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AG Opinions on cross-border loss relief

Sweden - Cross-Border Loss Relief – Final Losses – 'Marks & Spencer Exception' - Freedom of Establishment – Merger Directive - Balanced Allocation of Taxing Rights

On January 10, 2019, Advocate General (AG) Kokott of the Court of Justice of the European Union (CJEU) rendered Opinions in the Memira (C-607/17) and in the Holmen (C-608/17) cases. Both cases concerned the compatibility with EU law of the Swedish rules on the deductibility of losses from foreign subsidiaries, and the extent to which the 'Marks & Spencer exception' applies, i.e. losses are considered final. The AG concluded that in the cases under review, losses cannot be considered as final.

Background

In both cases, a Swedish parent company used the 'Marks & Spencer exception' as the basis for deducting from its taxable base in Sweden, the losses incurred at the level of its foreign subsidiary. In the Memira case, the Swedish Revenue Law Commission held that losses incurred by a German subsidiary cannot be considered as final upon the merger of the latter with its Swedish parent company, as carrying over losses to another company under similar circumstances is not possible under German law either. In the Holmen case, the Swedish Revenue Law Commission's conclusions depended on the scenarios envisaged for the liquidation of the Spanish loss-making subsidiary of the group. Under Swedish law, a parent company may, under certain conditions, deduct in Sweden definitive losses incurred by a wholly and directly-owned foreign subsidiary. In the case at hand, the Spanish loss-making subsidiary was held through an intermediate Spanish resident company with which it formed a tax consolidated group. According to the Swedish Revenue Law Commission, a liquidation of the sub-subsidiary could not result in the recognition of final losses at the level of the intermediate company, as this was not possible in Spain (upon dissolution of a tax group, unused losses are allocated back to the companies that incurred them). However, if the intermediate company is first absorbed by the sub-subsidiary, part of the losses of the latter may be considered as definitive and incurred by a directly wholly-owned subsidiary.

Both taxpayers appealed the Swedish Revenue Law Commission's findings before the Swedish Supreme Tax Court, which in December 2017 requested the CJEU to clarify under which circumstances a loss can be considered as final under the 'Marks & Spencer exception'.

The AG Opinion

The AG first notes that in both cases a restriction to the freedom of establishment exists, as Swedish law allows full loss relief between Swedish group companies, whereas deductibility of losses incurred by a non-resident subsidiary is limited by certain conditions. She further notes that based on settled case law, both resident and non-resident loss-making subsidiaries are in a comparable situation.

She then addresses whether such a restriction is justified by overriding reasons of public interest. As regards the avoidance of the double use of losses, she underlines that the risk seems non-existent or limited, and if applicable, it would then be for the Swedish Court to determine whether the losses of the foreign subsidiary are in fact final and could therefore be used twice. With respect to the need to ensure a balanced allocation of taxing rights between Member States, the AG observes that allowing the transnational use of a subsidiary's losses incurred over the years would undermine the fiscal autonomy of the Member States involved. She further notes that in the cases at hand, the 'Marks & Spencer exception' does not apply, as the condition of losses which are usable in law, but not in fact, is not satisfied. In that respect, the AG interprets the CJEU's finality requirement (i.e. all avenues for taking the losses into account have been exhausted) as also covering losses being transferred to a third party by way of a sale. She concludes that if the taxpayer has the possibility to sell the subsidiary (and therefore transfer the losses) rather than liquidate or merge it, such losses cannot be final. Finally, the AG rejects the applicability of the ability-to-pay principle, as developed by the CJEU in the recent Bevola decision (C650/16), to the cases at hand and further concludes that cross-border loss relief may threaten an EU 'fair internal market'.

The AG consequently concludes that the losses cannot be considered as final, although she recognizes that in both cases no activities remain in Germany or Spain respectively after the liquidation of the loss-making subsidiary there. As regards the Memira case, this results from the combined facts that carrying over losses to another company by way of a merger is not possible under German law and that the parent company did not choose to transfer losses to a third party by way of selling its subsidiary, although this was legally possible under German law. She further adds in the Holmen case that losses incurred by an indirectly owned subsidiary cannot in principle be considered as final losses at the level of the ultimate parent company. The AG therefore seems to imply that the 'Marks & Spencer exception' can never be used in practice.

EU Tax Centre comment

In her Opinion, the AG adopts a very restrictive interpretation of the 'Marks & Spencer exception' and seems to suggest from the outset that the CJEU should consider abandoning it altogether. It remains to be seen whether the CJEU will follow the AG's Opinion in this respect or provide additional insight on what should be considered as final losses. However, it should be noted that although AG Kokott had already adopted a similar position in several Opinions, the CJEU has not always followed her and has consistently upheld the 'Marks & Spencer exception in the past.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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