OPINION OF ADVOCATE GENERAL

KOKOTT

delivered on 19 April 2012 (1)

Case C-18/11

The Commissioners for Her Majesty's Revenue & Customs

v

Philips Electronics UK Ltd

(Reference for a preliminary ruling from the Upper Tribunal, Tax and Chancery Chamber (United Kingdom))

(Freedom of establishment – National tax legislation – Corporation tax – Group relief – Preclusion of the surrender of losses of a resident permanent establishment of a non-resident company to a resident company linked through a consortium)

I – **Introduction**

1. For the third time the Court is hearing a case relating to the group relief tax scheme in the United Kingdom of Great Britain and Northern Ireland. The scheme allows losses to be surrendered between different companies within a group or consortium. Losses can be transferred in this way to wherever they can be best 'used' for tax purposes. The group or the consortium should then be treated as a single undertaking for tax purposes.

2. For the third time the Court is also faced with the question whether the exclusion of certain taxpayers from that scheme is compatible with the freedom of establishment. The Court has already dealt with the exclusion of foreign subsidiaries (2) and domestic holding companies which operate mainly foreign subsidiaries. (3)

3. The present case concerns a consortium involving UK and Netherlands companies. The UK-resident branch of a Netherlands company wishes to surrender its losses to a UK company. The UK tax authorities do not wish to permit this, since the losses did indeed arise in the United Kingdom, but they may also be taken into account for tax purposes at the company's seat in the Netherlands.

II – **Legislative framework**

4. Corporation tax is levied in the United Kingdom. For the years at issue, 2001 to 2004, it is regulated in the Income and Corporation Taxes Act 1988 (ICTA).

5. UK-resident companies are chargeable to corporation tax on all their profits. Companies

established outside the United Kingdom are chargeable to corporation tax only in so far as a UK-resident permanent establishment generates profits.

6. This is consistent with the double taxation convention concluded between the United Kingdom and the Kingdom of the Netherlands, Article 7 of which includes the following provision:

‘(1) The profits of an enterprise of one of the States shall be taxable only in that State unless the enterprise carries on business in the other State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.’

7. Both UK companies and permanent establishments of foreign companies may transfer losses arising in the United Kingdom to earlier or subsequent tax periods.

8. In addition, section 402(1) ICTA provides for a scheme for the surrender of losses between different taxpayers known as ‘group relief’:

‘(1) Subject to and in accordance with this Chapter and section 492(8), relief for trading losses and other amounts eligible for relief from corporation tax may, in the cases set out in subsections (2) and (3) below, be surrendered by a company (“the surrendering company”) and, on the making of a claim by another company (“the claimant company”), may be allowed to the claimant company by way of a relief from corporation tax called “group relief”.’

9. Group relief may be claimed, depending on the relationship between the surrendering company and the claimant company, by way of either a group claim or a consortium claim.

10. If the surrendering company is not resident in the United Kingdom, section 403D contains the following special provision for group relief:

‘(1) In determining for the purposes of this Chapter the amounts for any accounting period of the losses and other amounts available for surrender by way of group relief by a non-resident company, no loss or other amount shall be treated as so available except in so far as

(a) it is attributable to activities of that company the income and gains from which for that period are, or (were there any) would be, brought into account in computing the company’s chargeable profits for that period for corporation tax purposes;

(b) it is not attributable to activities of the company which are made exempt from corporation tax for that period by any double taxation arrangements; and

(c) no part of

(i) the loss or other amount, or

(ii) any amount brought into account in computing it,

corresponds to, or is represented in, any amount which, for the purposes of any foreign tax, is (in any period) deductible from or otherwise allowable against non-UK profits of the company or any other person.

…

(3) In this section “non-UK profits”, in relation to any person, means amounts which

(a) are taken for the purposes of any foreign tax to be the amount of the profits, income or gains on which (after allowing for deductions) that person is charged with that tax, and

(b) are not amounts corresponding to, and are not represented in, the total profits (of that or any other person) for any accounting period,

or amounts taken into account in computing such amounts.

…

(9) In this section “foreign tax” means any tax chargeable under the law of any territory outside the United Kingdom which

(a) is charged on income and corresponds to United Kingdom income tax; or

(b) is charged on income or chargeable gains or both and corresponds to United Kingdom corporation tax;

…’

III – **Facts and questions referred for a preliminary ruling**

11. The main proceedings relate to the corporation tax payable by Philips Electronics UK Ltd (‘the taxpayer’) in the United Kingdom for the period from 2001 to 2004.

12. For those years, in its tax returns the UK-resident taxpayer made various consortium claims for group relief, most recently on 9 July 2009. The aim was for losses incurred by another company totalling around GBP 64 million to be surrendered to the taxpayer and thus deducted from the basis for assessment for its corporation tax. Those losses had arisen in a UK-resident branch of the Netherlands company LG Philips Displays Netherlands BV (‘LG.PD Netherlands’).

13. LG.PD Netherlands is part of a group which is a consortium of a Netherlands and a South Korean company. The Netherlands company is the taxpayer’s parent company. In the main proceedings, this link between LG.PD Netherlands and the taxpayer must be regarded, in principle, to give entitlement to group relief. (4)

14. The surrender of losses of the UK branch of LG.PD Netherlands to the taxpayer was agreed by both companies in an agreement which provided for a payment for LG.PD Netherlands. On 27 January 2006, insolvency proceedings were initiated against LG.PD Netherlands.

15. In the main proceedings it is disputed whether the United Kingdom tax authorities may refuse group relief on the ground that the losses to be surrendered are taken into account, in principle, in the Netherlands taxation of LG.PD Netherlands and the condition under section 403D(1)(c) ICTA is not therefore satisfied. The taxpayer takes the view that that provision is contrary to the freedom of establishment.

16. Against this background, the Upper Tribunal, Tax and Chancery Chamber, has referred the following questions to the Court for a preliminary ruling:

'(1) Where a Member State (such as the UK) includes in its tax base the profits and losses of a company incorporated and tax resident in another Member State (such as the Netherlands) to the extent that the profits are attributable to a business carried on by the Netherlands company in the UK through a permanent establishment situated in the UK, is it a restriction on the freedom of a national of a Member State to establish in the UK under Article 49 TFEU (ex Article 43 EC) for the UK to prevent the surrender of the UK losses of a permanent establishment situated in the UK of a non-UK resident company to a UK company by way of group relief where any part of those losses or any amount brought into account in computing them "corresponds to, or is represented in, any amount which, for the purposes of any foreign tax is (in any period) deductible from or otherwise allowable against non-UK profits of the company or any person" i.e. to permit the surrender of UK losses in the case of a permanent establishment situated in the UK only where it is clear that at the time of the claim there can never be any deduction or allowance in any State outside the UK (including another Member State (such as the Netherlands)), and it being insufficient that relief available overseas has not in fact been claimed, and in circumstances where there is no equivalent condition applicable to the surrender of UK losses of a UK resident company?

(2) If so, is that restriction capable of being justified

(a) solely on the basis of the need to prevent the double use of losses, or

(b) solely on the basis of the need to preserve the balanced allocation of taxing powers between Member States, or

(c) on the basis of the need to preserve the balanced allocation of taxing powers between Member States in conjunction with the need to prevent the double use of losses?

(3) If so, is the restriction proportionate to such justification or justifications?

(4) If any restriction on the rights of the Netherlands company is not justified or to the extent that it is not proportionate to any justification, does EU Law require the UK to provide the UK company with a remedy such as the right to claim group relief against its profits?'

17. In the proceedings before the Court, the taxpayer, the Danish Government, the United Kingdom Government and the European Commission submitted written observations and presented oral argument at the hearing.

IV – **Legal assessment**

18. The questions asked by the referring court concern the interpretation of the freedom of establishment. I will base my analysis on Article 43 EC, since Article 49 TFEU is not applicable to the situation in the main proceedings. (5) Furthermore, I will understand the questions asked by the national court as also referring to the application of Article 48 EC, which treats certain companies in the same way as natural persons within the meaning of Article 43 EC.

19. The questions relating to the interpretation specifically of the freedom of establishment are justified. The freedom of establishment is the relevant fundamental freedom in the present case. The Court has already ruled that the creation and the ownership by a company of a permanent establishment situated in another Member State falls within the scope of application *ratione materiae* of Article 43 EC. (6) The present case concerns a Netherlands company and the right to surrender losses of a branch which it maintains in the United Kingdom. Such a branch comes under the notion of 'permanent establishment' for tax purposes. (7)

20. It must therefore be clarified hereinafter whether the freedom of establishment precludes a restriction of the right of a foreign company to surrender losses of its domestic permanent establishment (in the form of a branch).

A – *The first question: restriction of the freedom of establishment*

21. In accordance with the questions referred, I will first consider whether a provision such as section 403D(1)(c) ICTA restricts the freedom of establishment. Under that provision, a surrender of domestic losses of the permanent establishment of a foreign company by way of group relief is not possible where the losses, for the purposes of any foreign taxation, are allowable against non-UK profits.

22. It is settled case-law that, while direct taxation falls within the competence of the Member States, they must none the less exercise that competence consistently with European Union law. (8) Against this background, it should be stated that under EU law the Member States are, in principle, not required to provide in their corporation tax legislation for group relief for losses, as is granted by United Kingdom law in the present case. The formulation of the tax system is a matter for each Member State. (9) If, however, a Member State provides for such a right, it must be regulated in accordance with the fundamental freedoms under EU law, in this case the freedom of establishment in particular.

23. Companies are accorded the freedom of establishment by Article 43 EC and Article 48 EC. The Court has inferred, in summary, from the content of these provisions that companies established in a Member State of the Community have the right to exercise their activity in another Member State through a subsidiary, a branch or an agency. (10)

24. In addition, as the second sentence of the first paragraph of Article 43 EC expressly leaves traders free to choose the appropriate legal form in which to pursue their activities in another Member State, that freedom of choice must not be limited by discriminatory tax provisions in the host Member State. (11) The freedom to choose the appropriate legal form in which to pursue activities in another Member State primarily serves to allow companies having their seat in a Member State to open a branch in another Member State in order to pursue their activities under the same conditions as those which apply to subsidiaries. (12)

25. This case-law means that foreign companies may carry on commercial activity in the host Member State under the same conditions as domestic companies. Furthermore, the host Member State may not rely on the fact that the foreign company may prevent any detrimental difference in

treatment by choosing another legal form for its activity in the host Member State, for example a subsidiary rather than a branch. (13)

1. Detrimental difference in treatment

26. In the present case, there is a difference in treatment between domestic and foreign companies in the exercise of their independent commercial activity in the United Kingdom.

27. The United Kingdom Government itself submits that the tax rules on group relief treat domestic companies and foreign companies with a UK-resident permanent establishment differently. The separate conditions under section 403D(1) ICTA apply solely to companies resident abroad.

28. Those conditions include section 403D(1)(c) under which foreign companies may surrender the losses of a UK-resident permanent establishment only where they cannot be used for the purposes of any foreign tax. Such a condition does not apply to companies resident in the United Kingdom.

29. Foreign companies suffer at least two disadvantages as a result of the difference in treatment. First, it becomes more difficult for them to form a consortium with UK companies. Because it may not be possible to surrender losses of UK-resident permanent establishments of foreign companies, they will tend to do their business in consortiums with domestic companies, which are not subject to these restrictions. Second, a foreign company suffers direct disadvantages through a refusal to surrender losses. The foreign company will – as in the present case – be unable to receive a payment from the company which benefits from the surrender of losses.

30. As has already been explained, it also follows from case-law that the host Member State may not rely on the fact that foreign companies may avoid disadvantages by carrying on their commercial activity in the host Member State in the form of a subsidiary rather than a branch. Thus, the surrender of losses of a subsidiary of LG.PD Netherlands in the United Kingdom would not be subject to any restrictions. However, foreign companies are free to exercise their right of establishment in the United Kingdom through a branch or a subsidiary.

2. Objective comparability

31. None the less, the United Kingdom Government contends that a domestic company and a foreign company with a UK-resident branch are not in an objectively comparable situation as regards their taxation. Whilst the entire income of a domestic company is taxed, that is the case for a foreign company only in relation to the income from its domestic permanent establishment.

32. It is true that it is settled case-law that discrimination can arise only through the application of different rules to comparable situations or the application of the same rule to different situations. (14) Therefore, a difference in treatment is compatible with the provisions of the Treaty on the freedom of establishment if it relates to situations which are not objectively comparable. Objective comparability must be examined having regard to the aim pursued by the national provisions at issue. (15)

33. According to settled case-law, in relation to direct taxes, the situations of residents and of non-residents are not, as a rule, comparable. (16) Nevertheless, the Court found in *Marks & Spencer* that in each specific situation it is necessary to consider whether the fact that a tax advantage is available solely to resident taxpayers is based on objective elements. (17)

Consequently, a restriction exists where there is no objective difference in the situation, with regard to the tax levy in question, which would justify different treatment between the various categories of taxpayer. (18)

34. Thus, the Court has ruled on several occasions that a resident company and a non-resident company which operates domestically through a permanent establishment may be in a comparable situation with regard to their domestic taxation. (19)

35. In *Royal Bank of Scotland* the Court held that such companies were in an objectively comparable situation, since the basis for assessment for corporation tax was calculated in the same way for both companies. Accordingly, it was unimportant, in the view of the Court, that resident companies were taxed on the basis of their world-wide income and non-resident companies only on the basis of their income generated domestically. (20) Such differences with regard to the Member States' power of taxation, highlighted by the United Kingdom Government, are therefore significant not in connection with the objective comparability of the situations, but at best in examining justifications. (21)

36. In *Saint Gobain ZN* the Court also recognised a comparable situation of resident and non-resident companies primarily because the difference in treatment applied only as regards the grant of the tax concessions in question. (22) In the present case, the lower court in the main proceedings found in this regard that domestic companies and UK-resident permanent establishments of foreign companies are treated in exactly the same way, for the purposes of corporation tax, with regard to profits and losses made in the United Kingdom, with the exception of the group relief which is at issue here. (23)

37. A restriction of the freedom of establishment cannot therefore be rejected on the ground that a domestic company and a foreign company with a UK-resident branch are not in an objectively comparable situation as regards their taxation. Thus, foreign companies are permitted, in relation to their permanent establishments, in particular to transfer losses to earlier or subsequent tax periods, in the same way as domestic companies. UK law clearly therefore regards the situations as essentially comparable with regard to losses.

3. Interim conclusion

38. The answer to the first question must therefore be that the special conditions laid down by section 403D(1)(c) ICTA for group relief in relation to companies established in a Member State other than the United Kingdom constitute a restriction of the freedom of establishment.

B – *The second question: justification for the restriction*

39. By its second question, the referring court wishes to know whether there is a justification for the restriction of the freedom of establishment. According to case-law, a restriction of the freedom of establishment is permissible if it is justified by overriding reasons in the public interest. (24) The referring court cites as possible justifications the balanced allocation of taxing powers between Member States, the risk of the double use of losses and a combination of the two.

40. The nature of the question stems from the uncertainty which clearly still exists over the interpretation of the judgment in *Marks & Spencer*. In that case, the Court had cited as justifications the preservation of the balanced allocation of the power to impose taxes between Member States, the danger that losses might be taken into account twice and the risk of tax avoidance and applied all three together to justify a restriction of the freedom of establishment. (25)

41. In my Opinion in *Oy AA*, I stated that preserving the allocation of the power to impose taxes is at the heart of these three elements. (26) In the judgment in that case, the Court accordingly recognised that a justification is possible through the two elements of safeguarding the allocation of the power to tax between the Member States and the need to prevent tax avoidance. (27) Subsequently, in *Lidl Belgium* it also accepted a justification solely on the basis of the allocation of the power to tax between the Member States and the danger that the same losses will be taken into account twice. (28)

42. Therefore it is clear that the crucial factor for the justification is ultimately that national legislation pursues the objective of preserving the allocation of the power to tax. Against this background, the objectives of preventing the double use of losses and tax avoidance do not constitute an end in themselves, but are relevant only in so far as they serve to preserve the allocation of the power to tax between the Member States. (29) Accordingly, the Court examined and accepted this justification, most recently in *National Grid Indus*, simply in itself, i.e. without recourse to the aspects of preventing the double use of losses or tax avoidance. (30)

43. This finding is particularly important in the present case. As I will show below, preserving the allocation of the power to tax does not justify the restriction of the freedom of establishment at issue, even though it is intended to prevent the double use of losses.

1. Allocation of the power to tax

44. The preservation of the allocation of the power to impose taxes between Member States is a justification recognised by the Court in its settled case-law. (31)

45. The allocation of the power to tax is a matter for the Member States. Union law, in its current state, does not lay down any general criteria for the attribution of powers of taxation between the Member States. (32) The Member States have, as a rule, delimited their powers in accordance with international taxation practice in such a way that a State has the power to tax both the world-wide income of domestic companies and the domestically generated income of permanent establishments of foreign companies. The resulting double taxation of the income of the permanent establishments is generally avoided by a company’s home State exempting that income from taxation or crediting the tax incurred in the other State to the tax levied by it within the framework of the taxation of the company. (33)

46. In the light of this international taxation practice, the Member States may take measures to preserve the allocation of their powers of taxation in order to safeguard the exercise of their taxing powers in relation to activities carried on in their territory. (34)

47. In the present case, the powers of taxation are regulated in accordance with the abovementioned international taxation practice. Under Article 7 of the UK-Netherlands double taxation convention, the United Kingdom has the power to tax both the income of domestic companies and the income of UK-resident permanent establishments of foreign companies.

48. The question then arises whether those powers of taxation enjoyed by the United Kingdom

are impaired if the losses of a UK-resident permanent establishment of a foreign company (LG.PD Netherlands) can be deducted from the basis for assessment of corporation tax of a domestic company (the taxpayer), even though those losses are also deductible, in principle, in the Netherlands.

49. That is not the case in my view. The power of taxation enjoyed by the United Kingdom with regard to the taxpayer’s income is not impaired by the surrender of the losses. Only losses which were also incurred within the scope of the power of taxation of the United Kingdom are to be surrendered. All the transactions at issue in the present case are subject to the fiscal jurisdiction of the United Kingdom: domestic losses of a domestic taxable person (LG.PD Netherlands with regard to its permanent establishment in the United Kingdom) are intended to be credited against domestic profits of another domestic taxable person (the taxpayer).

50. It is irrelevant to safeguarding the power of taxation of the United Kingdom whether the losses to be surrendered can also be taken into account in the Netherlands. Taking the losses into account there has no bearing on the power of taxation enjoyed by the United Kingdom. That power can be impaired only if losses which are incurred within the scope of the exclusive power of taxation of another Member State are taken into account. Such losses would reduce the tax revenue of the United Kingdom, even though the profits from the activity cannot be taxed.

51. Accordingly, the Court has examined the need to prevent the double use of losses almost exclusively in cases where a Member State refused to take into account losses incurred in another Member State. (35) On the single occasion so far when domestic losses were at issue, in *Papillon*, the Court rejected reliance on the objective of preventing the double use of losses on the ground that losses recorded in one and the same Member State were being taken into account. (36)

52. In the present case, the profits from the domestic activity of the permanent establishment of LG.PD Netherlands are subject to the power of taxation of the United Kingdom. Use of the losses from that activity cannot therefore be refused by relying on the preservation of the allocation of the power of taxation. As the Court found in *Lidl Belgium*, that justification is intended only to safeguard symmetry between the right to tax profits and the right to deduct losses. (37) Or, as the United Kingdom Government itself put it in *Marks & Spencer*: profits and losses are two sides of the same coin. (38)

53. This position likewise cannot be countered by the abovementioned argument put forward by the United Kingdom to the effect that a domestic company and a branch of a foreign company are not in an objectively comparable situation as regards their taxation, an argument which I would like to consider once again here.

54. In *X Holding* the Court ruled, with regard to the justification of the allocation of the power of taxation, that, from the perspective of a company’s State of origin, its permanent establishments situated in another Member State and its non-resident subsidiaries are not in a comparable situation. A subsidiary is subject to unlimited tax liability in the other Member State, whilst the permanent establishment remains in principle and in part subject to the fiscal jurisdiction of the

Member State of origin. (39)

55. However, as I explained in my Opinion in *X Holding*, there are different duties for the Member State of origin and the host Member State with regard to the allocation of the power to impose taxes. (40) The Member State of origin may treat the foreign permanent establishments and subsidiaries of a domestic company differently. It enjoys a – generally subordinate – right of taxation only with regard to the foreign permanent establishments, but not with regard to the foreign subsidiaries.

56. The situation is different, however, for the host Member State. As a rule, it has the right to tax with regard to both types of establishment. The host Member State must also therefore treat both those types of establishment of a company established in another Member State equally in levying tax. (41)

57. On these grounds, the United Kingdom, as the host Member State, cannot rely on the justification of preserving the allocation of the power of taxation where it refuses group relief, under certain conditions, for UK-resident branches, in contrast with domestic companies.

2. Double use of losses

58. It must still be examined whether the objective of preventing the double use of losses can constitute an autonomous justification.

59. According to the findings in the main proceedings, LG.PD Netherlands is able, in Netherlands tax proceedings, to claim the losses incurred by its UK-resident permanent establishment at least partially itself or within a fiscal unity. As *X Holding* has already shown, the losses of foreign permanent establishments of a Netherlands-resident company may lead to a temporary reduction in the tax on the company there. (42) In the present case there is therefore the risk of an – at least temporary – double use of losses in the United Kingdom and in the Netherlands.

60. In *Lidl Belgium*, however, the Court recognised that it is compatible with the freedom of establishment if a company cannot deduct losses relating to a permanent establishment situated in another Member State, to the extent that, by virtue of a double taxation convention, its income is taxed in the other Member State and losses can also be taken into account there in future accounting periods. If the Member State in which the permanent establishment is situated takes into account both profits and losses for tax purposes, the company's Member State can therefore ignore the losses incurred by such a permanent establishment for tax purposes. The Kingdom of the Netherlands does not therefore exercise the powers which it enjoys according to that case-law.

61. On the other hand, taking into account such losses of a foreign permanent establishment also does not breach the freedom of establishment. (43) The Member States may therefore take into account losses of foreign permanent establishments in the taxation of their domestic companies, but are not required to do so, as a rule, under EU law. (44)

62. If the Member State in which the company is established nevertheless takes into account the losses of the foreign permanent establishment, there is an – at least temporary – double use of the losses of a foreign permanent establishment. In such a case, however, it is not clear why the Member State in which the permanent establishment is situated should have the power to rule out the use of the losses on the ground that they are already taken into account in the Member State

in which the company is established. As we have seen, the power of taxation of the Member State in which the permanent establishment is situated is not affected. Its tax revenue is the same irrespective of whether losses of the permanent establishment are also taken into account in the company's home State.

63. Furthermore, the current international delimitation of taxation rights may even require a double use of losses. This is the case whenever the income is taken into account for tax purposes by two different States. If double taxation of the income of a foreign permanent establishment is countered through the credit procedure in the company's home State, its income will be subject to tax both in the State in which the permanent establishment is situated and in the company's home State. The double use of losses in such cases is a logical consequence of the double significance of one source of income.

64. Against this background, the prevention of the double use of losses cannot be an end in itself. The aspect of prevention of the double use of losses, as understood so far in the case-law, solely concerns the question whether a Member State has the right, in the context of the balanced allocation of the powers of taxation, not to take into account a loss in the taxation of its taxpayer. That right may stem from the fact that the loss is taken into account in another Member State under whose fiscal jurisdiction the taxation of the profits from the relevant activity falls. The loss is attributed to that other Member State because it taxes the relevant profits. Use in a further Member State which does not tax the profits would possibly be 'double'.

65. The use of the losses of a permanent establishment in the United Kingdom whose profits are taxed in the United Kingdom is therefore not 'double', but 'single'. This is also provided for, in principle, by United Kingdom law in so far as the losses of the permanent establishment may be transferred to earlier or subsequent tax periods.

66. For this reason, even if the prevention of the double use of losses were to be recognised as an autonomous justification, the tax rules in the United Kingdom would not, in any case, be capable of preventing double use. As the Court has pointed out, national legislation is appropriate for ensuring attainment of the objective pursued only if it genuinely reflects a concern to attain it in a consistent and systematic manner. (45)

67. This is clearly not the case in the United Kingdom with regard to the double use of losses of UK-resident permanent establishments of foreign companies. The condition under section 403D(1)(c) ICTA applies only to group relief. However, carrying losses forward and back over different tax periods is permitted for permanent establishments situated in the United Kingdom irrespective of whether such losses are also taken into account in the company's Member State. The tax rules on the deduction of losses do not therefore, on the whole, pursue in a consistent manner the objective of preventing the double use of losses.

3. Interim conclusion

68. The answer to the second question must therefore be that the restriction is not capable of being justified on the basis of the preservation of the allocation of taxing powers, even in combination with the aspect of the prevention of the double use of losses. It is also not capable of being justified solely on the basis of the prevention of the double use of losses, since that does not

constitute an autonomous justification.

C – *The third question: proportionality of the restriction*

69. If the Court nevertheless takes the view that the prevention of the double use of losses constitutes an autonomous justification and the contested provision is capable, moreover, of attaining this objective, a justification of the restriction in the present case would nevertheless be ruled out.

70. Even if a justification exists, the restriction of the freedom of establishment must not go beyond what is necessary to attain that objective. (46)

71. It must be stressed that in the present case the examination of the necessity of the contested provision could not be based on the criteria laid down in *Marks & Spencer*, as was discussed by some of the parties. That judgment relates to a situation in which a national provision serves to preserve the allocation of the power of taxation. The provision at issue in the present case does not serve that purpose, as has already been explained. If an autonomous justification for that provision were to be recognised in the form of the prevention of the double use of losses, the criteria for the necessity of such a provision must be adapted to that justification.

72. In that context, I take the view that section 403D(1)(c) ICTA goes beyond what would be necessary to prevent the double use of losses in several respects.

73. First, under that provision, a surrender of losses is ruled out even where only a part of the losses in question is allowable for the purposes of any foreign tax. If only a part of the losses incurred in the United Kingdom is taken into account in another Member State, the surrender of losses is refused for the other part, even though there is no danger of double use of losses.

74. Second, the provision does not differentiate according to the manner in which the losses are taken into account for the purposes of any foreign tax: permanently or only temporarily. If the other Member State takes into account losses of a foreign permanent establishment of its company only temporarily by reversing that use in respect of subsequent profits of the permanent establishment, (47) the foreign use of the losses may cease retrospectively. However, in such a case, the United Kingdom law on corporation tax does not, according to the available information, provide for any subsequent possibility of group relief.

75. Third, in my view, it goes beyond what is necessary if group relief under section 403D(1)(c) ICTA is precluded where there exists merely the possibility of taking into account losses in another State ‘in any period’. That possibility cannot be ruled out even where insolvency proceedings have been initiated against the foreign company in question, as in the present case. It may thus be possible, for example, to carry back losses or the insolvency proceedings result in the continued existence of the undertaking.

76. As a result of these multiple restrictions, I consider that section 403D(1)(c) ICTA is essentially geared to permitting group relief only where there is no provision in the Member State of the foreign company for losses of a UK permanent establishment to be taken into account *at all*. The situation in the individual case is, by contrast, almost irrelevant.

77. In any case, the third question should therefore be answered to the effect that, on the whole, the provision goes beyond what is necessary to prevent the double use of losses.

D – *The fourth question: legal consequences of a prohibition of the restriction*

78. By its fourth question, lastly, the referring court wishes to establish the importance of a breach of the freedom of establishment in the main proceedings. Because a provision such as section 403D(1)(c) ICTA breaches the freedom of establishment, (48) this question must be answered.

79. The background to this question is the fact that in the present case only LG.PD Netherlands has exercised the freedom of establishment granted by Article 43 EC and Article 48 EC. The freedom of establishment of the taxpayer, which is claiming an entitlement to group relief in the main proceedings, is not restricted. Rather it suffers because the freedom of establishment of its contracting partner, from which it wishes to assume the losses in return for a payment, is restricted under United Kingdom tax rules. Is the taxpayer nevertheless able to benefit from the prohibition under Article 43 EC in the main proceedings?

80. The United Kingdom Government submitted that the freedom of establishment is an individual right. Furthermore, it cited settled case-law according to which the detailed procedural rules governing actions for safeguarding an individual’s rights under EU law must be no less favourable than those governing similar domestic actions (principle of equivalence) and must not render practically impossible or excessively difficult the exercise of rights conferred by EU law (principle of effectiveness). (49) The national court must examine the effects of compliance with these principles in the main proceedings.

81. In my view, the cited case-law is a priori not relevant in the present case since it concerns only procedural rules for the assertion of rights under EU law. For the main proceedings, however, the crucial factor is whether the substantive content of the freedom of establishment extends sufficiently far that the taxpayer in the main proceedings is also protected by Article 43 EC. This will therefore be examined below:

82. Article 43 EC has direct effect. (50) The national court must therefore disapply any provision of national law which may be to the contrary. (51)

83. The first sentence of the first paragraph of Article 43 EC prohibits restrictions on the freedom of establishment. There is no need to clarify, in the present case, whether that prohibition regulates a purely individual right or whether it has objective regulatory content which is independent of the person who exercises his right of establishment under that provision. In any case, the Court has stated on several occasions in connection with various fundamental freedoms that persons other than those who enjoy the fundamental freedom directly may also benefit from the freedom if that freedom cannot otherwise be fully effective. (52)

84. In the present case, it is clear, in my view, that the freedom of establishment can be fully effective only if the taxpayer in the main proceedings can also rely on the breach of the freedom of establishment by the national provision.

85. The contested restriction of the surrender of losses is prohibited by Article 43 EC. As we have seen, the restriction of the freedom of establishment of LG.PD Netherlands resides in the fact that its contracting partner – the taxpayer – is denied an advantage and it suffers disadvantages itself as a result. (53) The freedom of establishment of the LG.PD Netherlands can therefore be guaranteed only if its contracting partner is accorded the advantage. Nevertheless, only that company can invoke the advantage of surrendering losses, namely reducing the tax base of the claimant company – in this case the taxpayer – in taxation proceedings.

86. On the other hand, the full effect of the freedom of establishment cannot be guaranteed if LG.PD Netherlands, which has exercised its right of establishment in the present case, could claim damages, as the United Kingdom Government has argued. First, the associated effort would constitute a further impairment of the freedom of establishment enjoyed by LG.PD Netherlands. Second, it could not eliminate the disadvantage resulting from the fact that companies in the United Kingdom may not wish to form a consortium involving LG.PD Netherlands at all because it is not possible to surrender losses.

87. Furthermore, a different view would allow the Member States to adopt a discriminatory rule in an indirect form. Thus the Member State could sanction only the contracting partners of a company which exercises its freedom of establishment. The foreign company could possibly claim damages against the Member State concerned, but damage could be difficult to prove in many cases where, as a result of the sanction, the contracting partners have refrained from establishing business relations with the foreign company.

88. In order to guarantee the freedom of establishment, the direct effect of Article 43 EC and Article 48 EC must in any case extend to a contracting partner where its disadvantages are the cause of the restriction of the freedom of establishment.

89. Against this background, it is irrelevant that the taxpayer in the main proceedings does not exercise its right of establishment itself. Article 43 EC and Article 48 EC also require that the contested provision contained in section 403D(1)(c) ICTA be disapplied in the main proceedings.

V – **Conclusion**

90. In the light of the foregoing, I suggest that the Court answer the questions asked by the Upper Tribunal, Tax and Chancery Chamber, as follows:

(1) It is a restriction on the freedom of establishment granted by Article 43 EC and Article 48 EC for a Member State to prevent the surrender of the losses incurred in that Member State by a resident permanent establishment of a non-resident company to a resident company by way of group relief where any part of those losses, for the purposes of any foreign tax, is in any period deductible from or otherwise allowable against non-domestic profits of the company or any other

person.

(2) That restriction is not capable of being justified on the basis of either the preservation of the allocation of taxing powers between Member States or the prevention of the double use of losses, or by a combination of both objectives.

(3) In a situation like that in the main proceedings, a Member State is required to disapply a provision which is contrary to Article 43 EC and Article 48 EC also for the benefit of the taxpayer who is claiming group relief.

1 – Original language: German.

2 – Case C-446/03 *Marks & Spencer* [2005] ECR I-10837.

3 – Case C-264/96 *ICI* [1998] ECR I-4695.

4 – Under section 406(2) ICTA, the link is not sufficient, since neither of the consortium companies is resident in the United Kingdom. However, the lower court in the main proceedings considers that provision to be inapplicable because it constitutes a prohibited restriction of the freedom of establishment. This finding is no longer disputed in the main proceedings in the absence of an appeal.

5 – Article 49 TFEU entered into force on 1 December 2009. However, the group relief at issue in the main proceedings was claimed for periods from 1 July 2001 to 31 December 2004, and the last of these claims was submitted on 9 July 2009.

6 – Case C-414/06 *Lidl Belgium* [2008] ECR I-3601, paragraph 15.

7 – See Article 5(1)(b) of the European Commission's Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) of 3 October 2011 (COM(2011) 121 final/2).

8 – Case C-279/93 *Schumacker* [1995] ECR I-225, paragraph 21, and Case C-157/10 *Banco Bilbao Vizcaya Argentaria* [2011] ECR I-13023, paragraph 28.

9 – See Case C-204/90 *Bachmann* [1992] ECR I-249, paragraph 23.

10 – See, inter alia, Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 18; Case C-307/97 *Saint-Gobain ZN* [1999] ECR I-6161, paragraph 35; Case C-337/08 *X Holding* [2010] ECR I-1215, paragraph 17; and Case C-97/09 *Schmelz* [2010] ECR I-10465, paragraph 36.

11 – See, inter alia, Case 270/83 *Commission* v *France*, cited in footnote 10, paragraph 22, and Case C-231/05 *Oy AA* [2007] ECR I-6373, paragraph 40, and order in Joined Cases C-439/07 and C-499/07 *KBC Bank and Beleggen, Risicokapitaal, Beheer* [2009] ECR I-4409, paragraph 77.

12 – Case C-253/03 *CLT-UFA* [2006] ECR I-1831, paragraph 15.

13 – See Case C-231/05 *Oy AA*, cited in footnote 11, paragraph 40.

14 – Case C-253/09 *Commission* v *Hungary* [2011] ECR I-12391, paragraph 50 and the cited case-law.

15 – Case C-337/08 *X Holding*, cited in footnote 10, paragraphs 20 and 22.

16 – Case C-279/93 *Schumacker*, cited in footnote 8, paragraph 31, and Case C-282/07 *Truck Center* [2008] ECR I-10767, paragraph 38.

17 – See Case C-446/03 *Marks & Spencer*, cited in footnote 2, paragraphs 37 and 38.

18 – See, with regard to freedom to provide services, Case C-169/08 *Presidente del Consiglio dei Ministri* [2009] ECR I-10821, paragraph 35.

19 – For the first time in Case 270/83 *Commission* v *France*, cited in footnote 10, paragraph 20.

20 – Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, paragraphs 27 to 29.

21 – See also Case C-337/08 *X Holding*, cited in footnote 10, paragraph 38.

22 – See Case C-307/97 *Saint-Gobain ZN*, cited in footnote 10, paragraph 49.

23 – First-tier tribunal, Decision of 27 July 2009, [2009] UKFTT 226(TC), point 21.

24 – Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, paragraph 47; Case C-418/07 *Papillon* [2008] ECR I-8947, paragraph 33; and Case C-9/11 *Waypoint Aviation* [2011] ECR I-9697, paragraph 27.

25 – Case C-446/03 *Marks & Spencer*, cited in footnote 2, paragraph 51.

26 – Opinion in Case C-231/05 *Oy AA* [2007] ECR I-6373, point 48.

27 – Case C-231/05 *Oy AA*, cited in footnote 11, paragraph 60.

28 – Case C-414/06 *Lidl Belgium*, cited in footnote 6, paragraph 42.

29 – See my Opinion in Case C-311/08 *SGI* [2010] ECR I-487, paragraph 59.

30 – Case C-371/10 *National Grid Indus* [2011] ECR I-12273, paragraphs 45 to 49; see also Case C-470/04 *N* [2006] ECR I-7409, paragraph 42.

31 – See, inter alia, Case C-446/03 *Marks & Spencer*, cited in footnote 2, paragraph 45; Case C-414/06 *Lidl Belgium*, cited in footnote 6, paragraph 31; and Case C-371/10 *National Grid Indus*, cited in footnote 30, paragraph 45.

32 – See Case C-128/08 *Damseaux* [2009] ECR I-6823, paragraphs 30 and 33, and the cited case-law.

33 – See Opinion of Advocate General Geelhoed in Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, points 49 to 51.

34 – See Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas*, cited in footnote 24, paragraph 56; Case C-347/04 *Rewe Zentralfinanz* [2007] ECR I-2647, paragraph 42; Case C-231/05 *Oy AA*, cited in footnote 11, paragraph 54; Case C-330/07 *Jobra* [2008] ECR I-9099, paragraph 33; and Case C-371/10 *National Grid Indus*, cited in footnote 30, paragraph 46.

35 – See Case C-446/03 *Marks & Spencer*, cited in footnote 2; Case C-231/05 *Oy AA*, cited in footnote 11; and Case C-414/06 *Lidl Belgium*, cited in footnote 6.

36 – Case C-418/07 *Papillon*, cited in footnote 24, paragraph 39.

37 – Case C-414/06 *Lidl Belgium*, cited in footnote 6, paragraph 33.

38 – Case C-446/03 *Marks & Spencer*, cited in footnote 2, paragraph 43.

39 – Case C-337/08 *X Holding*, cited in footnote 10, paragraph 38.

40 – Opinion in Case C-337/08 *X Holding* [2010] ECR I-1215, points 51 to 62.

41 – Opinion in Case C-337/08 *X Holding*, cited in footnote 40, point 62.

42 – See Case C-337/08 *X Holding*, cited in footnote 10, paragraph 35, and my Opinion in Case C-337/08 *X Holding*, cited in footnote 40, point 39.

43 – See Case C-157/07 *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt* [2008] ECR I-8061.

44 – See my Opinion in Case C-337/08 *X Holding*, cited in footnote 40, point 50.

45 – Case C-169/07 *Hartlauer* [2009] ECR I-1721, paragraph 55, and – with regard to freedom to provide services – Joined Cases C-447/08 and C-448/08 *Sjöberg* [2010] ECR I-6921, paragraph 40.

46 – See, inter alia, Case C-19/92 *Kraus* [1993] ECR I-1663, paragraph 32; Case C-9/02 *de Lasteyrie du Saillant* [2004] ECR I-2409, paragraph 49; and Case C-371/10 *National Grid Indus*, cited in footnote 30, paragraph 42.

47 – See, with regard to this recovery arrangement in the Netherlands, my Opinion in Case C-337/08 *X Holding*, cited in footnote 40, points 39 and 48.

48 – See above under A, B and C.

49 – Case C-177/10 *Rosado Santana* [2011] ECR I-7907, paragraph 89 and the cited case-law.

50 – Case C-91/08 *Wall* [2010] ECR I-2815, paragraph 68.

51 – See, inter alia, Case 106/77 *Simmenthal* [1978] ECR 629, and Case C-409/06 *Winner Wetten* [2010] ECR I-8015, paragraph 55.

52 – See Case C-370/90 *Singh* [1992] ECR I-4265, paragraph 23; Case C-350/96 *Clean Car Autoservice* [1998] ECR I-2521, paragraph 20; and Case C-208/05 *ITC* [2007] ECR I-181, paragraph 26; see also Case C-1/93 *Halliburton Services* [1994] ECR I-1137, paragraph 20.

53 – See above, point 29.