European Union

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Has the Case Law of the ECJ on Final Losses Reached the End of the Line?

The author traces the development of ECJ case law on final losses beginning with *Marks & Spencer*, wherein the Court held that foreign losses only need to be taken into consideration in exceptional cases, and culminating in a series of cases that have so restricted loss utilization that virtually no possibilities remain. The author highlights the practical questions that have arisen in this regard and suggests possible solutions.

1. The *Marks & Spencer* Decision as the Origin of ECJ Case Law on Final Losses

Almost ten years have passed since the ECJ delivered its decision in *Marks & Spencer* (Case C-446/03).[1] The decision came as a surprise at the time: until then, the ECJ had almost always ruled that advantages, the scope of which is limited to domestic situations, must be granted across borders in relation to other EU Members States. This is the only way that the requirements of the basic freedoms can be complied with.[2] Accordingly, one would have expected the ECJ to require the UK legislator to also grant loss relief to UK parent companies with a subsidiary in another EU Member State, previously granted only with regard to UK group companies. The losses suffered by the foreign subsidiary would then be deductible from the profits of the UK parent company, regardless of whether they could also be taken into account abroad.

Instead, the ECJ took a new approach: losses abroad only need to be taken into account in exceptional cases. The parent company is only able to deduct these:[3]

> [...] where the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods, if necessary by transferring those losses to a third party or by offsetting the losses against the profits made by the subsidiary in previous periods, and where there is no possibility for the foreign subsidiary's losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.

The ECJ formulated its reasoning as follows: in an initial step, the Court found that the domestic and the cross-border cases are comparable. Subsequently, it reviewed three justifications: the need to safeguard a balanced allocation of the power to impose taxes, the risk of the double use of losses and the risk of tax avoidance. The Court regarded the combination of these justifications as crucial. These justifications together would justify the differential treatment of domestic and foreign losses. Apparently, the ECJ considered it too restrictive not to take into account foreign losses at all. Therefore, the proportionality assessment played an important role in the reasoning. The ECJ wanted to ensure the single use of foreign losses but did not consider it necessary, in the light of EU law, to deduct the loss suffered abroad both there and in the residence state of the parent company. Therefore, the residence state of the parent company can introduce measures to rule out the double use of losses, but must also step in for the residence state of the subsidiary as a substitute.

The criteria cited by the ECJ in its *Marks & Spencer* decision raised a series of practical questions from the very beginning:[4] for instance, it was not clear which requirements would rule out any possibility for the losses to be taken into account in the residence state of the subsidiary. *Marks & Spencer* had ceased trading in some of the Member States under consideration. The decision left it open whether the mere suspension of activities would suffice to rule out the possibility of losses being taken into account. After all, a company legally still in existence may later resume its activities and – based on the tax laws of its residence state – offset previous losses against profits – if such ever materialized. In the event of a sale of a subsidiary to third parties, the question is not only whether the subsidiary will generate any profits after its sale, but also whether a deduction of losses will then be possible at all and whether, for instance, regulations governing shell company acquisitions rule this out. This is closely connected to questions on an evidentiary level: in the event of a sale of the subsidiary, the previous shareholder not only has no influence over the future corporate gover-

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1. UK: ECJ, 13 Dec. 2005, Case C-446/03, *Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes)*, ECJ Case Law IBFD.
2. UK: ECJ, 16 July 1998, Case C-264/96, *Imperial Chemical Industries plc (ICI) v. Kenneth Hall Colmer (Her Majesty's Inspector of Taxes)*, ECJ Case Law IBFD; SE: ECJ, 21 Nov. 2002, Case C-436/00, *X & Y v. Riksskatteverket*, ECJ Case Law IBFD; NL: ECJ, 13 Apr. 2000, Case C-251/98, *C. Baars v. Inspecteur der Belastingdienst Particulieren/Ondernemingen Gorinchem*, ECJ Case Law IBFD; and NL: ECJ, 18 Sept. 2003, Case C-168/01, *Bosal Holding BV v. Staatssecretaris van Financiën*, ECJ Case Law IBFD.
3. *Marks & Spencer* (C-446/03), para. 55.
4. *See* M. Lang, *The* Marks & Spencer *Case – The Open Issues Following the ECJ's Final Word*, 46 Eur. Taxn. 2, p. 54 at p. 61 (2006), Journals IBFD. *See also* M. Lang, Marks & Spencer – *Eine erste Analyse des EuGH-Urteils*, 16 Steuer und Wirtschaft International (SWI), p. 3 et seq. (2006).

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nance of his former subsidiary, and thus over whether it will engage in an activity that meets the requirements of a shell company acquisition, but the former shareholder often has no knowledge of the course of events that follow the sale.

Another issue that remains open is when the losses must be taken into account.[5] It seems evident that this would be in the period in which they were incurred. It is equally conceivable, however, to deduct them in the assessment period, in which period it becomes clear that their use in the other Member State is not possible.

The criteria introduced by the ECJ were also subject to criticism from a legal point of view:[6] if the residence state of the parent company is obliged to take into account the foreign losses if the losses cannot be used abroad, the fiscal sacrifice of the parent company's residence state is even greater the more restrictive the utilization of losses is regulated in the other state. Individual EU Member States might even feel encouraged to further limit their possibilities of taking losses into account, so as to thus oblige other states to apply their group relief or similar regulations.

2. The Further Development of the *Marks & Spencer* Case Law

2.1. Extending the scope of the *Marks & Spencer* decision to foreign PEs

The criticism voiced immediately after the publication of the *Marks & Spencer* decision, however, did not prevent the ECJ from applying the criteria developed in *Marks & Spencer* to resolve other cross-border loss constellations. In the *Lidl Belgium* (Case C-414/06), in an initial step, the Court transferred its case law also to foreign permanent establishments (PEs) subject to an exemption under a tax treaty.[7] The ECJ treated the *Marks & Spencer* criteria like elements of an exemption regulation that must be applied:[8]

> In that regard, the Court held in paragraph 55 of the judgment in Marks & Spencer that a measure which restricts the freedom of establishment goes beyond what is necessary to attain the objectives pursued where a non-resident subsidiary has exhausted the possibilities for having the losses incurred in the Member State where it is situated taken into account for the accounting period concerned and also for previous accounting periods and where there is no possibility for that subsidiary's losses to be taken into account in that State for future periods.

These requirements were not met in this specific case:[9]

> As regards the main proceedings, it appears from the documents in the case transmitted to the Court that Swedish law provides for the possibility of taking a taxpayer's losses into account in future tax years for the purpose of calculating the taxable basis. [...] As was confirmed at the hearing before the Court, Lidl Belgium has in fact benefited from such an offsetting of the losses incurred by its permanent establishment in 1999 in a subsequent tax year, namely 2003, in which that entity generated profits.

The ECJ thus delivered a double reasoning for its opinion that it was not a necessity to deduct the foreign loss in the residence state of the head office. The *Lidl Belgium* decision made it clear that, according to the criteria developed in *Marks & Spencer*, it remains open whether the legal or factual possibility of taking losses into account is relevant. In the *Lidl Belgium* case, the ECJ did not feel compelled to settle this question, since, both legally and factually, the loss suffered in the state of the PE could also be used there.

Case law then took a new turn with the decision in *Krankenheim Ruhesitz am Wannsee* (Case C-157/07):[10] here, too, the issue was a foreign PE. The provisions of the residence state – Germany – took the foreign loss into account but later provided for its addition. As a result, the losses could not be deducted in the state of residence. In the state of the PE – Austria – carrying the loss forward was not possible, so that ultimately the loss could not be taken into account anywhere. Based on *Marks & Spencer*, one would have expected that the residence state would step in to remedy the breach and would be obliged to take the loss into account and must, therefore, refrain from adding the profits. Surprisingly, the ECJ reached the opposite conclusion: the Member State's power to define the criteria for taxing income and wealth:[11]

> [...] also implies that a Member State cannot be required to take account, for the purposes of applying its tax law, of the possible negative results arising from particularities of legislation of another Member State applicable to a permanent establishment situated in the territory of the said State which belongs to a company with a registered office in the first State (see, to that effect, Columbus Container Services, paragraph 51, and Case C-293/06 Deutsche Shell [28 February 2008] ECR I-0000, paragraph 42). [...] The Court has held that freedom of establishment cannot be understood as meaning that a Member State is required to draw up its tax rules on the basis of those in another Member State in order to ensure, in all circumstances, taxation which removes any disparities arising from national tax rules, given that the decisions made by a company as to the establishment of commercial structures abroad may be to the company's advantage or not, according to circumstances (see Deutsche Shell, paragraph 43). [...] Even supposing that the combined effect of taxation in the State where the principal company of the permanent establishment concerned is situated and tax due in the State where that establishment is situated might lead to a restriction of the freedom of establishment, such a restriction is imputable only to the latter of those States. [...] In such a case, that restriction would arise not from the tax system at issue in the main proceedings, but from the allocation of tax competences under the German-Austrian Agreement.

The arguments are confusing: where the ECJ argues on the basis of the allocation of taxation powers and holds the state of the PE responsible for not taking losses into account, one cannot deny a contradiction with the previous *Marks & Spencer* case law. Had the ECJ argued in the same manner as in the *Lidl Belgium* case, the issue would not be if the possibility to take losses into account exists according to the tax law of the state of the PE, or if the losses

5. *See* Lang, SWI, *supra* n. 4, at p. 9.
6. *See* M. Lang, *Direct Taxation: Is the ECJ heading in a new direction?*, 46 Eur. Taxn. 9, p. 421 at p. 427 (2006), Journals IBFD. *See also* M. Wathelet, Marks & Spencer plc v. Halsey: *lessons to be drawn*, 2 British Tax Rev., p. 131 (2006).
7. DE: ECJ, 15 May 2008, Case C-414/06, *Lidl Belgium GmbH & Co. KG v. Finanzamt Heilbronnl*, ECJ Case Law IBFD.
8. *Lidl Belgium* (C-414/06), para. 47.
9. *Lidl Belgium* (C-414/06), paras. 49-50.
10. DE: ECJ, 23 Oct. 2008, Case C-157/07, *Finanzamt für Körperschaften III in Berlin v. Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt GmbH*, ECJ Case Law IBFD.
11. *Krankenheim* (C-157/07), paras. 49-52.

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were actually taken into account there. Instead, under no circumstances would the losses need to be taken into account in the state of the parent company. The impossibility of taking the losses into account would have to be exclusively attributed to the state of the PE. By analogy, the ECJ did not have to agonize in *Marks & Spencer* over whether the losses could be used in the residence states of the subsidiaries, since it would then never have been the task of the United Kingdom to deduct the losses.

The justification of the ECJ, however, already points to the special situation of the case: the issue under consideration was whether one is "required to take account, for the purposes of applying its tax law, of the possible negative results arising from particularities of legislation of another Member State".[12] One of the questions referred for a preliminary ruling already openly addressed the possible violation of the freedom of establishment by the provisions of the state of the PE:[13]

> Is the position in the State of residence affected if the limitations on deduction of losses applicable in the other Member State (being the source State) themselves contravene Article 31 of the [EEA] Agreement on the ground that they discriminate against a taxpayer with income from his permanent establishment who is subject only to limited taxation there compared with a taxpayer who is subject to unlimited taxation there?

In the proceedings, which dealt with the taxation right of the residence state – Germany –, the ECJ did not have the possibility of deciding on the conformity of the tax legislation of the other state – Austria – with EU law. This would have required a request for a preliminary ruling by an Austrian court in the proceedings pending before it, or an action by the Commission against Austria. Already, in the wake of *Marks & Spencer* and *Lidl Belgium*, the ECJ was notoriously being criticized because, as a consequence of its case law, restrictive legislation in respect of losses in the residence state of the subsidiary or in the state of the PE would result in a situation in which the residence state of the parent company or the state of the head office would have to make a greater fiscal sacrifice. This led to the impression that the ECJ did not want to oblige the residence state to step into the breach for the source state, possibly acting in violation of the Treaty, especially in a constellation in which a violation of the freedom of establishment was in the air in the state of the PE.

2.2. Extending the scope of the *Marks & Spencer* case law to cross-border mergers

The issue in *A Oy* (Case C-123/11) was a cross-border merger of a Swedish company with its Finnish parent company.[14] The ECJ had to address the question as to whether the freedom of establishment and the *Marks & Spencer* case law defining it obliged Finland to take into account the losses suffered by the Swedish subsidiary before the merger in the parent company in Finland. The Swedish subsidiary disappeared as a result of the merger, so that taking the losses into account in this company in Sweden was no longer an option.

Advocate General Kokott used the question referred as an opportunity to demand the previous position in the ECJ case law to be abandoned.[15] Foreign losses should not only not be taken into account under the strict requirements set by the ECJ in *Marks & Spencer* and endorsed in the subsequent case law but – with a few exceptions – not at all. She argued that, in *Marks & Spencer*, the proportionality assessment, which resulted in the criteria described, was based on the justification of avoiding the double use of losses. This justification subsequently became irrelevant and was replaced by the justification of safeguarding a balanced allocation of taxation powers. Against this background, however, it would no longer be necessary to oblige the state of residence of the company to – by way of exception – step into the breach for the source state. The extent to which losses are deductible would then lie exclusively within the responsibility of the state of the PE or the residence state of the subsidiary. In addition, the Advocate General pointed to the fact that, already in *X Holding*, no mention was made of the consideration of losses and, therefore, it could be assumed that the ECJ had already implicitly abandoned the *Marks & Spencer* case law.

The ECJ itself, however, held firm to the *Marks & Spencer* case law:[16]

> It follows, secondly, from the Court's case law that a restrictive measure such as that at issue in the main proceedings goes beyond what is necessary to attain the essential part of the objectives pursued in a situation in which the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account (see, to that effect, *Marks & Spencer*, paragraph 55). It is for the parent company to show that that is the case (see, to that effect, *Marks & Spencer*, paragraph 56).

The ECJ did not respond at all to the arguments of the Advocate General.

It is interesting to review the considerations of the ECJ with regard to the question of whether the possibility to take losses into account generally depends on the legislation or the specific situation. The ECJ first mentions the legislation in general:[17] "As regards the main proceedings, it appears from the documents in the case transmitted to the Court that Swedish law provides for the possibility of taking a taxpayer's losses into account in future tax years for the purpose of calculating the taxable basis". The Court then continues:[18]

> However, A submits that, once the merger operation has been carried out, B will be liquidated, and A will no longer have a subsidiary or a permanent establishment in Sweden. Neither of those two companies would thus appear to have the possibility of relying in Sweden, after the merger, on the losses incurred by B in Sweden before the merger. [...] Nevertheless, those specific circumstances are not in themselves capable of showing that there is no possibility of taking into account the losses that exist in the subsidiary's State of residence. [...] Thus several Member States

12. *Krankenheim* (C-157/07), para. 49.
13. *Krankenheim* (C-157/07), para. 22.
14. FI: ECJ, 21 Feb. 2013, Case C-123/11, *Veronsaajien oikeudenvalvontayksikkö and Valtiovarainministeriö v. Oy A*, ECJ Case Law IBFD.
15. FI: Opinion of Advocate General Kokott, 19 July 2012, Case C-123/11, *Veronsaajien oikeudenvalvontayksikkö and Valtiovarainministeriö v. Oy A*, ECJ Case Law IBFD.
16. *A Oy* (Case C-123/11), para. 49.
17. *A Oy* (Case C-123/11), para. 50.
18. *A Oy* (Case C-123/11), paras. 51-54.

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> which have intervened in the case consider, on the contrary, that the possibility of taking B's losses into account in Sweden continues to exist. The German Government submits that those losses can be deducted from the income, admittedly very small, which B continues to receive in Sweden. It adds that B is still involved in leases which could be assigned. The French Government also submits that Swedish law allows companies to take losses into account in previous tax years or on the occasion of the taxation of capital gains made on the assets and liabilities of the merged company. The Italian Government submits that Sweden is entitled to evaluate the assets transferred and to tax the merged company on the profit thus realised. [...] It is therefore for the national court to determine whether A has in fact proved that B has exhausted all the possibilities of taking account of the losses which exist in Sweden.

On the one hand, the ECJ is less concerned with the Swedish legislation than with the taxpayer's actual situation. On the other hand, it points out that "these specific circumstances are not in themselves capable [...]". It also mentions anticipated future taxable income in Sweden, against which the losses can then be offset. Whether, for instance, the expressly cited lease agreements would result in income in the coming years, however, will also depend on the extent to which the contractual partners are capable of meeting their payment obligations. It remains unclear how the taxpayer will furnish the required proof that he "has exhausted all the possibilities of taking account of the losses".

Advocate General Kokott delivered a clear opinion on the question of whether the losses must be calculated according to the law of the parent company's or the subsidiary's residence state.[19] She suggested that:

> [...] the losses to be taken into account must in principle be calculated according to the tax law of the receiving company's state of residence. [...] only in that way would calculation of the losses lead to equal treatment in cases within a single Member State and in cross-border situations, that is to say, a merger with a resident subsidiary and a merger with a foreign subsidiary would receive equal treatment for tax purposes. Equal treatment in that way would remove the restriction of the freedom of establishment which, as we have seen, arises precisely from the different treatment of the two situations.

Yet, the answer of the ECJ leaves everything open.[20] Although the Court first assumes that "in principle, the 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", this also suggests that the law of the receiving company's state of residence must be considered relevant in determining the losses. Immediately after that, it relativized this statement: "That question cannot, however, be addressed in an abstract and hypothetical manner, but must be analysed where necessary on a case-by-case basis".[21] If the ECJ had been fully convinced by the discrimination approach proposed by its Advocate General, this would have left no room for a case-by-case analysis. The relativization mentioned here, however, was not included in the tenor of the decision.

19. AG Opinion in *A Oy* (Case C-123/11), para. 73.
20. *A Oy* (Case C-123/11), para. 59.
21. *A Oy* (Case C-123/11), para. 60.

2.3. Extending the scope of the *Marks & Spencer* case law to foreign non-business income

The decision in *K* (Case C-322/11) further contributed to the confusion:[22] a Finnish taxpayer sold a privately owned French property at a loss and, under French law, did not have any opportunity to take this loss into account there. On the one hand, French tax law does not provide for any possibility at all to deduct such losses from private property sales. On the other, the taxpayer no longer had any assets in France and no other income sources against which he could have offset the losses.

In his Opinion, Advocate General Mengozzi voiced criticism against the *Marks & Spencer* case law.[23] The fact that the ECJ ignored the criticism previously expressed by Advocate General Kokott did not prevent Advocate General Mengozzi from basically subscribing to his colleague's view. He demanded that the ECJ's *Marks & Spencer* case law be abandoned and proposed that the first step in this direction would be to limit its scope of application to cases in which unilateral provisions preclude the use of foreign losses in the state of residence.

The ECJ was not impressed. It used the opportunity to expand the scope of application of its *Marks & Spencer* case law. Whereas previously the case law only covered participations in subsidiaries and PEs held as business assets, the issue at hand involved private assets. Accordingly, the subject here was not the freedom of establishment but the free movement of capital. This did not make any difference to the ECJ.

The ECJ's reasoning, however, probably results altogether in a significant limitation of the *Marks & Spencer* case law. The ECJ first refers to its previous case law, which stipulates:[24]

> [...] that a measure under which a resident parent company is denied the possibility of deducting from its taxable profit losses incurred in another Member State by a subsidiary established in the latter Member State, whilst the losses of a resident subsidiary may be deducted, or under which, in the context of a merger, a parent company established in a Member State is denied the possibility of deducting from its taxable income the losses of the merged subsidiary, which is established in another Member State, may be justified by the need to preserve the allocation of the power to impose taxes between the Member States and to prevent the risk of losses being used twice and of tax avoidance [...], but goes beyond what is necessary to attain the essential part of the objectives pursued in a situation in which the non-resident subsidiary has exhausted the possibilities available in its Member State of residence of having the losses taken into account (see, to that effect, *Marks & Spencer*, paragraph 55; and A, paragraph 49).

Surprisingly, the ECJ then claims that in a situation such as that at issue in the main proceedings, "a taxpayer such as K cannot be regarded to have exhausted the possibilities available in the Member State in which the property is situated of having the losses taken into account".[25] At first glance, however, it is not evident why the taxpayer "did not

22. FI: ECJ, 7 Nov. 2013, Case C-322/11, *K*, ECJ Case Law IBFD.
23. FI: ECJ, Opinion of Advocate General Mengozzi, 21 Mar. 2013, Case C-322/11, *K*, para. 61 et seq., ECJ Case Law IBFD.
24. *K* (C-322/11), para. 75.
25. *K* (C-322/11), para. 76.

exhaust" these possibilities of taking losses into account: "Since the Member State in which the property is situated does not provide for the possibility of losses incurred on the sale of the property being taken into account, such a possibility has never existed".[26] Hence, a non-existent possibility cannot be "exhausted". This leads to a paradox: since France does not allow for the offsetting of real estate losses against other income, Finland, as the state of residence, does not need to take the French losses into account. The fact that the taxpayer does not have any other French income at all is irrelevant. Were French tax law to provide for such a possibility to take losses into account, however, a taxpayer in the same situation would be entitled to deduct losses in his state of residence, i.e. Finland. In such a scenario, he would have exhausted the possibility of taking losses into account in France, with the result that Finland would have to step in.

The reasoning that followed shows that the ECJ continues to be occupied with the objection that its case law established in *Marks & Spencer* leads to a situation in which a Member State, by introducing restrictive tax laws on the use of losses, can indirectly impose the fiscal sacrifice required by the principle of the single use of losses onto the other Member State:[27]

> In such circumstances, if it were accepted that the Member State in which the taxpayer resides must nevertheless allow losses on immovable property to be deducted from taxable profits in that Member State, that would effectively oblige the latter to bear the adverse consequences arising from the application of the tax legislation adopted by the Member State in which the property is situated.

As was already the case in *Krankenheim Ruhesitz am Wannsee*, the following sentence refers to the "particularities" of the source state's tax legislation:[28]

> According to the Court's case law, a Member State cannot be required to take account, for the purposes of applying its tax law, of the possible adverse consequences arising from particularities of legislation of another Member State applicable to a property situated in the territory of that State which belongs to a resident in the first State [...].

In *Krankenheim Ruhesitz am Wannsee*, however, the "particularity" of the legislation was that the source state treats non-resident taxpayers more restrictively than residents, while here the source state does not take into account losses from the sale of private real estate at all. If, however, the provisions of a tax law system that generally rule out the deduction of losses for certain types of income must be qualified as "particularities", it remains unclear which forms of prohibition of loss deduction must not be qualified as "particularities", but as a general rule.

2.4. The limits of the scope of the *Marks & Spencer* case law

At least as interesting as the decisions in which the ECJ invoked the *Marks & Spencer* reasoning, are those decisions in which, although the case involved losses, the ECJ did not even consider basing its decision on the principles developed in *Marks & Spencer*. An early example of this is the decision in *Deutsche Shell* (Case C-293/06).[29] This case involved exchange losses in the conversion of Italian PE profits from Lira to Deutsche Mark for the purposes of the German parent company. In this case, the ECJ deemed it proper to take the losses into account in Germany, although such losses from fluctuations in foreign exchange rates are not even possible in respect of domestic PEs. In truth, the issue was not the equal treatment of similar situations but the – also necessary – unequal treatment of different situations.[30] The ECJ did not bother with any possible limitations on the use of losses. There was no risk of a double use of the losses. The single use of losses was guaranteed by the deductibility of losses demanded by the ECJ.

The ECJ also had to give its decision in cases such as *Papillon* (Case C-418/07), where the issue was the offsetting of the sub-subsidiary's losses against profits of the parent company in the same state.[31] The French legislator did not allow the use of losses because the parent company was established in another Member State. Had all entities been resident in the same state, they would have been allowed to take the losses into account. The ECJ demanded that the offsetting of profits and losses from the same state should be admissible. The Court deemed it legitimate for the national legislator to ensure that the same losses are not taken into account in the same state twice, for instance by depreciating the participation held by the parent company in the subsidiary company, which may become necessary due to the sub-subsidiary continuing to suffer losses. Interestingly, the ECJ was not worried about the possibility of a repeated use of this loss in another Member State – for example, by way of depreciation of the loss-making participation in the sub-subsidiary by the subsidiary company. The Court did not see any problem in the possible double use of the sub-subsidiary's losses in two different Member States.

Conversely, there are cases in which losses in the state of residence cannot be deducted, although it is by no means ensured, or in which it is even ruled out that they can be taken into account in the other state. In such cases, the ECJ accepts the impossibility of taking losses into account and deems this admissible under EU law. Such cases include the aforementioned decisions in *Krankenheim Ruhesitz am Wannsee* and *K*, in which the ECJ applied the criteria developed in *Marks & Spencer* but nevertheless reached the conclusion that there are no final losses worth taking into account.[32] In other cases, the ECJ does not even apply the proportionality assessment, because it regards the general exclusion of the use of foreign losses as justified. In *Oy AA* (Case C-231/05), for instance, the ECJ accepted a limitation on the application of the Finnish law on intra-group financial transfers to domestic cases so as to avoid "allow-

26. *K* (C-322/11), para. 77.
27. *K* (C-322/11), para. 78.
28. *K* (C-322/11), para. 79.
29. DE: ECJ, 28 Feb. 2008, Case C-293/06, *Deutsche Shell GmbH v. Finanzamt für Großunternehmen in Hamburg*, ECJ Case Law IBFD.
30. *See* M. Lang, *Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions and Contradictions*, 18 EC Tax Rev. 3, p. 98 et seq. (2009).
31. FR: ECJ, 27 Nov. 2008, Case C-418/07, *Société Papillon v. Ministère du budget, des comptes publics et de la fonction publique*, ECJ Case Law IBFD.
32. *See Krankenheim* (C-157/07), para. 55 and *K* (C-322/11), para. 83.

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ing groups of companies to choose freely the Member State in which the profits of the subsidiary are to be taxed".[33] In *X Holding* (Case C-337/08), the same argument prompted the ECJ to compare foreign subsidiaries and PEs as part of the proportionality assessment and to ultimately reject their comparability, yet without even examining the proportionality of the provisions.[34] In both cases, however, it would have been, by all means, logical to consider the transfer of losses in the state of residence as imperative once the use of losses was ruled out in the residence state of the other group company, thus making the losses final. In *Oy AA* the scope of the Finnish group contribution rule could be extended to cross-border situations in which one of the subordinated group companies suffers a final loss. The argument put forward by the ECJ, according to which it did not want to create a situation in which "parent companies would be allowed to choose freely the Member State in which the losses of their non-resident subsidiary are to be taken into account",[35] would not apply in these cases. Therefore, Advocate General Kokott convincingly – albeit, in retrospect, not correctly – drew the conclusion from *X Holding* that the Court had already implicitly abandoned the *Marks & Spencer* line of reasoning.[36]

3. The Fundamental Problems of the *Marks & Spencer* Line of Reasoning

3.1. The relevant tax regime for determining the losses

The above description of the development of the case law since *Marks & Spencer* already reveals its shortcomings: The *Marks & Spencer* decision has raised a number of issues that are difficult to resolve. Subsequently, the ECJ has increasingly narrowed the scope of the criteria developed in *Marks & Spencer*, creating the impression that its case law continues to be based on the key decision taken at that time. In the meantime, however, the contradictions have become palpable. In addition, the ECJ does not even consider the *Marks & Spencer* criteria in other decisions on foreign losses, without even mentioning a justification for doing so. In some of these decisions, it tacitly or expressly accepts losses being taken into account twice, as well as the exclusion of any use of losses.

Some of the difficulties mentioned are based on the shortcomings of this case law, which existed from the very beginning and should be subsequently addressed in greater depth. The ECJ regularly refers to the "losses" suffered by the foreign company or foreign PE as such, which must be taken into account under certain circumstances. Thus, the ECJ is acting as if these losses had a clear predefined value. The amount of a loss, however – just as that of a profit – is merely the result of an arithmetic operation. This result will depend on the respective relevant provisions defining what is taxable at all and how the assessment is to be addressed, as well as which deductions will be taken into account in which period. The profits and losses established for tax law purposes may, therefore, considerably differ from those determined, for instance, under corporate, social or other provisions of different jurisdictions. A loss is never a factual value but depends on the relevant provisions of positive law. Since the tax assessment basis is not harmonized within the European Union, the amount of a loss from the same economic activity can be completely different depending on the applicable legislation. What may appear as a loss under one piece of legislation may even prove to be a profit according to another.

The reasoning given by the ECJ for its case law on final losses does not make it easier to answer the question as to whether the tax law of the residence state or that of the source state applies. If one refers to the character of the basic freedoms as discrimination prohibitions, it is obvious that the tax law of the state of residence or of the parent company should be considered relevant: the foreign situation should not be treated worse than the domestic situation. Therefore, the result of the economic activity carried out in the other state should be taken into account only if and to the extent that the application of the tax law provisions of the residence state results in a loss.

If one, however, places emphasis on the idea of the single use of losses, which is also considered fundamental by the ECJ, this would constitute an argument in favour of referring to the law of the source state. The losses established according to the latter's provisions would have to be deducted in the residence state if they cannot be used in the source state. Only then will these losses be taken into account at least in one state.

Similar considerations can be made with regard to the relevant assessment period in which the losses must be taken into account. Those who emphasize that the basic freedoms are the legal basis of the *Marks & Spencer* case law, in the sense of being in the nature of a prohibition against discrimination, will demand that the losses be taken into account in the period in which they occurred. Those who want to ensure that only final losses – no matter how these are defined – can be used, for example, the German Federal Tax Court (*Bundesfinanzhof*), will look to the assessment year in which the requirements apply that allow for the characterization of these losses as final.[37]

In *A Oy*, at least the question as to which tax law system has to be considered relevant for the determination of the losses was expressly addressed by the referring court. Here, Advocate General Kokott clearly argued in favour of a discrimination approach.[38] The ECJ, too, revealed a preference for the use of the tax law system of the residence state of the parent company, but then subsequently relativized this by requiring a case-by-case analysis, thus leaving the issue open as to which situations would qualify for a different consideration.[39] The ECJ obviously became aware

33. FI: ECJ, 18 July 2007, Case C-231/05, *Oy AA*, para. 56, ECJ Case Law IBFD.
34. NL: ECJ, 25 Feb. 2010, Case C-337/08, *X Holding BV v. Staatssecretaris van Financiën*, para. 40, ECJ Case Law IBFD.
35. *X Holding* (C-337/08), para. 41.
36. AG Opinion in *A Oy* (Case C-123/11), para. 53.
37. DE: BFH, 9 June 2010, I R 107/09, BeckRS 2010, 24004092, Tax Treaty Case Law IBFD; and DE: BFH, 9 Nov. 2010, I R 16/10, BeckRS 2011, 94144.
38. AG Opinion in *A Oy* (Case C-123/11), para. 73 et seq.
39. AG Opinion in *A Oy* (Case C-123/11), para. 60.

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that the discrimination approach – imperative according to the basic freedoms – cannot go hand in hand with the concept of ensuring the single use of losses and giving the Member States means to rule out their double use. This conflict of objectives could only be avoided if the provisions on the assessment basis for direct taxation were to be harmonized, which is far from being achieved. Not even a common consolidated corporate tax base (CCCTB) applied throughout the European Union, would remove the disparities between the tax law systems; it would only create an additional tax assessment basis parallel to those existing under the national laws of the Member States.[40] The *Marks & Spencer* reasoning, however, suffers from the very start from the fact that it ignores this obvious conflict between its different underlying objectives and acts as if there were simply just *one* loss.

3.2. Exhausting the possibilities of taking losses into account

As regards the *Marks & Spencer* decision itself, it is evident that the criterion of the finality of losses has raised a plethora of questions. The subsequent case law has further tightened these criteria, so that, today, one can hardly imagine situations in which all possibilities for taking losses into account are exhausted in the subsidiary's residence state or in the state of the PE, meaning that the residence state of the parent company or of the head office is obliged to treat these foreign losses as domestic losses and to fill in for the other state.

Since *Lidl Belgium*, the ECJ has made a distinction between the legal and factual possibilities of taking losses into account and has, for the moment, left it open as to which of these two criteria is most relevant.[41] The case law of the German Federal Tax Court opted to consider losses final when possibilities to take losses into account do not exist due to actual circumstances.[42] An analysis of this case law, however, reveals how problematic it is to focus on factual possibilities: if losses can be carried forward for five years in the state of the PE and the PE is abandoned in the sixth year, the losses cannot be taken into account in the state of residence. If, however, the PE is abandoned prior to the expiry of this period, this actual circumstance leads to the finality of the losses and is, therefore, considered relevant for the exceptional deduction of losses.[43] It is difficult to understand, however, why the abandonment of a PE is treated completely differently in the fourth and sixth year after the loss was incurred, although the loss cannot be taken into account in the state of the PE in either of the two cases. The German Federal Tax Court itself maintains that, even though it seemingly focuses solely on the actual circumstances, it takes into account the "legal framework in the source state". The fact that the possibility to carry the loss forward for five years, based on the law of the source state, leads to a different treatment also clearly shows that the relevant legal provisions can never be dismissed.

Whether actual circumstances rule out the possibility of using losses will ultimately depend on the legislation of the source state: In the event of a transfer or abandonment of a PE, the losses can only be final if the taxpayer who acquires the PE is not allowed under the tax laws of the source state to continue using the losses or when these laws do not allow him to offset these losses against later income from other sources or profits of another PE founded later. Even if the legal system allows losses suffered in a business or another investment to be offset against future profits and other income, one cannot reliably predict the extent to which the taxpayer will eventually earn such income. The theoretical possibilities for establishing sources of income allowing for losses to be taken into account are unlimited. Nobody can predict which of these possibilities the taxpayer will eventually use. Even if the taxpayer himself follows specific plans, it is by no means certain which of these will materialize and whether – contrary to his own initial expectations – he will instead earn other income, which he currently cannot anticipate. In many instances, it is even more difficult to predict the level of such income. Even in constellations in which payment flows can be planned – such as interest on securities or rental income -, the other party may default and the anticipated income may never materialize. Even local governments have defaulted on their debts. Therefore, if one focuses solely on secured future income as "specific circumstances" for taking losses into account, every loss would have to be regarded as final immediately after the end of the year in which it is incurred and would have to be taken into account in the state of residence. Completely secured future income does not exist. If, however, all losses must be deducted in the state of residence in any event, the criterion of "specific circumstances" becomes irrelevant. It is obvious that obliging the state of residence to allow for a general deduction of foreign losses would not correspond to the spirit of the ECJ's *Marks & Spencer* decision.

In its decision in I R 48/11 (5 February 2014), the German Federal Tax Court attempted to attach further significance to the criterion of "specific circumstances", focusing on the question of whether, for instance, the reopening of a PE is "likely".[44] The same would have to apply, however, to all other possible future income that, under the tax law of

40. *See* European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2011) 121/4 (16 Mar. 2011), EU Law IBFD.
41. *Lidl Belgium* (C-414/06), paras. 49-50. *See also* D. Blum & E. Huisman, *Die Rechtssache K: Neues zum Finalitätskriterium in der grenzüberschreitenden Verlustverrechnung*, SWI, p. 433 at p. 441 et seq. (2014).
42. DE: BFH, 9 June 2010, I R 100/9; A. Musil, *Was sind finale Verluste?*, 64 Der Betrieb, p. 2451 at p. 2453 et seq. (2011); A. Perdelwitz, *Recent Developments on the Deductibility of Foreign Permanent Establishment Losses in Germany*, 51 Eur. Taxn. 1, p. 31 et seq. (2011), Journals IBFD; M. Schwenke, *Kann ein Transfer ausländischer Verluste trotz „Finalität" scheitern? Folgeüberlegungen zum BFH-Urteil I R 107/09*, IStR, p. 368 at p. 372 (2011); *see also* D. Hohenwarter, *Verlustverwertung im Konzern* p. 518 (2010); D. Gosch, *Abzug finaler Verluste von EU-Tochtergesellschaften bei der inländischen Muttergesellschaft*, BFH/PR, p. 403 at p. 405 et seq. (2013); F. Hruschka, *Abzug finaler Verluste von EU-Tochtergesellschaft bei Muttergesellschaft*, DStR, p. 392 at p. 397 (2013); and E. Cohrs, *Unresolved Issues in the ECJ's Case Law on Cross-Border Intra-Group Loss Relief in the Light of* A Oy, 53 Eur. Taxn. 7, p. 345 at p. 349 (2013), Journals IBFD.
43. I R 107/09 (9 June 2010).
44. DE: BFH, 5 Feb. 2014, I R 48/11, n. 13; *see also* W. Mitschke, *Ausnahmsweiser Abzug „finaler" ausländischer Betriebsstättenverluste*, IStR, p. 377 at p. 381 et seq. (2014).

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the source state, would allow for losses to be taken into account. It is impossible to accurately predict how a taxpayer's life will unfold, what income he will, therefore, obtain and what income is "rather unlikely". Any case law that would force the tax authorities to play the role of a soothsayer is not very convincing.

Considering, however, all possibilities that the taxpayer could use in the future to generate income against which the losses suffered can be offset, the "specific circumstances" obviously coincide with legal possibilities. As a result, the requirement for factual possibilities loses its autonomous justification in these cases. In the end, such constellations seem to completely depend on legal possibilities. If, therefore, a tax law system provides for a five-year loss carry-forward, there are legal possibilities for taking losses into account. Those who aim to achieve a single use of these losses, however, must regard the losses as final after the expiry of the five-year carry forward period.

This also demonstrates, however, that one also cannot focus on legal possibilities alone: the expiry of the five-year time limit itself is part of a factual situation. If the taxpayer generates income before the expiry of the five-year period, a loss deduction will no longer be considered in this respect. Therefore, the taxpayer's "specific circumstances" must also be taken into consideration. Even those who want to deny the deduction of losses in the state of residence when the source state only provides for the possibility of a loss carry-forward, may find themselves compelled to take the "specific circumstances" into consideration. The following simple, fictitious example should illustrate this: the tax law of the source state does not allow corporations to carry losses forward at all, but does allow individuals to do so for a limited time. Is it possible in such a scenario to refuse to regard the losses of the corporation as final because individuals can make use of a loss carry-forward? Those who answer in the negative must confess that it does, after all, depend on which "specific circumstances" a certain taxpayer finds himself in. One would then, however, also have to answer the question as to the "specific circumstances" that are relevant. In respect of provisions that differentiate between unlimited and limited tax liability, between non-profit and for-profit entities, between start-ups and other companies, or between sectors, does it make a difference to which group the taxpayer belongs? Those who want to avoid this discussion by denying the finality of losses merely because there are taxpayers who could use the losses, will be confronted with the unsatisfactory result that the granting of the loss carry-forward to a single taxpayer by the tax law of the source state – for instance, to the state itself in respect of its commercial activities – will deprive all other taxpayers of the possibility to deduct losses.

Resorting to the legislation, however, is also problematic for another reason: both in *Krankenheim Ruhesitz am Wannsee* and in *K*, the ECJ made a distinction between the "particularities" of the provisions governing the use of losses and evidently other, undesignated provisions.[45]

In *Krankenheim Ruhesitz am Wannsee*, the "particularity" of the legal situation in the source state was that the provisions ruling out the use of losses were even suspected of violating the basic freedoms. The ECJ, which was prevented on procedural grounds from addressing the violation of basic freedoms in the other state in this case (which was pending in the residence state), could not be blamed for being restrained and not obliging the residence state to take the losses into consideration. In *K*, however, the Court saw it as a "particularity" that the French legal system does not allow real estate losses to be taken into account at all. Neither the decision in *Krankenheim Ruhesitz am Wannsee* nor that in *K* provide any clues as to what a provision must look like in order not to be considered a "particularity". When even a general provision ruling out the offsetting of losses is to be considered a "particularity", it seems that few provisions exist that should not be regarded as a "particularity". If, however, the ECJ, by distinguishing between "particularities" and other rules, requires a certain minimum standard for taking losses into account, the completely diverging provisions in the Member States make it almost impossible to establish criteria based on which such a standard can be defined.

3.3. The tightening of the *Marks & Spencer* criteria in the light of changed justifications

The ECJ gave its decision in *Marks & Spencer* in a period during which other lines of case law in the field of taxation were also given, at least, a new emphasis.[46] Up to that time, the ECJ had almost always approved the comparability of domestic and foreign constellations in tax cases and accepted justifications for a differential treatment only in exceptional cases. Therefore, the proportionality assessment had hardly played a role. In some decisions given shortly before and after *Marks & Spencer*, the ECJ had become more reluctant to accept the comparability and to be more permissive towards justifications.[47] The *Marks & Spencer* decision fits into this mould:[48] although the ECJ approved the comparability of domestic and foreign situations, it then considered this distinction justified. In doing so, the Court used justifications that did not play any part in its earlier case law or that it even had rejected.[49] It explained the new line of case law by arguing that not a single one of these justifications would have sufficed to support this distinction and, as such, it was essential to look at three justifications "taken together". It thus attempted to avoid an open contradiction to its previous case law.

Soon afterwards, however, the discrepancy in relation to previous case law became obvious: in *Oy AA* and in *Lidl Belgium*, the ECJ held that three justifications are not

45. *See Krankenheim* (C-157/07), para. 49 and *K* (C-322/11), para. 79.

46. *See* Lang, *supra* n. 6, p. 421 et seq. *See also* M. Lang, *Eine Wende in der Rechtsprechung des EuGH zu den direkten Steuern?*, in *Aktuelle Entwicklungsaspekte der Unternehmensbesteuerung, Festschrift für Wilhelm H. Wacker* p. 365 et seq. (M. Hebig, K. Kaiser, K.-D. Koschmieder & M. Oblau eds., Erich Schmidt 2006).

47. Detailed Lang, *supra* n. 6, pp. 421 and 422. *See also*, Lang, *Eine Wende in der Rechtsprechung des EuGH zu den direkten Steuern?*, *supra* n. 46.

48. *Marks & Spencer* (C-446/03), paras. 33 and 51.

49. For a critical approach, *see* Lang, *supra* n. 4, at p. 58 et seq.

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strictly required in order to justify a different treatment of a foreign situation in loss cases or similar constellations:[50] two out of these three would suffice. In *Lidl Belgium*, the key word was the symmetry that would be established through the equal treatment of profits and losses.[51] The same consideration was also pivotal in *Krankenheim Ruhesitz am Wannsee*.[52] The justification used here by the ECJ did not reflect the three that were considered critical in *Marks & Spencer*, but relied on the idea of coherence instead. As a result, not even a combination of two justifications is necessary to justify a distinction. Instead, it suffices to invoke one justification, coherence. So, in less than three years after *Marks & Spencer*, the ECJ had returned to a single justification.

The coherence justification had played a role in *Bachmann* (Case C-204/90) at the time[53] but was interpreted so narrowly in each successive case over decades that it essentially had become irrelevant. It was not until *Manninen* (Case C-319/02) that the term was stretched again, breathing new life into it.[54] In this respect, it is not surprising that the ECJ later invoked coherence again – i.e. in *Krankenheim Ruhesitz am Wannsee*.[55] Having said this, many years before – in *Wielockx* (Case C-80/94)[56] – the ECJ had not accepted a distinction because the Member State relinquished its own coherence with the conclusion of a tax treaty. Therefore, the Member State was considered unable to invoke this justification for refusing to allow the deduction. Had the ECJ followed the same approach in *Krankenheim Ruhesitz am Wannsee*, it would have had to reject this justification because, with the conclusion of a tax treaty, the residence state gave up the otherwise existing coherence – that is, the taxation of foreign profits and the deduction of foreign losses. The present case law, which regards coherence as established by the conclusion of a tax treaty, is diametrically opposed to this earlier case law. At least since the decision in *Krankenheim Ruhesitz am Wannsee*, it has become evident that the ECJ has actually changed its case law and has only concealed this shift with the – superficially – new line of justification adopted in *Marks & Spencer*.

This shift, however, did not take place overnight but over a long period. This also explains why it is not easy to reconcile decisions like *Marks & Spencer* and *Lidl Belgium*, on the one hand, with *Krankenheim Ruhesitz*, on the other. The symmetry concept very clearly expressed by the ECJ for the first time in *Krankenheim Ruhesitz am Wannsee* is based on the equal treatment of foreign profits and foreign losses: those who do not tax foreign profits also do not need to allow foreign losses to be deducted. Consequently, however, this would also have to apply to final losses – whatever their definition may be. A case law thought through to the end, referring to the symmetry argument, has no use for the consideration of final losses as still required by *Marks & Spencer*. It is precisely this contradiction that afflicts the justification put forward in *Krankenheim Ruhesitz am Wannsee* and those in more recent decisions like *K*. Ultimately, the ECJ attempts to achieve a breakthrough in respect of the symmetry approach without formally breaking with *Marks & Spencer* altogether. Therefore, it tries to find arguments explaining why, in a specific case, the losses are not final, and is willing to accept that these arguments are weak or absolutely unconvincing.

3.4. The proportionality assessment and the most moderate means

The criteria developed by the ECJ in *Marks & Spencer*, however, also raise other fundamental questions: they are the result of the application of basic freedoms and depend, in particular, on the choice of the comparison pair and the justifications. It was the acceptance of comparable situations and justifications that opened the way for the proportionality assessment, in which the ECJ then defined the criteria according to which – at least by virtue of the key decision in *Marks & Spencer* itself – the residence state of the parent company is obliged to deduct the losses suffered by the subsidiary abroad from its own assessment basis.

Therefore, it was at first essential that the ECJ accept the comparability of the UK parent companies with a domestic subsidiary, on the one hand, and foreign subsidiary, on the other. This comparison pair was not the only possibility: in his Opinion, Advocate General Maduro had considered a comparison between a UK company with a foreign PE and a UK company with a foreign subsidiary, only to reject it again after a thorough analysis.[57] Subsequently, the ECJ did not even address this comparison pair.

A comparison, however, between subsidiary and PE would have been absolutely worth considering, particularly since the ECJ frequently – to this day – makes it clear that it is also willing to regard two cross-border situations as comparable.[58] The horizontal comparability assessment has not yet acquired practical significance in the case law because the ECJ either combines horizontal and vertical comparison pair assessments or justifies why two cross-border situations are not comparable after all in a specific case. It is, however, precisely this assessment in individual cases that reveals that the ECJ does not universally rule out a horizontal comparability assessment.[59]

Had the ECJ further pursued the horizontal comparability assessment, the proportionality assessment would probably have been different as well. Especially in respect of the credit method – quite common in UK tax treaties – losses in foreign PEs are first taken into account and thus

50. *Oy AA* (C-231/05), para. 60 and *Lidl Belgium* (C-414/06), paras. 40-42.
51. *Lidl Belgium* (C-414/06), para. 33.
52. *Krankenheim* (C-157/07), para. 43.
53. BE: ECJ, 28 Jan. 1992, Case C-204/90, *Hanns-Martin Bachmann v. Belgian State*, para. 28, ECJ Case Law IBFD. *See also* Lang, *supra* n. 6, p. 424.
54. FI: ECJ, 7 Sept. 2004, Case C-319/02, *Manninen*, ECJ Case Law IBFD. *See also* Lang, *supra* n. 6, at p. 425.
55. *Krankenheim* (C-157/07), para. 43.
56. NL: ECJ, 11 Aug. 1995, Case C-80/94, *G.H.E.J. Wielockx v. Inspecteur der Directe Belastingen*, paras. 23-25, ECJ Case Law IBFD.
57. UK: Opinion of Advocate General Maduro, 7 Apr. 2005, Case C-446/03, *Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes)*, para. 42 et seq., ECJ Case Law IBFD. *See also*, Lang, *supra* n. 6, at p. 422; Lang, *supra* n. 4, at p. 55 et seq.; and Lang, *supra* n. 4 (SWI), at p. 4.
58. *See* M. Lang, *Jüngste Tendenzen zur "horizontalen" Vergleichsbarkeitsprüfung in der steuerlichen Rechtsprechung des EuGH zu den Grundfreiheiten*, SWI, p. 154 et seq. (2011).
59. Id., p. 154 et seq.

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deducted from the domestic assessment basis. The single use of these losses is ensured and, as a rule, double use is avoided by recapturing the loss deduction in the event of future profits of the foreign PE in the state of residence. This is in line with the spirit of the credit method. If the foreign PE were seen to be comparable with the subsidiary, it would seem natural to apply this method to losses of foreign subsidiaries. If profits were earned in later years, the loss deduction would be recaptured. If there are no profits, there would be no recapture and the deduction of losses would remain in place.

The ECJ did have ample opportunity to consider the comparison with the foreign PE as falling within the scope of the credit method, yet failed to do so: in *Lidl Belgium*, as well as in *Krankenhaus Ruhesitz am Wannsee*, where the ECJ had to decide on cases involving PEs exempted under tax treaty law,[60] this comparison pairing would suggest itself more than in the *Marks & Spencer* case. After all, in this case, the comparison between two foreign PEs – using the exemption method in one case and the credit method in the other – was almost imperative. In *X Holding*, the ECJ considered – as part of the proportionality assessment – regarding the foreign PE and subsidiary as comparable, only to ultimately reject the notion.[61]

Had the ECJ opted for this approach in *Marks & Spencer*, taking the losses into account such that foreign losses were immediately deducted and recaptured in the event of later profits, many of the problems addressed herein would not have emerged at all. The provisions of the foreign tax legislation would not have been, in any way, relevant, since foreign losses, just like foreign profits, would have to be calculated according to the laws of the residence state of the parent company, just as the state of the head office of a foreign PE determines its losses and profits according to its own tax laws for the purposes of the credit method. The fact that this provision – against the background of the desirable objectives of the single use of losses and the avoidance of double use of losses – would have been the most moderate means from the taxpayer's perspective, made this course impracticable at least from a political point of view. The *Marks & Spencer* decision must be seen in the context of an – albeit not dramatic – unmistakable reversal of trend by the ECJ, as of 2005, towards a greater understanding of the fiscal interests of the Member States and the creation of the necessary space for this in its lines of reasoning.[62] This trend has remained in place, something especially reflected in the fact that the ECJ almost completely removed the remaining scope of application from the requirements it itself developed, based on which foreign losses must be taken into account.

4. Conclusions

The *Marks & Spencer* line of case law is not over yet, but is in its final stages. There are at least two different reasons for this: in the ten years since the eponymous key decision, the ECJ has further tightened the criteria according to which it is admissible to take losses into account. Today, one may justifiably pose the question whether these criteria still have any scope at all. The ECJ, however, has glossed over these inconsistencies in its case law and has failed to lift the lid on them. It comes as no surprise that, in the course of time, and in view of an ever-increasing number of decisions, these contradictions are becoming more and more obvious. In addition, however, case law that a priori aims to regard the legal situation in another state as relevant for taxation in the state of residence, is doomed to be contradictory. The significantly older *Schumacker* case law, which, in its cross-jurisdictional approach, also aims to take certain deductions into account once but rules out their double use, and which led to extremely questionable decisions and contradictory justifications, should have been a lesson for the ECJ.[63] Those who deny the lack of harmonization in tax law systems and act as if the loss is one and the same, which would have to be taken into account here or there, cannot reach any convincing solutions. Harmonization cannot be achieved through case law.

The *Marks & Spencer* line of case law has failed. If the ECJ does not want to change anything, or as little as possible, about the guidelines it developed, it would be best to admit this and generally not allow for foreign losses to be taken into account, citing symmetry considerations. This would seem logical, since the ECJ has recently almost completely deprived the criteria that it developed at the time of their significance. It would be honest to admit this and also to formally abandon the case law. Such a step would significantly contribute to greater legal certainty. It would remove, once and for all, any remaining doubt as to whether there is still room for the deduction of foreign losses in very exceptional situations.

Though unrealistic from a political perspective, it would be worth considering a return to the deliberations of Advocate General Maduro, expressed in his Opinion in *Marks & Spencer*, and to seriously contemplate the comparison of the foreign company and the tax treaty-exempted foreign PE with the foreign PE falling within the scope of the credit method. The possibility of deducting foreign losses with a recapture in the event of profits would constitute a balanced concept, which, in view of the consideration of their fiscal interests, would not be met with enthusiasm from the governments of the Member States that have been spoiled by the ECJ in recent years.

A concept that is even more politically unrealistic – but which the author finds most convincing – would be for the ECJ to return to its case law prior to 2005 and to also stand back from its symmetry considerations. From a legal point of view, these considerations were never convincing and this is also why the ECJ did not deal closer with them

60. *Lidl Belgium* (C-414/06), para. 11 and *Krankenheim* (C-157/07), para. 22.
61. *X Holding* (C-337/08), para. 40.
62. Lang, *supra* n. 6, p. 430. *See also* N. Herzig & T. Wagner, *EuGH-Urteil Marks & Spencer – Grenzüberschreitende Verlustverrechnung in der Gruppe*, Der Konzern, p. 180 (2006), 180; J. Hey, *Die EuGH Entscheidung in der Rechtssache Marks & Spencer und die Zukunft der deutschen Organschaft*, GmbH Rundschau p. 113 (2006); Lang, *supra* n. 4 (SWI), at pp. 11-12; and Lang, *supra* n. 4, at pp. 66-67.
63. *See* M. Lang, *Ist die Schumacker Rechtsprechung am Ende?*, RIW, p. 336 at p. 343 et seq. (2005).

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in its earlier case law. Those whose foreign *losses* cannot be deducted pay the price of the foreign *profitsof another taxpayer* remaining untaxed. It was not without reason that the ECJ initially interpreted coherence so narrowly that coherent treatment must also be reflected in the same individual to be legally relevant. At first glance, case law that would force Member States to take into account foreign losses and accept the double use of losses at home and abroad in situations in which domestic losses are deducted, would not only be provocative from a fiscal point of view but would seemingly represent a severe infringement of the legislative jurisdiction of the national legislator. Upon closer scrutiny, however, the contrary proves to be true. The fact that the ECJ does not consider double taxation per se as a violation of the fundamental freedoms should alone prompt the Court to also regard the possibility of the double use of losses in a relaxed manner. Above all, the current case law results in the ECJ exerting considerable influence over the legislative jurisdiction of the Member States. After all, the Court itself has developed the system for taking losses into account and leaves little room for Member States to derogate therefrom. Effectively, today, the ECJ is thus behaving like a legislator. If, in contrast, the ECJ were to allow for the double deduction of losses, this would simply prompt the Member States to act. The ECJ could prevent short-term revenue losses by the Member States by using its competence to limit the temporal effects of its own decisions and to rule out the deduction of losses at least for cases that already lie in the past.[64] In the medium and long term, however, the national governments will not accept the loss of tax revenue caused by a possible double deduction. The Member States, acting through the Council, would then come under pressure. They would then have to agree on rules jointly developed by them regarding an assessment basis and implement them as part of secondary law. In view of budgetary necessity, they would likely succeed. The considerations developed in the course of the CCCTB preparations by experts from governments of all Member States could prove useful in this respect.[65] Just as we know from a national context that the seemingly more radical action of a constitutional court often better serves the principle of the separation of powers, since it forces the legislator to act,[66] a prima facie far-reaching decision of the ECJ may ultimately be the more cautious method of complying with the separation of powers.

64. *See* M. Lang, *Die Beschränkung der zeitlichen Wirkung von EuGH-Urteilen im Lichte des Urteils Meilicke*, IStR p. 235 et seq. (2007).
65. *Seesupra* n. 40; *see also* S. Gonzalez & J. Diaz-Palacios, *The Common Consolidated Corporate Tax Base: Treatment of Losses*, in *Common Consolidated Corporate Tax Base* p. 441 et seq. (M. Lang, P. Pistone, J. Schuch & C. Staringer eds., Linde 2008); and W. Schön, *Perspektiven der Konzernbesteuerung*, in *A common consolidated corporate tax base for Europe* p. 49 at p. 57 et seq. (W. Schön, U. Schreiber & C. Spengel eds., Springer 2008).
66. *See* M. Lang, *Der Sitz der Rechtswidrigkeit* in *Das verfassungsrechtliche Verfahren in Steuersachen* p. 269 at p. 295 (M. Holoubek & M. Lang eds., Linde 2010).

BOOK

ECJ Direct Tax Compass 2014

The ECJ Direct Tax Compass is a collection of summaries of the 244 most significant judgments of the Court of Justice of the European Union – rendered up to 31 January 2014 – which are relevant for EU direct taxation. With its useful search features and valuable content, the booklet serves as a reliable guide through the thicket of ECJ case law on direct taxation.

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