main difference between those cases was merely that, e.g., in *Marks & Spencer* the entire foreign legal entity was outside the UK taxing jurisdiction, whereas in *Lidl Belgium* only foreign branch income was outside the German taxing jurisdiction. If the Court says 'A' with regard to losses of foreign subsidiaries, it would be hard to fathom to not say 'B' in the case of exempt foreign establishments. Consequently, in *Lidl Belgium* the Court's assumption of comparability was not deterred by the fact that Germany's tax system was, from an international tax perspective, a consistent, entirely neutral territorial system, as it neither taxed the profits of the foreign branch nor took its losses into account. However, many have criticized that outcome and argued that such a symmetrical, territorial system does not even entail any discrimination or urged the Court to reconsider its traditional approach to comparability in such cases.[21] Indeed, in *Nordea Bank Danmark* and specifically in *Timac Agro*[22] the Court seemed to have changed course with respect to comparability of taxed domestic ('resident') and exempt foreign ('non-resident') permanent establishments. It noted that 'companies which have a permanent establishment in another Member State are not, in principle, in a comparable situation to that of companies possessing a resident permanent establishment' with respect to measures concerned with the prevention of double taxation,[23] and followed in *Timac Agro* with a seemingly absolute statement regarding the non-discriminatory nature of Germany's base exemption[24]:

> "In the present case, it must be held that, since the Federal Republic of Germany does not exercise any tax powers over the profits of such a permanent establishment, the deduction of its losses no longer being permitted in Germany, 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 […].[25]

This statement of the Court in *Timac Agro*, which concerned the same legal framework at issue in *Lidl Belgium*, was broadly understood as a departure from the comparability standard under *Lidl Belgium*, rejecting the existence of an unequal treatment and therefore not only the need for justification but also the obligation of the home State to take into account even 'final' losses on the level of proportionality.[26] Others have, however, pointed out that the Court's statement should be understood in light of the fact that *Timac Agro* did not concern

[12] CJEU, 3 Feb. 2015, Case C-172/13, *Commission v. UK (Marks & Spencer II)*, EU:C:2015:50, paras 22–23.

[13] CJEU (Grand Chamber), 18 Jul. 2007, Case C-231/05, *Oy AA*, EU:C:2007:439, paras 31–38.

[14] EFTA Court, 13 Sep. 2017, Case E-15/16, *Yara International*, [2017] EFTA Ct. Rep. 434.

[15] CJEU, 19 Jun. 2019, Case C-608/17, *Holmen*, EU:C:2019:511.

[16] CJEU, 25 Feb. 2010, Case C-337/08, *X Holding*, EU:C:2010:89, paras 17–24.

[17] CJEU, 21 Feb. 2013, Case C-123/11, *A Oy*, EU:C:2013:84.

[18] CJEU, 19 Jun. 2019, Case C-607/17, *Memira Holding*, EU:C:2019:510.

[19] CJEU, 15 May 2008, Case C-414/06, *Lidl Belgium*, EU:C:2008:278.

[20] CJEU, 15 May 2008, Case C-414/06, *Lidl Belgium*, EU:C:2008:278, paras 21–22.

[21] *See* Opinion AG Kokott, 19 Jul. 2012, Case C-123/11, *A Oy* ECLI:EU:C:2012:488, para. 50; Opinion AG Mengozzi, 21 Mar. 2013, Case C-322/11, *K*, ECLI:EU:C:2013:183, para. 88; Opinion AG Kokott, 13 Mar. 2014, Case C-48/13, *Nordea Bank Danmark*, ECLI:EU:C:2014:153, paras 21–28; Opinion AG Kokott, 23 Oct. 2014, Case C-172/13, *Commission v. UK (Marks & Spencer II)*, ECLI:EU:C:2014:2321, paras 49–53.

[22] CJEU, 17 Dec. 2015, Case C-388/14, *Timac Agro*, EU:C:2015:829.

[23] CJEU (Grand Chamber), 17 Jul. 2014, Case C-48/13, *Nordea Bank Danmark*, EU:C:2014:2087, para. 24; CJEU, 17 Dec. 2015, Case C-388/14, *Timac Agro*, EU:C:2015:829, para. 27; CJEU (Grand Chamber), 12 Jun. 2018, Case C-650/16, *Bevola*, EU:C:2018:424, para. 37.

[24] In contrast to 'symmetrical' base exemption (of profits and losses), some Member States apply the 'asymmetrical' deduction/reincorporation method with regard to treaty-exempt permanent establishments, where profits remain exempt but *current* losses are first deducted and later recaptured (e.g., once the branch returns to profits). Interestingly, Germany used this method until 1998, but reverted to base exemption from 1999 onwards. Both periods have been scrutinized by the Court: *Lidl Belgium* dealt with Germany's base exemption (CJEU, 15 May 2008, Case C-414/06, EU:C:2008:278), *Krankenheim Ruhesitz am Wannsee* with the 'deduction/reincorporation method' (CJEU, 23 Oct. 2008, Case C-157/07, EU:C:2008:588), and *Timac Agro* with both, i.e., periods before and after 1999 (CJEU, 17 Dec. 2015, Case C-388/14, EU:C:2015:829). The Court's statement quoted here from *Timac Agro* referred to the second phase, i.e., periods after 1999, in which Germany applied the 'symmetrical' base exemption.

[25] CJEU, 17 Dec. 2015, Case C-388/14, *Timac Agro*, EU:C:2015:829, para. 65.

[26] *See* the submissions by Denmark, Germany, Austria and the Commission in *Bevola* (CJEU (Grand Chamber), 12 Jun. 2018, Case C-650/16, EU:C:2018:424, paras 30–31), and such reading of *Timac Agro* by several national supreme courts in Europe (e.g., German Bundesfinanzhof, 22 Feb. 2017, IR 2/15, and Austrian Verwaltungsgerichtsof, 29 Mar. 2017, Ro 2015/15/0004). *See also* e.g., Opinion AG Kokott, 23 Oct. 2014, Case C-172/13, *Commission v. UK (Marks & Spencer II)*, EU:C:2014:2321, para. 26.

'final' losses at all.[27] It was only in *Bevola*, where foreign losses could be taxed based on the applicable tax treaty's credit method but were exempt under domestic law, that the Grand Chamber of the Court attempted to clarify that it had not abandoned its approach to comparability of domestic and foreign situations[28] and to reconcile its decisions in *Nordea Bank* and *Timac Agro* with its previous case law. In doing so, it resorted to link the question of comparability to the existence of (somewhat) 'final' losses (and thereby establishing a difference in comparability between 'current' and 'final' losses, and blurring the line between comparability and proportionality as regards the latter)[29]:

> [A]s 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 preventing double deduction of the losses.[30]

The relationship between *Timac Agro* and *Bevola* is the metaphorical elephant in the room: Some argue that after *Bevola* – and in line with *Lidl Belgium* – comparability with taxable domestic situations must be taken to exist (at least where losses are somewhat 'final') even if a tax system symmetrically 'exempts' foreign profits and losses.[31] Others, however, contend that there is a need to distinguish between base exemption under domestic law (*Bevola*) and under a tax treaty (*Timac Agro*), and that in the latter situation domestic and cross-border situations would not be comparable at all.[32]

The pending *W AG* case might bring clarity: It concerns the same German treaty-based base exemption of foreign permanent establishments at issue already in *Lidl Belgium* and *Timac Agro*. Faced with the uncertainty still remaining after the Courts' recent case law, the referring German Bundesfinanzhof inquires, inter alia, if 'final losses' of exempt foreign branches need to be taken into account in the home State, Germany.[33] In his Opinion in *W AG*, AG Anthony Collins indeed distinguishes between exemption under domestic law and under tax treaty law, and argues – heavily relying on *Timac Agro* – that in the latter situation domestic and foreign investments are not in a comparable situation.[34] In his view, it was only in *Timac Agro* (and not in *Bevola*) 'that the State of residence can be regarded as having effectively and completely waived its power to tax the income of non-resident permanent establishments', and this 'factor is decisive in order to find that the respective situations of residents and non-residents are not objectively comparable in relation to the tax regime of a Member State, including, in particular, to the deductibility of losses'.[35] He hence concludes that the freedom of establishment:

> does not preclude legislation of a Member State which prevents a resident company from deducting final losses incurred by a permanent establishment in another Member State from its taxable profits where that legislation exempts profits and losses by reference to a bilateral convention for the avoidance of double taxation between the two Member States.[36]

If that were true, however, the impact would be fundamental: Not only would the 'final loss' exception for foreign treaty-exempt branches acknowledged in *Lidl Belgium* be fully abandoned, but the whole body of *Marks & Spencer* case law be put in doubt, even though the Court has upheld the final loss exception in *Commission v. UK, Holmen*, and *Memira*, all of which were handed down after *Timac Agro*. Indeed, *Lidl Belgium* was decided by the Court in line with *Marks & Spencer*, and if comparability is denied where a State could tax the profits and losses of a *foreign branch* under domestic law (but agreed in a tax treaty to exempt), how could comparability be assumed to exist in cases of *foreign subsidiaries*, which are outside the parent's State's taxing jurisdiction altogether? Moreover, it is indeed hard to see the significant difference between a situation where a Member State would tax under domestic law but exempts under a tax treaty (*Lidl Belgium, Timac Agro, W AG*) and a situation where a Member State could tax under the tax treaty[37] but exempts under domestic law (*Bevola*).[38]

27 As indeed argued by AG Campos Sánchez-Bordona in para. 57 of his Opinion, 17 Jan. 2018, Case C-650/16, *Bevola*, EU:C:2018:424, EU:C:2018:15, and also pointed out by in the Opinion AG Wathelet, 3 Sep. 2015, Case C-388/14, *Timac Agro*, ECLI:EU:C:2015:533, para. 67.

28 CJEU (Grand Chamber), 12 Jun. 2018, Case C-650/16, *Bevola*, EU:C:2018:424, para. 33.

29 CJEU (Grand Chamber), 12 Jun. 2018, Case C-650/16, *Bevola*, EU:C:2018:424, para. 38; *see also* CJEU, 4 Jul. 2018, Case C-28/17, *NN*, EU:C:2018:526, para. 35.

30 CJEU (Grand Chamber), 12 Jun. 2018, Case C-650/16, *Bevola*, EU:C:2018:424, para. 38.

31 *See* for that general conclusion for all cases concerning the lack of symmetry between taxation of profits and use of losses also Opinion AG Kokott, 10 Jan. 2019, Case C-608/17, *Holmen*, EU:C:2019:9, para. 39, and Opinion AG Kokott, 10 Jan. 2019, Case C-607/17, *Memira*, EU:C:2019:8, para. 47.

32 *See* Roland Ismer & Harald Kandel, *A Finale* Incomparabile *to the Saga of Definitive Losses? Deduction of Foreign Losses and Fundamental Freedoms After* Bevola *and* Sofina, 47 Intertax 573, at (581–584) (2019), who indeed assume that comparability would not exist in the case of an exemption under a tax treaty.

33 The case is currently pending before the Court as Case C-538/20 and was referred by the German Bundesfinanzhof, 6 Nov. 2019, I R 32/18.

34 Opinion AG Collins, 10 Mar. 2022, Case C-538/20, *W AG*, EU:C:2022:184, paras 21–50.

35 *Ibid.*, para. 46.

36 *Ibid.*, para. 49.

37 I.e., under the credit method in the Nordic Convention.

38 It should be noted that the situation where a Member State might exempt both under domestic law and under treaty law is also raised in *W AG* with regard to the structurally territorial German trade

Moreover, the Court in *Bevola* had linked comparability to a (cross-border) ability-to-pay principle, noting that base exemption aims at ensuring taxation in line with the taxpayer's ability to pay, which requires the prevention of both double taxation and a double deduction of losses, but that a taxpayer is 'affected in the same way' whether its domestic establishment has incurred losses or a foreign permanent establishment has 'definitively incurred losses'.[39] However, AG Anthony Collins rejects the relevance of the ability-to-pay principle for treaty-exempt permanent establishments, finding it not appropriate 'to add to the exemption method under the Convention a purpose that is not already expressed in the specific objectives of avoiding double taxation and avoiding double deduction of losses'.[40]

3 Can carried forward losses ever become 'final'?

This 'final loss exception' has become an overarching theme not only for cross-border loss relief within corporate groups[41] and in cross-border mergers,[42] but also for losses of foreign permanent establishments, as in *W AG*. Over the years that concept has been explained and operationalized by the Court,[43] but the precise scope is (still) ambiguous,[44] intensely debated[45] and awaiting further clarification[46]; it is not even clear that the concept has the same meaning in all situations.[47] In that regard, *Marks & Spencer* has not 'brought about *quieta*, as it has consistently remained unclear with regard to its effects',[48] and frequent calls for its extremely restrictive application[49] or even complete abandonment[50] are made.

W AG raises one particularly contested question, i.e., if losses of a 'permanent establishment which, under the law of the State in which that establishment is situated, could have been carried forward to a subsequent tax period on at least one occasion also be considered to be "final losses"'. This debate is based on the Court's decision in *Commission v. UK*, where it might have accepted that the determination of the finality of a loss

tax, under which 'income, whether positive or negative, of non-resident permanent establishments is excluded from the basis of assessment to trade tax, irrespective of whether the applicable convention for the avoidance of double taxation has recourse to the exemption method or to the credit method or that no such convention applies' (*see* Opinion AG Collins, 10 Mar. 2022, Case C-538/20, *W AG*, EU:C:2022:184, para. 53). The German Bundesfinanzhof, however, only asked about the 'final loss' doctrine with regard to the trade tax in case that the regarding corporate tax was answered in the affirmative, i.e., requiring the taking into account of 'final losses'. AG Collins has suggested not to do so but also noted that 'an affirmative answer to the first question should also lead to an affirmative answer to the second question' (Opinion AG Collins, 10 Mar. 2022, Case C-538/20, *W AG*, EU:C:2022:184, para. 55). It is quite surprising that the German Bundesfinanzhof did not ask that question independently of the Court's answer regarding corporate taxation, as it might have shed some light on situations where a Member State primarily exempts under a tax treaty, but would likewise exempt under domestic law if a treaty either foresees the credit method of if no applicable tax treaty exists.

39 CJEU (Grand Chamber), 12 Jun. 2018, Case C-650/16, *Bevola*, EU:C:2018:424, para. 39; *see also* in more detail, Opinion AG Campos Sánchez-Bordona, 17 Jan. 2018, Case C-650/16, *Bevola*, EU:C:2018:424, EU:C:2018:15, paras 37–39. This implies that comparability is inextricably linked to the objective of the tax system to tax income in accordance with taxpayer's ability to pay. It remains unclear, however, why the Court considers the situation of domestic losses only to be comparable to that of *definitive* foreign losses, since these are defined, in the Court's own case law, as losses that could not *ever* be taken into account anywhere else but in the residence State. But the taxpayer's ability to pay is clearly already affected where a loss is not definitive: if a taxpayer's current global income is 0, there is no ability to pay and thus no tax should be payable in the relevant tax year. This holds true regardless of whether it results from foreign or domestic losses. The fact that losses might be carried forward does not change the lack of capacity to pay taxes in the year when the loss is incurred.

40 Opinion AG Collins, 10 Mar. 2022, Case C-538/20, *W AG*, EU:C:2022:184, para. 48, referring to the reasoning of the German Bundesfinanzhof, 6 Nov. 2019, I R 32/18.

41 *See* e.g., CJEU, 3 Feb. 2015, Case C-172/13, *Commission v. UK (Marks & Spencer II)*, EU:C:2015:50; EFTA Court, 13 Sep. 2017, Case E-15/16, *Yara International*, [2017] EFTA Ct. Rep. 434, paras 40–46; CJEU, 19 Jun. 2019, Case C-608/17, *Holmen*, EU:C:2019:511.

42 CJEU, 21 Feb. 2013, Case C-123/11, *A Oy*, EU:C:2013:84; CJEU, 19 Jun. 2019, Case C-607/17, *Memira*, EU:C:2019:510.

43 Most notably in CJEU, 21 Feb. 2013, Case C-123/11, *A Oy*, EU:C:2013:84, paras 49–55; CJEU, 7 Nov. 2013, Case C-322/11, *K*, EU:C:2013:716, paras 74–82; CJEU, 3 Feb. 2015, Case C-172/13, *Commission v. UK (Marks & Spencer II)*, EU:C:2015:50; CJEU, 19 Jun. 2019, Case C-608/17, *Holmen*, EU:C:2019:511.

44 *See* in this regard, Opinion AG Geelhoed, 23 Feb. 2006, Case C-374/04, *ACT Group Litigation*, EU:C:2006:139, para. 65; Opinion AG Kokott, 19 Jul. 2012, Case C-123/11, *A Oy*, EU:C:2012:488, paras 47–54; Opinion AG Kokott, 23 Oct. 2014, Case C-172/13, *Commission v. UK (Marks & Spencer II)*, EU:C:2014:2321, paras 42–53; Opinion AG Mengozzi, 21 Mar. 2013, Case C-322/11, *K*, EU:C:2013:183, paras 63–89.

45 *See* for many, Michael Lang, *Has the Case Law of the ECJ on Final Losses Reached the End of the Line?*, 54 Euro. Tax'n 530–540 (2014); Erik Pinetz & Karoline Spies, *'Final Losses' After the Decision in Commission v. UK ('Marks & Spencer II')*, 24 EC Tax Rev. 309–319 (2015); Yariv Brauner, Ana Paula Dourado & Edoardo Traversa, *Ten Years of* Marks & Spencer, 43 Intertax 306–314 (2015); Axel Cordewener, *Cross-Border Compensation of 'Final Losses' for Tax Purposes – The Drama Continues …* , 22 Maastricht J. Eur. & Comp. L. 417–431 (2015); Axel Cordewener, *Cross-Border Loss Compensation and EU Fundamental Freedoms: The 'Final Losses' Doctrine Is Still Alive!*, 27 EC Tax Rev. 230–236 (2018); Johanna Hey, *Taxation of Business in the EU: Special Problems of Crossborder Losses and Exit Taxation*, in *Research Handbook on European Union Taxation Law* 194, at 194–211 (Christiana HJI Panayi, Werner Haslehner & Edoardo Traversa eds, Edward Elgar Publishing 2020).

46 *See* e.g., the questions raised by the German Bundesfinanzhof, 6 Nov. 2019, I R 32/18, pending before the Court as Case C-538/20, *W*.

47 *See* Pinetz & Spies, *supra* n. 45, at 309, at 314–318.

48 Opinion AG Kokott, 23 Oct. 2014, Case C-172/13, *Commission v. UK (Marks & Spencer II)*, EU:C:2014:2321, para. 42.

49 *See* Opinion AG Geelhoed, 23 Feb. 2006, Case C-374/04, *ACT Group Litigation*, EU:C:2006:139, para. 65, pointing out that the 'final loss exception' 'has introduced an additional disparity in the interrelation between national tax systems, thereby further distorting the exercise of the freedom of establishment and free movement of capital within the Community'.

50 *See* for that call the Opinion AG Kokott, 23 Oct. 2014, Case C-172/13, *Commission v. UK (Marks & Spencer II)*, EU:C:2014:2321, paras 42–53, which would, however, imply that the home State would not be required to take into account even foreign 'final' losses.

should be made at the end of each year, and once a loss is not 'final' then, it can never become 'final' again.[51] This would essentially mean that only losses arising in the last year (and, perhaps, the loss incurred in the accounting period that immediately follows[52]) can be regarded as the 'final' loss, whereas losses which are regarded as non-final in one year (because they can be carried forward or setting off the losses was precluded under national law) cannot subsequently become 'final'. Excluding 'carried forward' losses from the potential to become 'final', however, would certainly come as a surprise for those domestic courts that have applied the 'final loss exception' to accumulated foreign losses.[53] Moreover, the 'final loss exception' would clearly lose much of its potential practical relevance (because, typically, only the liquidation loss could be considered 'final'). It should be noted, moreover, that the Court has not addressed the issue in subsequent cases where accumulated losses of several years were at issue,[54] which could either imply that the Court has not intended to fully settle that question yet or that it tacitly applies a different standard of 'finality' depending on the tax regime and context at issue.[55]

However, this rather narrow understanding of an exclusion of 'carried forward' losses was strongly supported by AG Juliane Kokott[56] and now also by AG Anthony Collins in *W AG*,[57] arguing that considering accumulated (carried forward) losses as 'final losses' would upset the appropriate allocation of the power to impose taxes, as 'the initially successful activity of the subsidiary (or of the permanent establishment) would be taxed solely in the State in which it is situated, while the subsequently loss-making activity would be financed by the tax revenue of the State of residence of the parent company'.[58] Should the Court not abandon the 'final loss' exception altogether in *W AG*, it will have to further clarify the elusive concept of 'finality' of losses regarding inter-temporal loss utilization.

4 Does hypothetical usability of losses prevent 'finality'?

While the Court in *Bevola* did not give much additional clarification to the concept of 'final' losses, it might implicitly have added a nuance for situations involving permanent establishments: While a subsidiary is a separate taxpayer and its losses 'disappear' once liquidated, in some national tax systems a permanent establishment's loss 'stick' to the non-resident taxpayer ('head office') even after the branch is closed, and might indeed be used at a later point in time if the non-resident taxpayer resumed a business in the source State. Taken to the extreme, such losses could therefore never become 'final' (also when the re-opening of a branch is a purely hypothetical option) – a result indeed accepted by AG Wathelet in *Timac Agro*,[59] and perhaps even suggested by a 'strict reading'[60] of the Court's judgments in *Holmen*[61] and *Memira.*[62]

The Court in *Bevola* might, however, to have provided a first hint on that issue by referring to a situation where the taxpayer has ceased to receive any income from 'that' establishment,[63] which could imply that (future) positive income from other activities of the non-resident taxpayer in the source State is irrelevant, i.e., that the Court equates a permanent establishment effectively with a separate entity also in that regard. Also, AG Anthony Collins in *W AG* did not entertain a 'strict reading' and noted that an interpretation that would go too far to consider the theoretical possibility of a subsequent opening of a new permanent establishment in the same Member State:

> However, that interpretation appears to go too far in circumstances where the parent company does not yet own another permanent establishment in the State where the

[51] *See* CJEU, 3 Feb. 2015, Case C-172/13, *Commission v. UK (Marks & Spencer II)*, EU:C:2015:50, para. 37.

[52] According to the UK's legislative implementation of *Marks & Spencer*, 'final losses' can also exist 'where, immediately after the end of the accounting period in which the losses have been sustained, that subsidiary ceased trading and sold or disposed of all its income producing assets' (*see* the UK's position as restated in CJEU, 3 Feb. 2015, Case C-172/13, *Commission v. UK (Marks & Spencer II)*, EU:C:2015:50, para. 37). This implies that loss relief is possible not only in 'respect of a single accounting period' (as the Commission had claimed) but rather for losses from *two* accounting periods, i.e., *(1)* for the losses incurred in the accounting period *before* the subsidiary ceased trading and sold or disposed of all its income producing assets, and *(2)* for the losses incurred *in* the accounting period in which the subsidiary ceased trading and sold or disposed of all its income producing assets. One might then pose the question if the losses of even more accounting periods may be eligible for relief, e.g., because disposing of assets takes more than one accounting period.

[53] *See* concerning 'final' permanent establishment losses, e.g., German Bundesfinanzhof, 9 Jun. 2010, I R 107/09 (taxable years 2000–2001), and German Bundesfinanzhof, 5 Feb. 2014, I R 48/11 (taxable years 1997–1998).

[54] *See* CJEU, 19 Jun. 2019, Case C-608/17, *Holmen*, EU:C:2019:511, and CJEU, 19 Jun. 2019, Case C-607/17, *Memira*, EU:C:2019:510.

[55] For such a differentiated approach *see* Pinetz & Spies, *supra* n. 45, at 309, at 314–318..

[56] *See* Opinion AG Kokott, 10 Jan. 2019, Case C-608/17, *Holmen*, EU:C:2019:9, paras 50–55, and Opinion AG Kokott, 10 Jan. 2019, Case C-607/17, *Memira*, EU:C:2019:8, paras 57–60.

[57] Opinion AG Collins, 10 Mar. 2022, Case C-538/20, *W AG*, EU:C:2022:184, paras 70–71.

[58] *Ibid.*, paras 70, referring to Opinion AG Kokott, 10 Jan. 2019, Case C-608/17, *Holmen*, EU:C:2019:9, paras 54–55, Opinion AG Kokott, 10 Jan. 2019, Case C-607/17, *Memira*, EU:C:2019:8, paras 58–59, and Opinion AG Kokott, 17 Oct. 2019, Case C-405/18, *AURES*, EU:C:2019:879, paras 61 to 65.

[59] Opinion AG Wathelet, 3 Sep. 2015, Case C-388/14, *Timac Agro*, ECLI:EU:C:2015:533, para. 67 with n. 45. *See also* the short remark by the Court that 'the Republic of Austria has indicated that not all the possibilities for taking those losses into account have been exhausted in Austria' (CJEU, 17 Dec. 2015, Case C-388/14, *Timac Agro*, EU:C:2015:829, para. 56).

[60] *See* Opinion AG Collins, 10 Mar. 2022, Case C-538/20, *W AG*, EU:C:2022:184, para. 65.

[61] CJEU, 19 Jun. 2019, Case C-608/17, *Holmen*, EU:C:2019:511.

[62] CJEU, 19 Jun. 2019, Case C-607/17, *Memira*, EU:C:2019:510.

[63] CJEU (Grand Chamber), 12 Jun. 2018, Case C-650/16, *Bevola*, EU:C:2018:424, para. 64; *see also* with regard to the 'recapture' of losses CJEU, 17 Dec. 2015, Case C-388/14, *Timac Agro*, EU:C:2015:829, para. 55.

> closed permanent establishment was situated and the possibility that it could, at any time in the future, open a new permanent establishment in that State, to which the past losses could be transferred, is purely hypothetical. Not only would it be practically impossible or excessively difficult for the parent company to demonstrate that such a possibility is not open to it, but that approach would lead to losses incurred by a permanent establishment situated in another Member State never being considered to be final losses, which would render meaningless the obligation to take into account final losses set out in *Marks & Spencer*.[64]

5 How to calculate a 'final' loss?

A 'tax loss' is not a natural phenomenon. Its existence and amount depend on domestic tax law. It might therefore be the rule rather than the exception that if two Member States look at the same facts, the amount of profit or loss would diverge depending on their respective domestic tax rules. One State may, e.g., allow accelerated depreciation, deferral, or the deduction of even private expenses, while the other might have a much broader definition of the tax base. That said, it could even be the case that one State 'sees' a loss, the other a profit. As for the 'final loss' exception it is therefore highly relevant, under which State's rules a relevant 'loss' is determined. It is against this background that the Bundesfinanzhof inquires:

> whether the amount of final losses of the non-resident permanent establishment to be taken into account in the Member State of the parent company's residence should be limited to the amount of final losses which, had it been possible, would have been taken into account in the Member State where the permanent establishment is located.[65]

The Court's case law is not entirely clear on that point. In *Marks & Spencer* it had tacitly accepted the prerogative of the home State when it comes to the determination of foreign losses.[66] In *A Oy* it has explicitly stressed that such 'calculation must not lead to unequal treatment compared with the calculation which would have been made in a similar case for the taking over of the losses of a resident subsidiary',[67] i.e., in principle under the rules of the home State,[68] but that this 'question cannot, however, be addressed in an abstract and hypothetical manner, but must be analysed where necessary on a case-by-case basis'.[69] The detailed dogmatic and technical problems surrounding that question are exemplified by the long-lasting UK litigation following the Court's 2005 *Marks & Spencer* judgment, where the UK Supreme Court eventually favoured an approach whereby the unutilized losses as determined under source State rules are converted to home State rules.[70]

More generally, it is still unclear whether the amount of the foreign losses (as determined under the rules of the *source* State) is an *upper* limit for loss-relief in the *home* State, so that only the lower amount of the loss, as determined under home State rules as well as under source State rules, has to be taken into account.[71] The answer is not obvious: Equal treatment with domestic situations would arguably require determination solely under *home* State rules. The logic of 'final' losses, however, would likewise suggest that the home State does not need to take more losses into account than could have been used in the source State under that State's rules (because if the losses had been used there, they would never have become 'final' in the first place). It is not the home State's obligation to equalize tax base differences. Indeed, AG Anthony Collins in his Opinion in *W AG* advocated for such a 'dual limit' that is determined as the lower amount of loss as determined both under *home* State and *host* State rules:

> [I]n order to ensure equal treatment for the deductibility of final losses between resident companies possessing a non-resident permanent establishment and resident companies possessing a resident permanent establishment, the amount of final losses to be taken into account should not exceed that calculated by applying the rules of the parent company's State of residence (here, Germany). However, if the amount of the final losses calculated in accordance with the rules of the parent company's State of residence were to be higher than that calculated in accordance with the rules of the State in which the permanent establishment is situated (here, the United Kingdom), it should be limited to the latter amount. Otherwise, resident companies possessing a resident permanent establishment would be placed at an advantage in relation to resident companies possessing a non-resident permanent establishment. Furthermore, in the absence of such a limit, the Member State of the parent company's residence would be obliged to bear the adverse consequences of applying the tax legislation of the Member State in which the non-resident permanent establishment is situated.[72]

64 Opinion AG Collins, 10 Mar. 2022, Case C-538/20, *W AG*, EU:C:2022:184, para. 66.
65 *See ibid.*, para. 72.
66 CJEU (Grand Chamber), 13 Dec. 2005, Case C-446/03, *Marks & Spencer*, EU:C:2005:763, para. 22, noting that the parties agreed 'that the losses must be computed on a United Kingdom tax basis'.
67 CJEU, 21 Feb. 2013, Case C-123/11, *A Oy*, EU:C:2013:84, para. 59.
68 *See also* specifically Opinion AG Kokott, 19 Jul. 2012, Case C-123/11, *A Oy*, EU:C:2012:488, paras 70–76.
69 CJEU, 21 Feb. 2013, Case C-123/11, *A Oy*, EU:C:2013:84, para. 60.
70 *See* paras 49–53 of UK Supreme Court, 19 Feb. 2014, *Commissioners for Her Majesty's Revenue and Customs v. Marks and Spencer plc*, [2014] UKSC 11.
71 Indeed, the UK legislation at issue in *Commission v. UK* (Case C-172/13) required that 'final' losses need to be recomputed in accordance with UK rules but also provided a further limitation, i.e., that only the lower of the two amounts (foreign computed loss *v.* domestic computed loss) is to be taken into account at the UK level. Unfortunately, the Court did not (have to) address this issue.
72 Opinion AG Collins, 10 Mar. 2022, Case C-538/20, *W AG*, EU:C:2022:184, paras 74–75.

This interpretation would also provide a logical link to the Court's decision in *K*, where losses were not considered 'final' because under source State rules the loss at issue could not be used at all,[73] which resembles the extreme situation that the foreign loss exists only under *home* State rules, whereas the *source* State would 'see' a profit or nothing at all.

6 Outlook

The reference by the German Bundesfinanzhof in Case C-538/20, *W AG*, will force the Court to finally show its true colors on the future and scope of the 'final loss' doctrine, which was first established in the 2000s in *Marks & Spencer* and *Lidl Belgium*. AG Anthony Collins' Opinion calls for a seismic shift: Implicitly abandoning *Lidl Belgium*, he argues that treaty-exempt foreign permanent establishments are not even comparable with domestic permanent establishments as regards the utilization of ('final') losses, which, if accepted by the Court, would also put the whole body of *Marks & Spencer* case law in doubt. However, the Opinion also provides important analysis not only on the elusive concept of 'finality' of losses, but also on the question, under which Member State's law such losses be determined. The Court's answers are hence eagerly expected, and *W AG* might well become a new landmark.

[73] CJEU, 7 Nov. 2013, Case C-322/11, *K*, EU:C:2013:716, para. 77.