CJEU decision 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 June 19, 2019, the Court of Justice of the European Union (CJEU) rendered its decision 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 CJEU generally upheld the "Marks and Spencer exception" but further limited its applicability. In particular, the CJEU clarified that the losses of sub-subsidiaries may be considered final only if the intermediate parent companies are situated in the same Member States as the sub-subsidiary. The CJEU further concluded that the losses would not be characterized as final before the completion of the subsidiary's liquidation if there is a possibility to transfer them to a third party. In that respect, the existence of certain local provisions restricting the transfer of losses in the subsidiary's Member State is irrelevant.

Background

In both cases, a Swedish parent company used the 'Marks & Spencer exception' to argue in favor of the deduction from its taxable base in Sweden of 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 group's Spanish loss-making subsidiary. 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 consolidated tax 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'. In this case, the CJEU had concluded that losses can be deducted in the parent company's Member State if (1) the EU subsidiary has exhausted the possibilities available in its state of residence for offsetting the losses in the current accounting period and also for previous accounting periods (i.e., it cannot transfer those losses or carry back the losses against profits made by the subsidiary in previous periods), and (2) there is no possibility for the EU 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 CJEU decision

In the Holmen case, the CJEU first analyzed whether the Swedish parent company has to directly own its Spanish subsidiary in order to have the right to deduct final losses. The CJEU ruled that in the context of final losses of a non-resident subsidiary, direct ownership is generally a requirement. The CJEU explains that the direct ownership requirement aims to prevent the double use of losses and the "cherry picking" of Member States in which to apply the losses. However, the CJEU acknowledges that while the direct ownership requirement is justified in principle, it is disproportionate for Sweden to preclude the possibility for the parent company to take into account the final losses of a non-resident subsidiary if the intermediary subsidiaries between the Swedish parent and Spanish sub-subsidiary are all established in the same Member States (in this case, Spain). In the Holmen case the intermediate subsidiary was in the same Member State.

The CJEU goes on to analyze in both the Memira and Holmen cases whether the fact that a subsidiary's Member State does not allow the transfer of losses in the event of a merger (Memira) or liquidation (Holmen), can in itself be sufficient to regard the losses of the subsidiary as being final. The CJEU concluded that for the purposes of the assessment of finality of the losses of a non-resident subsidiary, the fact that the subsidiary's Member State does not allow the losses of one company to be transferred in the event of a merger or a liquidation to another company is not decisive in determining the finality of the losses. Thus, whether or not there are entities in the jurisdiction of the loss-making subsidiary that could have had the losses of the subsidiary transferred to them via a merger (Memira) or liquidation (Holmen) if such possibility had been afforded is irrelevant. The CJEU goes on to note that unless a parent company demonstrates that it is impossible for it to deduct losses by ensuring by means of sale that they are fiscally taken into account by a third party for future tax periods, the losses will not be considered final and cannot be deducted. Finally, the CJEU confirms in the Holmen case that restrictions on off-setting losses and loss carry-forwards in Spain are irrelevant in assessing whether the losses are considered final and can be deducted by the parent company.

EU Tax Centre comment

The CJEU shed some light on the applicability of the Marks & Spencer exception to sub-subsidiaries and clarified that certain restrictions in the local law of the subsidiary's Member State are not directly relevant to appreciate the finality requirement. However, in reiterating that losses should only be considered final to the extent that the parent company demonstrates that it is impossible to pass on those losses by means of sale to a third party, the CJEU failed to provide much needed clarity on how to assess this in practice.

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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