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Advocate General's Opinion in Case 446/03

Marks & Spencer plc v David Halsey (HM Inspector of Taxes)

ACCORDING TO ADVOCATE GENERAL POIARES MADURO A GROUP RELIEF SCHEME WHICH DOES NOT ALLOW A PARENT COMPANY TO DEDUCT THE LOSSES OF ITS SUBSIDIARIES ESTABLISHED ABROAD UNDER ANY CIRCUMSTANCES IS INCOMPATIBLE WITH COMMUNITY LAW

However, such a scheme would be compatible with the freedom of establishment if it made the right to deduct the losses of foreign subsidiaries subject to fulfilment of the condition that those losses cannot be accorded equivalent tax treatment in the Member States in which the foreign subsidiaries are established

The United Kingdom system of corporation tax provides for a special regime known as group relief, under which a company in a group may surrender its losses to another company in the same group so that the latter may deduct those losses from its taxable profits. The surrendering company loses any right to use the losses surrendered for tax purposes. Relief may be granted only if the surrendering company is resident or carries on trade in the United Kingdom.

Marks & Spencer plc ('M&S'), a United Kingdom company, is the principal trading company of a group specialising inter alia in the general retail of clothing and food. It has subsidiaries in Germany, Belgium and France. From the middle of the 1990s, those subsidiaries recorded losses. In 2001 M & S ceased trading on the Continent. M&S then sought group relief in respect of losses incurred by its subsidiaries from 1998 to 2001. Those claims were rejected by the Inspector of Taxes on the ground that the group relief scheme does not apply to subsidiaries which are neither resident nor economically active in the United Kingdom

M & S challenged that decision before the UK courts. The High Court of Justice, before which the case came on appeal, asked the Court of Justice of the European Communities whether the United Kingdom provisions were compatible with Community law, in particular with the principle of freedom of establishment.

Today Advocate General Miguel Poiares Maduro has delivered his Opinion in this case.

The Advocate General points out that the refusal of a tax advantage might be regarded as a restriction contrary to the Treaty if it was principally associated with the exercise of the right to establishment. In his view the application of the group relief scheme constitutes a tax advantage for a group of companies; a group whose parent company is resident in the UK wishing to establish subsidiaries in other Member States, is deprived of that advantage. The United Kingdom legislation therefore constitutes an 'exit restriction' which creats an obstacle such as to dissuade companies established in the UK from establishing subsidiaries in other Member States, and thus restricts freedom of establishment.

It must therefore be determined whether that restriction could be justified as a measure pursuing a legitimate objective justified on general-interest grounds.

First, the Advocate General rejects the German Government's argument that the taking into account of foreign losses by the State concerned could not be permitted because it would lead to a reduction in tax revenue, and thus to major budgetary difficulties for the Member State concerned.

Secondly, as regards justification under the territorial principle, Mr Poiares Maduro explains that that principle does not require that the conferral of a tax advantage be subject to a corresponding power of taxation. It is important merely to inquire whether the grant of that advantage is such as to compromise the enjoyment of sovereignty in tax matters by all the Member States. There is nothing to prevent the United Kingdom from extending the relief to parent companies with non-resident subsidiaries. The parent company resident in the United Kingdom is subject to unlimited fiscal obligations in that country. Accordingly, the principle of territoriality can not justify the current restriction.

Finally, the Advocate General states that the need to preserve the coherence of a tax system has to be verified in light of the aim pursued by the tax legislation in question. In other words, there has to be a direct connection between the grant of a fiscal advantage and the offsetting of that advantage by a specific charge to tax.

The Advocate General notes that the aim of the United Kingdom scheme of group relief was to ensure the fiscal neutrality of the effects of the creation of a group of companies. The scheme allows losses to be transferred but at the same time prohibits the surrendering company from using those same losses for tax purposes. If foreign subsidiaries are able to benefit both from the group relief scheme and at the same time from an analogous advantage in the State in which they were established, the consequent benefit might be a twofold taking into account of the losses in favour of the group, and thus a twofold advantage.

However, according to Mr Poiares Maduro, a general prohibition far exceeds what was necessary in order to protect the cohesion of a group system. It was appropriate for the Member State concerned to take account of the treatment applicable to losses of subsidiaries in the States in which they were respectively resident. Justification based on cohesion of the system of relief can be accepted only if the foreign losses could be accorded equivalent treatment in the State in which those losses arose.

Accordingly, the Advocate General proposes that the benefit of the relief should be subject to the condition that the losses of foreign subsidiaries can not receive advantageous tax treatment in the State in which they were resident. Where the State in which the foreign subsidiaries are

established enables those subsidiaries to impute their losses to another person, the Member States are entitled to oppose a claim for the cross-border transfer of those losses. Relief would then have to be sought in the State in which the subsidiary was established. Consequently, the companies would not be at liberty to choose the place of imputation of their losses; the Advocate General considers this circumstance likely to avert the risks of a 'trafficking in losses' at Community level.

IMPORTANT: The Advocate General's Opinion is not binding on the Court. It is the role of the Advocates General to propose to the Court, in complete independence, a legal solution to the cases for which they are responsible. The Judges of the Court of Justice are now beginning their deliberations in this case. Judgment will be given at a later date.

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