Administrative court of appeal judgment on the use of tax losses carried forward

On 25 April 2024, the Luxembourg administrative court of appeal (the Administrative Court" or "the Court) *(Cour administrative, 25 avril 2024, n°49336C)* issued a judgment to deny a corporate taxpayer (the taxpayer, the claimant or the appellant) the use of its tax losses carried forward. As its shares (therefore its stock of tax losses) were transferred to new shareholders under circumstances that the Administrative Court previously ruled in 2016 as abusive[1], the Court's position remained the same regarding their use, even though the circumstances considered as abusive in 2016 had subsequently ceased.

This 25 April 2024 judgment is particularly significant compared to another judgment that the Administrative Court rendered on the same day *(Cour administrative, 25 avril 2024, n°48917C),* in which the Court seemingly made an opposite decision.

Considered together, these two judgments help clarifying the subtle balance the Administrative Court strikes between two principles that seem antagonistic at first glance: the taxpayer's right to choose the least taxed path (*choix de la voie la moins imposée*) on the one hand, and the concept of abuse of law on the other.

Case summary

In the case under review, the taxpayer challenged tax assessments issued in financial year 2017 regarding financial years 2014 and 2015. In its administrative claim addressed to the director of the Luxembourg direct tax authorities, the taxpayer requested to be allowed to use tax losses incurred between 1992 and 2005 to offset profits realized during the litigious fiscal years of 2014 and 2015. To fully appreciate this case and the positions held by its parties, it is worth mentioning the taxpayer had previously filed two claims, respectively in 2011 and 2012, regarding the same matter[2]. After the director's refusal, those claims escalated to the point where the Administrative Court had to intervene in 2016. In this initial case, the Administrative Court[3] ruled that the tax losses incurred between 1992 and 2005 could not be used to offset profits generated in financial years 2009 and 2010.

The Court justified its judgment by the fact the taxpayer's shares had been abusively sold to a third-party group when the taxpayer was dormant. From the Court's perspective, this transaction had taken place solely to offset the appellant's tax losses carried forward against profits deriving from post-acquisition intra-group transactions, either with its new shareholder or affiliated companies. The Administrative Court highlighted that the group that acquired the appellant company was totally unrelated to it when the company had suffered those tax losses.

In the second claim of 25 April 2024, the appellant attempted to prove it was now carrying out a genuine activity. On this basis, it sustained that the circumstances were substantially different from those of the former abusive situation and, therefore, the losses it previously incurred should now be deductible again.

As its administrative claim went unanswered, the taxpayer further referred it to the Luxembourg administrative court of first instance (**the Administrative Tribunal**), which rejected it on 13 July 2023.[4]

Subsequently, the taxpayer lodged an appeal to the Administrative Court.

The Court's decision

In its 25 April 2024 judgment (n°49336C), the Administrative Court clarified the decision it had previously rendered in 2016.[5] The Court recalled that a group had acquired the appellant company in 2007. At that time, the appellant company was a shell company, having not carried out any business activity since 1995. However, it had accumulated a significant amount of losses carried forward before the acquisition.

In this initial 2016 decision, the Administrative Court had concluded that the losses of the acquired entity should not be used to offset income generated at its level by intra-group transactions entered into after the acquisition, considering that:
1. As per article 114, paragraph 2, n°3 of the Luxembourg Income Tax Law (LITL), only the entity that has actually incurred the losses may deduct them.
2. In addition, the acquisition of the company with tax losses carried forward was considered abusive based on the §6 Steueranpassungsgesetz (**StAnpG**)[6]. According to the Court, this acquisition was performed solely to circumvent the aforementioned requirement and enabled the taxpayer's new shareholder and other affiliated entities to indirectly benefit from the acquired company's losses carried forward. As per its analysis, such losses were meant to offset profits generated by new intra-group transactions implemented post-acquisition, while the corresponding expenses would be deductible at their level.

Therefore, for the Court, this situation should be considered abusive from a direct tax perspective, and the deductibility of the losses the taxpayer had at that time should be denied.

The main issue debated between the taxpayer and the Luxembourg direct tax authorities (comforted in their views by the Administrative Tribunal) was the impact of the Administrative Court's 2016 judgment. The tax authorities viewed those tax losses as forfeited irremediably. In contrast, the taxpayer argued that these tax losses were "frozen" until the disputed situation became non-abusive; therefore, potentially available to offset taxable profits in years 2014 and 2015, provided the abusive situation had stopped.

Unsurprisingly, the Administrative Court concluded that the existence of an abuse of law implies that the tax losses carried forward resulting from the abusive situation or transaction are irreversibly unusable and not just temporarily "frozen" until the abusive situation ends. For the judges, and contrary to the taxpayer's argument, it does not matter that the company with the claimed tax losses carried forward is operating a business again (and is no longer a dormant or shell company) even though this new business is unrelated to the activities performed by the other group entities that had acquired the company.

The appeal was rejected on this basis, and the challenged tax assessments ultimately confirmed.

Decision context

The April 2024 decision (n°49336C) was rendered on the same day as another (*Cour administrative, 25 avril 2024, n° 48917C*) in which the question of whether the use of losses carried forward could constitute an abuse of law was also raised.
- In this second case,[7] the company had incurred significant losses before ceasing its holding activity and becoming dormant for several years. These losses were then deducted from the substantial gain derived from acquiring and subsequently selling real estate.
- The Luxembourg direct tax authorities challenged these tax losses' deductibility, arguing that the company had remained dormant and that the real estate activity was lodged in this company solely to offset these losses against future profits.
- The issue was not the sale of the company that incurred the losses to another company belonging to the same group. Instead, the entity in question had started carrying out a completely different activity years later with - according to the Luxembourg direct tax authorities - the sole purpose of putting those losses to use.
- Based on parliamentary documents regarding article 114 LITL, the Court also reaffirmed that the tax losses carried forward must be understood as a whole. An identity is not required between the economic activity that generated the tax losses and the economic activity that generates the profits against which the taxpayer intends to offset the tax losses.
- In addition, diverging from the Administrative Tribunal's previous position, the Administrative Court specified that the transaction's unusual nature alone should not establish the existence of an abuse of law, although it may be an indicator. In the case at stake, proof of the cumulative conditions for establishing an abuse of law was not provided. Therefore, the Court concluded that the situation was within the limits of the taxpayer's freedom to choose the least taxed path.

The comparison of the two cases is interesting — case n°49336C led to an abuse of law being recognized, while in case n°48917C, the same Administrative Court did not conclude in the existence of an abuse of law. It is even more interesting to compare the Administrative Court's initial judgment issued in 2016 (n°35978C) with its judgment in case n°48917C.

The freedom of management principle (*liberté de gestion*) is a broad concept which includes, inter alia, the idea that, in the conduct of their affairs, taxpayers must be free to choose the path that seems most suitable to them and, in particular, to opt for the least taxed path.[8] For example, taxpayers can freely choose to form a capital company or to carry out their commercial activity in individual form.[9]

In 1963, in a still-prominent judgment, the Council of State recognized the existence of the freedom of management principle and its corollary the freedom to opt for the least taxed path.[10] However, the Council of State also set several limits on this basic rule, the origin of which can be found in the tax adaptation law of 16 October 1934 (StAnpG) and in the legal concepts of abuse of law and simulation.[11]

Considering their similarities but different outcomes, case n°35978C/n°49336C and case n°48917C illustrate that the abuse of law concept in tax matters is quite complex, as its recognition depends entirely on the circumstances. Notably, in both instances, there was a delayed use of losses after the companies that incurred them were inactive for several years, i.e., both companies were "dormant" at some point. However, in case n°35978C/n°49336C, the company that suffered the tax losses had been acquired/transferred to a third party group, and the taxpayer together with other members of its new group of companies had seemingly performed some structuring to locate profit in this company via new intra-group transactions — leading to the recognition of an abuse of law.

Whereas in case n°48917C, the company undisputedly changed activity (from holding participations to holding real estate), but its shares were not transferred, no other structuring appeared to have been made, and the company simply acquired and sold a real estate property to two different third parties. This led to the Administrative Court concluding on an absence of abuse of law and confirming the taxpayer's freedom to opt for the least taxed path.[12]

Put side-by-side, these two cases demonstrate once again that the courts systematically rule on a case-by-case basis when it comes to abuse of law, and reason in light of the tax mechanism's purpose at stake. As the Administrative Court outlined, carrying forward losses should not be considered as a favorable measure for taxpayers. Instead, it is a corrective measure deriving from the so-called principle of annuality of taxation (*principe de l'annualité de l'impôt*), aiming to reflect the taxpayer's actual ability to contribute over a period exceeding a single tax year.

Given this matter's complexity, we strongly recommend consulting tax professionals on the potential implications of any transactions involving tax losses.

Emilien LEBAS,
Partner, International Tax, Tax controversy & dispute resolution leader

Valentine PLATEAU,
Assistant Manager, International Tax,

KPMG Luxembourg

1) Administrative Court, 16 February 2016, n°35978C.
2) To challenge tax assessments issued with respect to the fiscal years 2009 and 2010 respectively.
3) Administrative Court, 16 February 2016, n°35978C.
4) Administrative Tribunal, 13 July 2023, n°46446.
5) Administrative Court, 16 February 2016, n°35978C.
6) *Steueranpassungsgesetz*, 16 October 1934, *Mém. A / J.O.G.D.L.* n° 901 dated 2 January 1934, p. 9001.
7) Administrative Court, 25 April 2024, n° 48917C.
8) A. Steichen, "Un janus du droit fiscal : le choix de la voie la moins imposée," *Droit bancaire et financier au Luxembourg. 10e anniversaire de l'Association luxembourgeoise des juristes de banques*, Larcier, 1994, pp. 403 and s.
9) J. Schaffner, *Droit fiscal international*, 3e éd., Luxembourg et Bruxelles, Promoculture et Larcier, 2014, n° 699, pp. 983 and s.
10) CE, 9 January 1963, n° 5677 du rôle, Société anonyme Hélios et société d'exploitation des établissements Hélios, Pierre Dierkum & Cie, SCS.
11) For additional details concerning the notions of abuse of law and freedom to choose the least taxed path, see in particular E. LEBAS, La gestion fiscale des entreprises et ses limites, Collection l'entreprise et l'impôt sous la direction d'A. STEICHEN, Legitech, 21 December 2021.
12) The least taxed path consisted of this taxpayer using a dormant existing company that ceased its activities but had tax losses carried forward to shelter a new real estate activity, rather than using another company — existing or newly incorporated — or to exercise the activity in question under its own name as an individual.