



# International tax policy

**Tashkent state university of economics**

*Lecture 10*





## Corporate tax restrictions

- ◎ Permanent establishments
- ◎ Group taxation (treatment of losses)
- ◎ Dividend payments
- ◎ Interest deduction limitations
- ◎ Controlled foreign subsidiaries (CFC-rules)



## Permanent establishment (PE) – host state

- ◎ A PE of a company established in another MS should be treated equally to a subsidiary resident in the MS
  - Access to same tax benefits (Avoir fiscal Case 270/83; Halliburton Services C-1/93)
  - Tax loss carry forward/back (C-311/97 Royal Bank of Scotland)
  - Tax rate should be the same (CLT-UFA C-253/03)

## Permanent establishment (PE)- host state

### ◎ Finland

- There are well established case law and tax practice that a PE of a foreign company resident in the EU (or in a tax treaty country based on the non-discrimination clause, Art 24.3 OECD MC) is treated similarly to a Finnish resident corporation (oy)
  - ◎ Same deductions
  - ◎ Same tax rate
  - ◎ Group contribution (KHO 2003:79)

## Permanent establishment (PE)- host state

◎ The host state of a PE is not required to take into account the losses of the head office (i.e. non-resident company) under EU law

→ This is in line with the OECD Model Convention

◎ Principle of territoriality: a PE is subject to limited tax liability whereby only the income and losses allocated to the PE are taken into account in the host state

◎ Company/individual/other person subject to

## Permanent establishment (PE) – host state

- ◎ A PE of a company established in another MS should be treated as a resident company for tax treaty purposes
  - In the case of a double-taxation treaty concluded between a Member State and a non-Member country, the national treatment principle requires the Member State which is party to the treaty to grant to permanent establishments of non-resident companies the advantages provided for by that treaty on the same conditions as those which apply to resident companies (Saint Gobain C-307/97)

◎ Under the principles of the OECD Model

## Permanent establishment (PE) – residence state

◎ Profits of the PE are taxable in the host state (OECD MC Art 7)

◎ Whether losses of the PE are taken into account in the residence state typically depend on whether a credit method (OECD MC Art 23B) or exemption method (OECD MC Art 23A) is applied to the profits of the PE

○ Credit method → losses are included in the tax base of the company having a PE in another state

○ Exemption method → losses are not included in

## Permanent establishment (PE) – residence state

### ◎ Lidl Belgium C-414/06

- In the case of exemption method, EU law does not require deduction of losses in the residence state as long as such losses may be deducted in the host state in future
- Balanced allocation of taxing rights

### ◎ Krankenhaus Ruhesitz am Wannsee C-157/07

- In the case of exemption method with loss recapture, EU law did not prevent the residence state from recapturing the deducted losses as soon as the PE turns profitable, where the host state allow loss carry forward (even if this is not

## Group taxation systems

- ◎ A group of companies may include profitable and loss making companies
  - If profits and losses cannot be balanced within the group companies, the group pays more taxes than it would if it were a single company
- ◎ Most EU countries apply a group taxation system to enable balancing of profits and losses at the group level but its application is often limited to domestic companies

## Group taxation systems

- ◎ Group taxation systems vary between countries
- ◎ Organschaft (Germany): profits and losses of the members are attributed to the parent
- ◎ Group relief (UK): transfer of tax losses
- ◎ Consolidation (e.g. NL): corporate income is combined at the group level after some adjustments
- ◎ Group contribution (Finland, Sweden,

## Marks & Spencer C-446/03

- ◎ The compatibility of the UK group relief system with the freedom of establishment
- ◎ UK company may offset only losses of another UK subsidiary
  - Offsetting losses of a subsidiary resident in another member state was denied
- ◎ M&S and the Commission claimed that the UK legislation was contrary to the freedom of establishment
- ◎ Several governments supported the UK: e.g. Germany, France, Ireland, the Netherland, Finland and Sweden Government.

## Marks & Spencer C-446/03

- ◎ Advocate general (AG): cross-border consolidation if the subsidiary cannot offset losses in the residence state.
- ◎ CJEU: Restriction which may be justified based on
  - Balanced allocation of taxing rights
  - Risk of losses taken into account twice
  - Risk of tax avoidance
- ◎ First time the CJEU accepted a combination of justifications

## Marks & Spencer C-446/03

### ◎ Proportionality test:

- If the subsidiary has exhausted all loss-relief opportunities in its home state, cross-border loss-consolidation in the parent company's home state is required  
→ the concept of final losses

### ◎ M&S case has had implications throughout the EU

### ◎ The concept of final losses has been subject to different interpretations

- The taxpayer has burden of proof

## Marks & Spencer C-446/03 – aftermath

© EU's view: Commissioner for Taxation: “Cross border loss relief is a basic need for businesses that expand beyond national borders. It is essential for entrepreneurship and for creating a positive business environment within the Single Market. I therefore urge the UK and all Member States to respect the case law on this matter.”

## Marks & Spencer C-446/03 – aftermath

- ◎ In 2012, the Commission decided to refer the UK to the CJEU for its tax legislation on cross-border loss relief. The Commission considers that the UK has failed to properly implement the CJEU's previous Marks & Spencer ruling (Case C-446/03) on this matter
  - Although the UK amended its legislation after the judgement, it continues to impose conditions on cross-border group loss relief which, in practice, make it very difficult to benefit from. The Commission considers this to infringe the principle of non-discrimination and the freedom of establishment, set down in the Treaty.

## Marks & Spencer C-446/03 – aftermath

### ◎ The Commission's view

- under that provision, whether the losses may be taken into account in the future must be made 'as at the time immediately after the end' of the accounting period in which the losses were sustained
- that provision has the effect of making it virtually impossible for a resident parent company to obtain cross-border group relief

### ◎ The Commission lost the case (C-172/13)