CONFEDERATION FISCALE EUROPEENNE

Opinion Statement of the CFE

on the decision of the European Court of Justice

of 6 September 2012

on the case C-18/11 *Philips Electronics*

and group relief

Prepared by the ECJ Task Force of the CFE

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This is an Opinion Statement prepared by the ECJ Task Force on the Philips Electronics case and group relief in the EU[1]*.*
The CFE is the leading European association of the tax profession with 32 national tax adviser organisations from 24 European countries representing over 180,000 tax advisers.
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1. This Opinion Statement considers the *Philips Electronics* case[2] and addresses the compatibility of the UK's group relief provisions with EU fundamental freedoms. The case was decided by the Fourth Chamber.

2. After setting out the facts of the case and the preliminary questions, this statement will consider what the Task Force considers to be crucial points of EU law arising from the decision, in particular the jurisprudence on the justification of the balanced allocation of taxing powers.

1. The facts and the preliminary questions

3. The rules considered in this case were a form of the UK's group relief rules known colloquially as the consortium relief rules. The consortium relief rules applied in situations where either one of the surrendering or claimant company is a member of a consortium and the other is either

a) a trading company owned by the consortium and is not a 75% subsidiary of any company or
b) a trading company which is a 90% subsidiary of a holding company owned by the consortium and which is not a 75% subsidiary of a company other than the holding company
c) a holding company owned by the consortium and is not a 75% subsidiary of any company.

4. The consortium relief rules provided for the surrender of losses within the group with some important limitations. In particular, under section 403D ICTA 1988, where the surrendering company is not resident in the UK, losses were not available for group relief unless the loss was attributable to activities of that company the income and gains from which for that period are brought into account in computing the company's chargeable profits for that period for corporation tax purposes (i.e. they fell within the charge to UK corporation tax), or where no part of the loss corresponds to an amount which is deductible or allowable against non UK profits for foreign tax (section 403D(1)(c) ICTA 1988).

5. The First-tier Tribunal described the operation of section 403D(1)(c) as "extremely strict" because "it prevents relief of any losses if

a) any part of the losses, however small, is deductible abroad,
b) in any period in the future, and
c) even if the losses are not allowed abroad because of a rule that prevents losses being allowed if they are deductible in the UK."

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[1] Members of the Task Force are: Axel Cordewener, Paul Farmer, Daniel Gutmann, Volker Heydt, Eric Kemmeren, Michael Lang, Franck Le Mentec, Pasquale Pistone, Albert Rädler†, Stella Raventos-Calvo (Chair), Isabelle Richelle, Friedrich Roedler and Kelly Stricklin-Coutinho. Although the Opinion Statement has been drafted by the ECJ Task Force, its content does not necessarily reflect the position of all members of the group.
[2] C-18/11 Philips Electronics.

It described the operation of section 406(2) ICTA 1988 as "limit[ing] the consortium claim by a group company to circumstances where the link companies could themselves have made consortium claims if they had taxable profits. Here the link companies […] being non-resident and not carrying on a business in the UK, could not make any consortium claim".

6. A UK resident company, Philips Electronics UK, was part of the Philips Group, which had its ultimate parent in the Netherlands. The Netherlands parent company entered into a joint venture with a South Korean group, LG Electronics. This joint venture had a Dutch subsidiary, which, in turn, had a branch (permanent establishment) in the UK. Philips Electronics UK sought to utilise the losses of the UK branch of the Netherlands company.

7. HMRC denied the claim on the basis that there was a possibility that the losses might be used in the Netherlands. Philips argued that this provision breached EU law.

8. The case was referred to the ECJ on the agreement of the parties after a decision of the First-tier Tribunal in favour of the taxpayer and an appeal by HMRC to the Upper Tribunal, which referred the matter to the ECJ.

9. The questions referred were:

a) Whether section 403D(1)(c) constituted a restriction on the freedom of establishment pursuant to Article 43 of the EC Treaty (now Article 49 of the Treaty on the Functioning of the European Union)
b) If so, was that restriction justified
c) If it was justified, was it proportionate
d) Whether EU law required the UK to provide Philips with a remedy, despite the company exercising its freedom of establishment being a Netherlands company.

2. The decision

10. The judgment of the ECJ was relatively straightforward. In respect of the first question, the ECJ held that section 403D(1)(c) ICTA 1988 constituted a restriction on the freedom of establishment. UK resident companies and UK branches of non-UK resident companies are taxed on a comparable base insofar as the deductibility of transfer of losses by group relief is concerned. However, a restriction on the freedom of establishment operated because UK branches of non-resident companies could not surrender losses which could be used outside the UK, where UK resident companies could.

11. As to the second question, the justifications of "overriding reasons in the public interest relating to the objective of preventing the double use of losses", the preservation of the balanced allocation of the power to tax or a combination of these, were considered.

12. In this regard, the Court first notes at paragraph 23, pursuant to *National Grid Indus*[3] that the preservation of the allocation of powers of taxation between Member States is a legitimate objective recognised by the Court.

13. It goes on to note at paragraph 24 that that objective (the preservation of the balanced allocation of powers of taxation) is designed to safeguard the symmetry between the right to tax profits and the right to deduct losses, citing *Lidl Belgium*[4].

14. It then seeks to make a distinction (in paragraphs 25 to 27). It notes that in the current proceedings the power of the host Member State to tax is not affected by the possibility of the use of losses sustained in its territory. To put it more simply: the profits which are taxed and the losses to be used all arise in one territory, so there is no allocation of taxing powers to be made, let alone a balance of competing powers to be found.

15. As to the double use of losses (paragraph 28), the ECJ simply finds that such a justification cannot be relied upon in the circumstances of this case because the risk that the loss may be used in both the UK and the Netherlands has no effect on whether the UK may tax the permanent establishment (paragraph 30).

16. Citing the previous paragraphs, the ECJ holds that a combination of justifications also fails to work.

17. In respect of the fourth question, the ECJ simply holds that provided a case is within the jurisdiction of a national court it must fully apply directly applicable EU law pursuant to Article 10 EC and that it is irrelevant that it is not the taxpayer whose freedom of establishment has been restricted, but rather the freedom of the non-resident with a permanent establishment in the UK. It goes on to conclude that the national court must not apply any provision of the national legislation which is contrary to Article 43 of the EC Treaty (now Article 49 of the Treaty on the Functioning of the European Union).

3. Comments

3.1 Balanced Allocation: Scope

18. The justification of the balanced allocation has been developing for a number of years. Given the increasing frequency with which this justification succeeds and the recent developments in the acceptability of the justification, the ECJ Task Force finds it important to make some comments on it.

19. Although it appeared before in *Marks & Spencer* its recent revival came from being cited with the double use of losses and preventing tax evasion in that case and subsequently in *Oy AA*[5] combined with the prevention of tax evasion.

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[3] Case C-371/10 National Grid Indus.
[4] C-414/06 Lidl Belgium [2008] ECR I-3601, paragraph 33.
[5] C-231/05 Oy AA.

20. More recently, as regards cross-border losses, the ECJ applied it on a stand-alone basis - e.g. in *Lidl Belgium*[6]. In *X Holding*[7] the ECJ applied it to disallow parent companies to choose freely the MS in which the losses of their non-resident subsidiaries were to be taken into account.

21. The United Kingdom invoked this justification in respect of losses in the Philips case. However, losses in this case originate from the United Kingdom and are attributable to a UK permanent establishment of a Dutch resident company. Therefore, in this context the only cross-border element arises as to the requirement of taking into account UK losses in the Netherlands, in the absence of which group relief could apply in the UK.

22. The ECJ has correctly rejected this justification in *Philips*. Just like in the ICI case[8], the UK taxable base is not affected at all in this case, since, under the UK group relief, UK losses are compensated in this case with UK profits and therefore the UK will not lose jurisdiction. What the UK is actually trying to do is to invoke this justification in order to gain tax jurisdiction, by requiring prior deduction of PE losses in the head office State despite the existence of group relief rules.

3.2 Preventing the double use of losses

23. The ECJ identifies the risk for a double deduction of losses in this case.
In the circumstances of the *Philips* case, where the country of origin of losses allows for their deduction within the group, such country cannot invoke the risk for them to be deducted also in a different Member State with a view to excluding their deduction. In *Thin Cap GLO*, ruling on the prevention of economic double taxation, the ECJ considered the flip side of a double dip that it is not up to the Member State in which the economic activity is carried on to prevent economic double taxation up to the arm´s length standard[9]. In *Lidl Belgium* there was an issue of double deduction of losses and the ECJ held that the head office was not obliged to set off the loss, since it was possible in the State of the economic activity to take such loss into account[10]. Furthermore, in *Block* the ECJ did not see a problem of (international juridical) double taxation, which could be considered the flipside of a double utilization of losses[11]. Therefore, one may hold on a general basis that the possibility of a double deduction of losses cannot justify the inconsistent treatment of PE losses in the PE State.

3.3 No bundling of balanced allocation and the double use of losses

24. Unlike in some previous judgments[12], the ECJ rejected here that two non-accepted justifications on a stand-alone basis could be a valid justification if bundled together. This is an indicator of the willingness of the ECJ to apply justifications only on a stand-alone basis, which is certainly more

[6] C-414/06 Lidl Belgium.
[7] C-337/08 X holding para.43.
[8] C-264/96 ICI plc v Kenneth Hall Colmer (Her Majesty's Inspector of Taxes).
[9] C-524/04 Test Claimants Thin Cap.
[10] C-414/06 Lidl Belgium GmbH & Co. KG v Finanzamt Heilbronn.
[11] C-67/08 Margarete Block v Finanzamt Kaufbeuren.
[12] Marks & Spencer, Rewe, Oy AA.

convincing and contributes to achieving more clarity as to the situations in which restrictions on fundamental freedoms can be justified.

4. The Statements

25. The *Confédération Fiscale Européenne* welcomes this judgment, since it contributes to clarifying its understanding of the scope of the justification based on the need to preserve a balanced allocation of taxing rights.

26. The *Confédération Fiscale Européenne* welcomes that the prevention of double deduction of losses was not accepted as a justification in this case.

27. The *Confédération Fiscale Européenne* also welcomes the rejection of bundling justifications together, since the application of stand-alone justifications is certainly more convincing and contributes to achieve greater clarity as to their respective scope. This seems to fit in a trend of departing from its previous case-law[13].

[13] Marks & Spencer, Rewe, Oy AA.