Opinion Statement ECJ-TF 3/2018 on the ECJ Decision of 12 June 2018 in *Bevola* (Case C-650/16), Concerning the Utilization of "Definitive Losses" Attributable to a Foreign Permanent Establishment

This CFE Opinion Statement, submitted to the European Institutions in November 2018, discusses the ECJ's decision in *Bevola* (Case C-650/16), which reaffirms that the concept of "definitive losses" first established in *Marks & Spencer* (Case C-446/03) and refined, inter alia, in *Commission v. United Kingdom* (Case C-172/13) is still applicable to permanent establishments and that the standard for testing comparability continues to be related to the aim pursued by the national provision at issue. Further, the CFE invites the EU to consider harmonizing measures that will introduce immediate loss utilization with a recapture mechanism.

1. Introduction

This is an Opinion Statement prepared by the CFE ECJ Task Force on *Bevola* (Case C-650/16),[1] in respect of which the Grand Chamber of the Court of Justice of the European Union (ECJ) delivered its decision on 12 June 2018. In general terms, the ECJ followed the reasoning of Advocate General Campos Sánchez-Bordona, who delivered his Opinion on 17 January 2018.[2]

The case concerned the compatibility of the Danish loss rules whereby losses attributable to a foreign (EU) permanent establishment (PE) of a Danish company could not be set off against taxable Danish income of that company except in a situation in which the company opted for an optional scheme of "international joint taxation". The loss attributable to the Finnish PE of Bevola was of a definitive nature. The Danish tax authorities refused to allow the loss to be utilized, denying the company the benefit of the *Marks & Spencer* (Case C-446/03)[3] doctrine.

In its decision, the Court confirmed its approach to "definitive losses" ("final losses"): A loss of a foreign PE must be taken into consideration by the state of residence of the company, provided that that company has exhausted the possibilities of deducting the losses available under the law of the Member State in which the establishment is situated and has ceased to receive any income from that establishment. The Danish company cannot be required, in order to offset its losses, to opt for an international joint taxation regime.

2. Background and Issues

Bevola is a Danish resident company with an ultimate Danish parent company, Jens W. Trock. Bevola's Finnish PE closed in 2009. According to Bevola, its losses could not be deducted in Finland following the closure. Bevola thus claimed them against Danish income, but this was denied by the Danish tax authorities.

Under section 8.2 of the Danish Corporate Income Tax Act,[4] taxable income does not include income and expenditure relating to a PE situated in a foreign state. This general rule is, however, subject to specific corporate tax law provisions establishing a national and international joint taxation regime. Joint income, calculated under section 31 of the Corporate Income Tax Act (dealing with the national joint tax regime), consists in the sum of the taxable income of each individual company covered by the regime. Losses of a foreign PE may generally only be offset against income of a Danish company if international joint taxation has been opted for (and maintained for a minimum period of 10 years).[5] The ultimate parent company participating in the joint tax regime is designated as the management company for the purposes of the regime. This regime is part of section 31A of the Corporate Income Tax Act, which allows the top parent company to extend the tax integration scheme to foreign companies of the group, as well as to all foreign PEs owned by Danish

* The Members of the Task Force are: Alfredo Garcia Prats, Werner Haslehner, Volker Heydt, Eric Kemmeren, Georg Kofler (Chair), Michael Lang, Jürgen Lüdicke, João Nogueira, Pasquale Pistone, Albert Rädler†, Stella Raventos-Calvo, Emmanuel Raingeard de la Blétière, Isabelle Richelle, Alexander Rust and Rupert Shiers. 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.

1. DK: ECJ, 12 June 2018, Case C-650/16, *A/S Bevola, Jens W. Trock ApS v. Skatteministeriet*, ECJ Case Law IBFD.
2. DK: Opinion of Advocate General Sánchez-Bordona, 17 Jan. 2018, Case C-650/16, *A/S Bevola, Jens W. Trock ApS v. Skatteministeriet*, ECJ Case Law IBFD.
3. UK: ECJ, 13 Dec. 2005, Case C-446/03, *Marks & Spencer plc v. Halsey (Her Majesty's Inspector of Taxes)*, ECJ Case Law IBFD.
4. DK: Corporate Income Tax Act, 2010, National Legislation IBFD.
5. *Bevola* (C-650/16), at paras. 25-27.

and foreign companies participating in the joint taxation regime.

Bevola and its parent company, Jens Trock, argued that, had Bevola had a Danish establishment, its losses would have been deductible in Denmark; as such, the fact that the foreign losses cannot be set off against Danish income constitutes a restriction of the freedom of establishment. They also considered that the Finnish losses, as definitive losses, should be deductible from Bevola's income, which is taxable in Denmark, its country of residence.

The Danish court hearing the dispute questioned the relevance of the companies' arguments, especially in view of the possibility, offered by the Danish tax legislation, to opt for the international tax integration regime. The Court thus referred the following question to the ECJ:

> Does Article 49 TFEU preclude a national taxation scheme such as that at issue in the main proceedings under which it is possible to make deductions for losses in domestic branches, while it is not possible to make deductions for losses in branches situated in other Member States, including in circumstances corresponding to those in the Court's judgment [of 13 December 2005] in *Marks & Spencer*, C-446/03, C-446/03, EU:C:2005:763, paragraphs 55 and 56, unless the group has opted for international joint taxation on the terms as set out in the main proceedings?

3. ECJ Decision

3.1. In general

As a first step, the Court[6] notes the existence of a difference in treatment, under Danish law, between Danish companies that have a PE in Denmark and those whose PE is situated in another Member State. The former can deduct losses from their local branch for Danish tax purposes, while the latter can deduct losses from their PE situated in another Member State only if they opt for international tax integration. This difference in treatment is likely to make it less attractive for a Danish company to exercise its freedom of establishment by creating PEs in other Member States.[7] This difference in treatment is also not called into question by the existence of the optional "international joint taxation" regime under section 31A of the Corporate Income Tax Act, the benefit of which "is subject to two strict conditions" (i.e. inclusion of global income and a minimum 10-year period).[8]

The Court then examined whether the difference in treatment constitutes an obstacle to the freedom of establishment. Such a restriction would not exist if (i) the difference in treatment concerns situations that are not objectively comparable, or (ii) if an overriding reason in the public interest is found to exist that (iii) is proportionate to that objective.[9] The Court addressed each step in some detail:

3.1.1. *Comparability of situations*

Some of the intervening governments,[10] relying on the *Nordea Bank* (Case C-48/13)[11] and *Timac Agro* (Case C-388/14)[12] cases, considered that a Danish company with a local branch and one with a branch in another Member State are not in a comparable situation since the income of the foreign PE "is not subject to the tax jurisdiction" of Denmark.[13] The European Commission, which shares this reading of the *Nordea Bank* and *Timac Agro* cases, pointed out, however, that those decisions contradict the previous case law of the Court, "which accorded no importance to the reason for the difference in treatment".[14] According to the Commission, taking into account the comparability analysis, the reason for the difference in treatment would mean considering two situations as not comparable "simply because the Member State would have chosen to treat them differently".[15] Referring to *Oy AA* (Case C-231/05),[16] *X Holding* (Case C-337/08)[17] and *SCA Group Holding* (Case C39/13),[18] the Court recalled that the "comparability of a cross-border situation with an internal situation must be examined having regard to the aim pursued by the national provisions at issue".[19] It then undertook to explain *Nordea Bank* and *Timac Agro*, stating that those cases "do not imply the abandonment … of that method of assessing the comparability of the situations, which is moreover expressly applied in later judgments".[20] Actually, the Court stated, concerning *Nordea Bank* and *Timac Agro*, that "there was no need for it to look at the purpose of the national provisions concerned, since they applied the same tax treatment to PEs abroad and those in national territory".[21] Referring to *Avoir Fiscal* (Case 270/83)[22] the Court added that "[w]here the legislature of a Member State treats those two categories of establishments in the same way for the purpose of taxing their profits, it recognizes that, with regard to the detailed rules and conditions of that taxation, there is no objective difference between their situations which could justify a difference in treatment".[23] However, it should not be understood from these statements that "where a national tax legislation treats two situations differently, they cannot be

6. In general terms, the ECJ followed the reasoning of Advocate General Campos Sánchez-Bordona. Therefore, the authors mainly refer to the decision in this Opinion Statement.
7. *Bevola* (C-650/16), para. 29.
8. Id., paras. 25-27.
9. Id., para. 20.
10. I.e. Austria, Denmark and Germany.
11. DK: ECJ, 17 July 2014, Case C-48/13, *Nordea Bank Danmark A/S v. Skatteministeriet*, ECJ Case Law IBFD.
12. DE: ECJ, 17 Dec. 2015, Case C-388/14, *Timac Agro Deutschland GmbH v. Finanzamt Sankt Augustin*, ECJ Case Law IBFD.
13. *Bevola* (C-650/16), para. 30.
14. Id., para. 31.
15. Id., para. 31.
16. FI: ECJ, 18 July 2007, Case C-231/05, *Oy AA*, ECJ Case Law IBFD.
17. NL: ECJ, 25 Feb. 2010, Case C-337/08, *X Holding BV v. Staatssecretaris van Financiën*, ECJ Case Law IBFD.
18. NL: ECJ, 12 June 2014, Joined Cases C-39/13, C-40/13 and C-41/13, *Inspecteur van de Belastingdienst/Noord/kantoor Groningen v. SCA Group Holding BV and Others*, ECJ Case Law IBFD.
19. *Bevola* (C-650/16), para. 32.
20. Id., para. 33, referring to DK: ECJ, 21 Dec. 2016, Case C-593/14, *Masco Denmark ApS and Damixa ApS v. Skatteministeriet*, ECJ Case Law IBFD; DE: ECJ, 22 June 2017, Case C-20/16, *Wolfram Bechtel and Marie-Laure Bechtel v. Finanzamt Offenburg*, ECJ Case Law IBFD and NL: ECJ, 22 Feb. 2018, Joined Cases C-398/16 and C-399/16, *X BV, X NV v. Staatssecretaris van Financiën*, ECJ Case Law IBFD.
21. *Bevola* (C-650/16), para. 34.
22. FR: ECJ, 28 Jan. 1986, Case 270/83, *European Commission v. French Republic (Avoir Fiscal)*, para. 20, ECJ Case Law IBFD.
23. *Bevola* (C-650/16), para. 34.

regarded as comparable".[24] This is because "to accept that a Member State may in all cases apply different treatment solely because the PE of a resident company is situated in another Member State would deprive Article 49 TFEU of its substance".[25]

According to the Court, where, as in the case at hand, the national legislation removes from the tax base both the income and losses of foreign PEs, this is intended to prevent the double taxation of income and, correspondingly, the double deduction of losses of foreign PEs. As regards such measures, companies with foreign PEs are not, as a rule, in a situation comparable to that of companies with a resident PE, for which conclusion the Court expressly refers to *Nordea Bank* and *Timac Agro*.[26] However, situations become comparable from the point of view of the objective of preventing double deduction of losses when the foreign PE (i) has ceased any activity and (ii) its losses can no longer be deducted in the state in which the PE is situated.[27] This approach is reinforced by considering the aim of the national provisions, which the Court said was to ensure that the taxation of a company with a foreign PE is in line with its ability to pay tax: a company with definitive foreign losses is in a situation comparable to that of a company with a loss-making resident PE.[28]

3.1.2. Justification of the restriction

Based on settled case law, the Court concluded that the Danish tax rules could be justified by overriding reasons in the public interest relating (i) to the balanced allocation of powers of taxation between the Member States, (ii) the coherence of the Danish tax system and (iii) the need to prevent the risk of double deduction of losses.

3.1.2.1. Balanced allocation of taxing rights

Regarding the balanced allocation of taxing rights, it is worth noting that the Court drew special attention to the possibility of the taxpayer being able to choose the place where the losses may be offset, which is something to be avoided.[29]

3.1.2.2. Coherence of the tax system

As to the coherence of the tax system, the Court recalled that the direct nature of the link between the tax advantage and the compensating tax charge must be examined in light of the objective pursued by the legislation in question.[30] On the one hand, a resident company may use the losses of its domestic PE but not foreign losses unless the company has opted for the international joint taxation regime. On the other hand, profits of the domestic PE are taxed in Denmark while profits attributable to the foreign PE are not, unless the international joint taxation regime applies. According to the Court, this national provision indeed establishes the necessary link between the tax advantage (use of losses) and the compensating tax charge (taxation of profits).[31] Such a direct link is, moreover, in line with the aim to tax according to the company's ability to pay because a "company's ability to pay tax would be systematically underestimated" if such "company possessing a PE in another Member State were allowed to set off against its results the losses incurred by that establishment without being taxed on the profits made by it".[32]

3.1.2.3. Double deduction of foreign losses

The risk of double deduction of foreign losses was also viewed by the Court as a justification,[33] although it was not expressly relied on by the Danish government.

3.1.3. Proportionality

In light of these justifications, the Court had to assess the proportionality of the measure and, in doing so, could largely rely on its decisions in *Marks & Spencer* and *Commission v. United Kingdom* (Case C-172/13).[34] As the Court narrowed down its analysis to the deductibility of "definitive losses", it has not directly ruled on the taxpayer's option to enter into the international joint taxation regime and its conditions.[35] The Court started its analysis by noting that "[w]here there is no longer any possibility of deducting the losses of the non-resident PE in the Member State in which it is situated, the risk of double deduction of losses no longer exists".[36] Denying cross-border loss utilization in such a situation would go beyond what is necessary to achieve the objectives of the Danish rules (i.e. a balanced allocation of the powers of taxation, coherence

24. Id., para. 35, referring to DE: ECJ, 22 Jan. 2009, Case C-377/07, *STEKO Industriemontage GmbH v. Finanzamt Speyer-Germersheim*, para. 33, ECJ Case Law IBFD.
25. *Bevola* (C-650/16), para. 35, referring to ECJ, 25 Feb. 2010, C-337/08, *X Holding BV v. Staatssecretaris van Financië*n, EU:C:2010:89, para. 23.
26. *Bevola* (C-650/16), paras 24 and 27.
27. Id., para. 38.
28. Id., para. 39.
29. Id., para. 43, referring to *X Holding BV* (C-337/08), para. 29.
30. *Bevola* (C-650/16), para. 45, referring, inter alia, to DE: ECJ, 30 June 2016, Case C-123/15, *Max-Heinz Feilen v. Finanzamt Fulda*, para. 30, ECJ Case Law IBFD.
31. *Bevola* (C-650/16), para. 48.
32. Id., paras. 49 and 50.
33. Id., para. 52, referring to UK: ECJ, 3 Feb. 2015, Case C-172/13, *European Commission v. United Kingdom of Great Britain and Northern Ireland*, ECJ Case Law IBFD.
34. *Commission v. United Kingdom* (C-172/13). For a detailed analysis, *see* CFE ECJ Task Force, *Opinion Statement ECJ-TF 2/2015 on the Decision of the European Court of Justice in* European Commission v. United Kingdom *("Final Losses") (Case C-172/13), Concerning the "Marks & Spencer Exception"*, 56 Eur. Taxn. 2/3 (2016), Journals IBFD.
35. *Bevola* (C-650/16), paras. 55-58. The Court, however, briefly addressed the conditions of the Danish international joint taxation regime and demonstrated sympathy for the underlying concepts (*Bevola* (C-650/16), para. 56): "It should be stressed that, if a resident company were free to define the extent to which that joint taxation was applied, it would be able to decide at will to incorporate only non-resident PEs facing losses, which would then be deducted from its taxable income in Denmark, while excluding establishments making profits and subject in their own Member State to a rate of tax that might be more favourable than in Denmark. Similarly, the possibility which would be left to the resident company of altering the extent of international joint taxation from one year to the next would be tantamount to allowing it to choose freely the Member State in which the losses of the non-resident PE in question were to be taken into account (see, to that effect, judgment of 25 February 2010, *X Holding*, C-337/08, EU:C:2010:89, paragraphs 31 and 32). Such possibilities would jeopardise both the balanced allocation of powers of taxation between Member States and the symmetry between the right to tax profits and the possibility of deducting losses sought by the Danish tax system".
36. *Bevola* (C-650/16), para. 58.

of the tax system and prevention of the risk of the double use of losses) and, conversely, "[a]lignment of the company's tax burden with its ability to pay tax is ensured better if a company possessing a PE in another Member State is authorised, in that specific case, to deduct from its taxable results the definitive losses attributable to that establishment".[37] In light of the coherence of the Danish tax system, however, "deduction of such losses can be allowed only on condition that the resident company demonstrates that the losses it wishes to set off against its results are definitive".[38] As for when a loss is "definitive", the Court referred to *Marks & Spencer*[39] and the further elaborations in *Commission v. United Kingdom*,[40] according to which "the losses incurred by a non-resident subsidiary may be characterised as definitive only if that subsidiary no longer has any income in its Member State of residence. So long as that subsidiary continues to be in receipt of even minimal income, there is a possibility that the losses sustained may yet be offset by future profits made in the Member State in which it is resident".[41] The Court then, without further discussion, found that standard to also be applicable to the situation of PEs in territorial systems.[42] "Definitive" losses hence exist where the company possessing the establishment (i) has exhausted all the possibilities of deducting those losses available under the law of the Member State in which the establishment is situated and (ii) has ceased to receive any income from that establishment, so that there is no longer any possibility of the losses being taken into account in that Member State.[43] The Court, however, ultimately left it to the national court to assess whether those conditions were satisfied in respect of Bevola's Finnish establishment.[44]

The Court hence concluded:

> Article 49 TFEU must be interpreted as precluding legislation of a Member State under which it is not possible for a resident company which has not opted for an international joint taxation scheme, such as that at issue in the main proceedings, to deduct from its taxable profits losses incurred by a PE in another Member State, where, first, that company has exhausted the possibilities of deducting those losses available under the law of the Member State in which the establishment is situated and, second, it has ceased to receive any income from that establishment, so that there is no longer any possibility of the losses being taken into account in that Member State, which is for the national court to ascertain.

37. Id., para. 59.
38. *Bevola* (C-650/16), para. 60, referring to *Marks & Spencer* (C-446/03), para. 56 and *Commission v. United Kingdom* (C-172/13), para. 27.
39. *Marks & Spencer* (C-446/03), para. 55.
40. *Commission v. United Kingdom* (C-172/13).
41. *See Bevola* (C-650/16), para. 63, referring to *Commission v. United Kingdom* (C-172/13), para. 36.
42. *See Bevola* (C-650/16), para. 64, noting that the standards set in *Marks & Spencer* (C-446/03) and *Commission v. United Kingdom* (C-172/13) for group taxation regimes "may be applied by analogy to the losses of non-resident permanent establishments".
43. *See Bevola* (C-650/16), para. 64.
44. Id., para. 65.

4. Comments

4.1. Introductory remarks

This Task Force has already had the opportunity to comment on the case law of the Court relating to cross-border use of losses: A 2009 Opinion Statement analysed the consequences for the state of residence of applying either worldwide or territorial taxation and the respective effects on the use of foreign losses in light of the Court's case law;[45] moreover, a 2015 Opinion Statement on *Commission v. UK*[46] addressed a number of issues relating to the question of whether losses are "definitive" ("final").[47] The present Opinion Statement will take up questions of comparability, the relevance of the principle of ability to pay in the context of loss utilization, and the definition of "definitive" or "final" losses in light of *Bevola* and other recent decisions. It should be noted at the outset that – in line with *Gielen* (Case C-44/08),[48] but without explicitly referring to it – the Court was not impressed by the existence of the optional "international joint taxation" regime under section 31A of the Danish Corporate Income Tax Act, the benefit of which "is subject to two strict conditions" (i.e. inclusion of global income and minimum period of 10 years).[49]

4.2. Comparability, ability to pay and double deduction of losses

The Court's explanations with regard to comparability of domestic ("resident") and foreign ("non-resident") PEs[50] are of particular importance. In an attempt to reconcile its decision in *Lidl Belgium* (Case C-414/06)[51] with those in *Nordea Bank* and *Timac Agro*, the Court resorted to linking the question of comparability to the existence of definitive losses. This marks an important new development that rejects a reading of the latter decisions as excluding the *ex ante* comparability between domestic and foreign PEs where the residence state applies a territorial tax system. In *Bevola*, the Court made it clear that it has not abandoned its approach to comparability of domestic and foreign situations from earlier case law.[52] This clarification is all the more relevant since its case law had already been misread in this manner by several national supreme courts in Europe.[53]

45. Confédération Fiscale Européenne, *Opinion Statement of the CFE ECJ Taskforce on Losses Compensation within the EU for Individuals and Companies Carrying Out Their Activities through Permanent Establishments: Paper Submitted by the Confédération Fiscale Européenne to the European Institutions in July 2009*, 49 Eur. Taxn. 10 (2009), Journals IBFD.
46. *Commission v. United Kingdom* (C-172/13).
47. CFE ECJ Task Force, *supra* n. 34, at p. 87 et seq.
48. NL: ECJ, 18 Mar. 2010, Case C-440/08, *F. Gielen v. Staatssecretaris van Financiën*, para. 49 et seq., ECJ Case Law IBFD.
49. *Bevola* (C-650/16), paras. 25-27.
50. The Court frequently uses the notion of "residence" when referring to PEs that are neither taxpayers nor persons (for example, *Bevola* (C-650/16), para. 30). It seems that this terminology is not used in a technical sense and must not, therefore, be confused with the international tax concept of tax residency, which only applies to persons.
51. DE: ECJ, 15 May 2008, Case C-414/06, *Lidl Belgium GmbH & Co. KG v. Finanzamt Heilbronn*, ECJ Case Law IBFD.
52. *Bevola* (C-650/16), para. 33.
53. *See* DE: *Bundesfinanzhof* (Federal Fiscal Court, BFH), 22 Feb. 2017, IR 2/15 and AT: *Verwaltungsgerichtshof* (Supreme Administrative Court, VwGH), 29 Mar. 2017, Ro 2015/15/0004.

The Court reaffirmed the principle that comparability needs to be assessed having regard to the aim of the national provision,[54] while rejecting the apparent consequence that comparability depends on the legal framework a given state adopts at a given time. A reading that would allow Member States to exclude comparability by designing its tax law in such a way as to always treat foreign PEs differently from domestic establishments would "deprive Article 49 TFEU of its substance".[55]

The Court also reiterated the statement from *Nordea Bank* and *Timac Agro* that "companies which have a PE in another Member State are not, in principle, in a comparable situation to that of companies possessing a resident permanent establishment" with respect to measures concerned with the prevention of double taxation.[56] This was followed in those decisions with an exception to this rule of non-comparability in the event that the state has decided to include the results from a resident company's foreign PE in its domestic tax base.[57] In *Bevola*, the Court made it clear that this was not to be understood to be the *only* exception to such a rule, as had been contended by several Member States intervening in the case.[58] The Court is undoubtedly correct in saying that such a reading of *Nordea Bank* (paragraph 24) and *Timac Agro* (paragraph 27) was not necessary, as these merely pointed to situations in which the Member State actually treated foreign PEs equal to domestic establishments; the same cannot be said regarding the statement in paragraph 65 of *Timac Agro*, wherein the Court denied comparability *solely* on the basis that Germany did not exercise any taxing powers over a foreign PE (that did not have definitive losses). In relation to that reasoning, the Court's clarification seems more like a reversal of the earlier decision. Rather than outright denying comparability in the equivalent situation, the Court accepted, in *Bevola*, that comparability may nevertheless follow from the existence of losses attributable to a foreign PE if that PE has "ceased activity and whose losses could not, and no longer can, be deducted from its taxable profits in the Member State [of its activity]".[59]

This result effectively corrects the overly restrictive approach seemingly taken in *Timac Agro*, which appeared to abolish the "*Marks & Spencer*" exception for "definitive losses" incurred by foreign PEs.[60] In doing so, it created a new uncertainty about the structure of the application of the fundamental freedoms, as the criterion defining comparability in this case seems to coincide with the standard used for testing proportionality.[61] The Court thus rejected anew the suggestions made by several Advocates General[62] who, concerned with the clarity and dogmatic coherence of the path taken by the Court in this context, urged the Court to drop both the exception for "definitive losses" and the traditional approach to comparability as relevant to the application of the freedom of establishment in such cases.[63]

The Court, finally, linked comparability to the ability-to-pay principle, noting that the relevant tax provisions aim to ensure taxation in line with the company's ability to pay, which requires the prevention of both double taxation and a double deduction of losses. The Court recognized that a company is "affected in the same way" whether its domestic establishment has incurred losses, or a foreign PE has "definitively incurred losses".[64] It is thus clear that comparability here is also inextricably linked to the objective of the tax system, which is to tax income in accordance with the taxpayer's ability to pay. It remains unclear, however, why the Court considers the situation of domestic losses only to be comparable to that of *definitive* foreign losses, since these are defined, in the Court's own case law, as losses that could never be taken into account anywhere other than the residence state. But the taxpayer's ability to pay is clearly already affected where a loss is not definitive: if a taxpayer's global income is 0, there is no ability to pay (or, in the Advocate General's words: there is no *tax paying capacity*) and thus no tax should be payable in the relevant tax year. This holds true regardless of whether it results from foreign or domestic losses. The fact that losses might be carried forward does not change the lack of capacity to pay taxes in the year the loss is incurred.[65]

54. *Bevola* (C-650/16), para. 32.
55. Id., para. 35.
56. Id., para. 37, referring to *Nordea Bank* (C-48/13), para. 24 and *Timac Agro* (C-388/14), para. 27.
57. *Nordea Bank* (C-48/13), para. 24 and *Timac Agro* (C-388/14), para. 28. In the latter case, the Court refers to Germany's granting of a "tax advantage" by permitting the deduction of losses, which established comparability. It should be noted here that the Court used that term (in line with its earlier case law on loss relief and the "coherence" justification) to establish a link between tax benefits and tax burdens, and not in the technical sense relevant to a State aid analysis: there is no indication in the Court's case law that the granting of loss relief would, in itself, be considered a tax advantage that could give rise to prohibited State aid. In fact, the recent decision in *Andres* (C-203/16P) makes it clear that loss relief could only be considered an "advantage" in this sense if it were a deviation from the normally applicable tax system (DE: ECJ, 28 June 2018, Case C-203/16 P, *Dirk Andres v. European Commission*, ECLI:EU:C:2018:505, para. 88).
58. *See* the arguments cited in *Bevola* (C-650/16), para. 30.
59. *Bevola* (C-650/16), para. 38.
60. Although one could rightly argue, as Advocate General Campos Sánchez-Bordona did in para. 57 of his Opinion, that this apparent deviation from *Marks & Spencer* (C-446/03) and *Lidl Belgium* (C-414/06) resulted merely from the fact that *Timac Agro* did not concern such definitive losses (as also pointed out clearly by Advocate General Wathelet in his Opinion in that case, at para. 67 (DE: Opinion of Advocate General Wathelet, 3 Sept. 2015, Case C-388/14, *Timac Agro Deutschland GmbH v. Finanzamt Sankt Augustin*, ECJ Case Law IBFD).
61. *See* sec. 4.4.
62. *See* FI: Opinion of Advocate General Kokott, 19 July 2012, Case C-123/11, *A Oy*, para. 50, ECJ Case Law IBFD; FI: ECJ, Opinion of Advocate General Mengozzi, 21 Mar. 2013, Case C-322/11, *K*, para. 88, ECJ Case Law IBFD; DK: Opinion of Advocate General Kokott, 13 Mar. 2014, Case C-48/13, *Nordea Bank Danmark*, para. 26, ECJ Case Law IBFD; and UK: Opinion of Advocate General Kokott, 23 Oct. 2014, Case C-172/13, *European Commission v. United Kingdom of Great Britain and Northern Ireland*, paras. 49-53, ECJ Case Law IBFD.
63. AG Opinion in *Nordea Bank* (C-48/13), para. 26.
64. *Bevola* (C-650/16), para. 39.
65. This is supported by the fact that countries typically do not deny a deduction of losses incurred by a domestic establishment on the basis that such loss might be capable of being offset against foreign profits in another country. Indeed, the Court has previously held that such a denial is an unjustifiable restriction of the freedom of establishment (UK: ECJ, 6 Sept. 2012, Case C-18/11, *The Commissioners for Her Majesty's Revenue & Customs v. Philips Electronics UK Ltd*, ECJ Case Law IBFD; *see also* ECJ, 14 Dec. 2000, C-141/99, *AMID*, EU:C:2000:696 and BE: ECJ, 4 Dec. 2000, Case C-141/99, *Algemene Maatschappij voor Investering en Dienstveriening NV (AMID) v. Belgische Staat*, ECJ Case Law IBFD.

Admittedly, the risk of double use of losses is increased whenever a PE exists outside the territory of the state of residence. Any double deduction would, as the Court also states,[66] be equally inconsistent with the ability-to-pay principle. Yet, the more proportionate way to prevent this remains a recapture mechanism at the time the state where the PE is situated actually grants such a deduction. This solution, which was already proposed by Advocate General Sharpston in *Lidl Belgium*[67] (but unfortunately rejected by the Court) is the only one that avoids a disadvantage resulting from establishing a presence in another Member State, which is protected by the freedom of establishment, while also safeguarding the fundamental principles underlying the tax system. The counterargument, that such a mechanism is insufficiently secure to prevent a double use of losses, is unconvincing in light of the experience with existing domestic (procedural) rules and in the context of increasingly effective exchange of information within the European Union.[68] But even if that risk were still considered to be so high as to potentially outweigh the freedom of establishment's restriction, this question ought to be analysed under the justification step, since it is an objection grounded in a lack of coordination of tax administrations rather than an aspect inherent to the companies involved and thus needs to be subject to a proportionality analysis.

4.3. Grounds of justification

In contrast with the lengthy discussion on comparability, the Court was rather brief in assessing the justifications for this measure. In this respect, the Court reviewed and considered three justifications: (i) a balanced allocation of taxing rights; (ii) coherence of the tax system; and (iii) risk of double deduction of losses. The analysis of the Court is aligned with the Court's traditional position in similar cases:[69]

4.3.1. Balanced allocation of taxing powers

Relying on *X Holding*,[70] the Court first found that allowing a deduction of losses of PEs located in other Member States would undermine the balanced allocation of taxing rights since it would allow taxpayers a right to choose the jurisdiction where its losses (and profits) are taken into account.

4.3.2. Coherence of the tax system

Second, tax coherence would also be undermined since there is a direct link between accepting the losses and taxing the profits of PEs. This link is particularly clear if one takes into account the joint taxation regime, pursuant to which the taxpayer can deduct losses of foreign PEs if it also opts for taxing its profits in Denmark.

4.3.3. Double use of losses

Lastly, and although not mentioned by the Danish government, the Court held that the national provision at stake could also be justified by the need to prevent double use of losses.[71]

4.4. Proportionality and the "definitiveness" of losses

The Court then analysed whether or not the legislation at issue goes beyond what is necessary to achieve those objectives and concluded that the risk of double deduction of losses no longer exists where there is no longer any possibility of deducting the losses of the non-resident PE in the Member State in which it is situated.[72] Referring to its decision in *Marks & Spencer*, the Court held that a Member State has to allow a company to deduct the "definitive losses" from its tax base attributable to a PE located in another Member State. Allowing the deduction of "definitive losses" is better aligned with the company's ability to pay.

In order to benefit from the deduction, the taxpayer is obliged to show that the losses in question satisfy the "*Marks & Spencer* requirements", as further clarified in *Commission v. United Kingdom*.[73] These requirements were originally stated in the context of a parent-subsidiary relationship and have to be applied by analogy to the losses of a foreign PE. As a result, losses attributable to a foreign PE become definitive if, first, the company possessing the establishment has exhausted all possibilities of deducting those losses available under the law of the Member State in which the establishment is situated and, second, it has ceased to receive any income from that establishment, so that there is no longer any possibility of the losses being taken into account in that Member State.[74] The second prong of the test – "ceased to receive any income from *that* establishment" – seems to imply that (future) positive income from other activities in the source state is irrelevant,[75] i.e. that the Court effectively equates a PE with a separate entity.

The "*Marks & Spencer* requirements" are now, in substance, applied both at the level of the comparability

66. *Bevola* (C-650/16), para. 39.
67. UK: Opinion of Advocate General Sharpston, 14 Feb. 2008, Case C-414/06, *Lidl Belgium*, para. 25, ECJ Case Law IBFD.
68. Such a recapture mechanism is indeed used in several Member States (*see*, for example, sec. 2(8) of AT: Income Tax Act, 1988, National Legislation IBFD) and has also been proposed by the European Commission (*see* Proposal for a Council Directive on a Common Corporate Tax base, COM(2016) 685 final (25 Oct. 2016), art. 42 on "Loss relief and recapture", EU Law IBFD [the Proposed CCTB Directive].
69. *Bevola* (C-650/16), paras. 41-54.
70. *X Holding* (C-337/08), paras. 28-29.
71. *See Bevola* (C-650/16), para. 52, referring to *Commission v. United Kingdom* (C-172/13), para. 24.
72. *Bevola* (C-650/16), para. 58.
73. *Commission v. United Kingdom* (C-172/13).
74. *Bevola* (C-650/16), para. 64.
75. For a contrary argument by the Austrian government, *see* AG Opinion in *Timac Agro* (C-388/14), para. 67, footnote 45: "According to the written observations of the Austrian Government, the losses of the Austrian PE accrued up to 2005 were in principle recoverable and capable of being deferred. The deferred losses could thus be set against any capital gain arising from the transfer, with any balance continuing to exist in principle for an unlimited period as deferred losses of Timac Agro. These losses could therefore be used at a later point in time if the applicant in the main proceedings resumed its business in Austria […]. The losses could also be passed on to the transferee limited company if the permanent establishment was transferred 'in a tax neutral manner' […]".

and proportionality analyses.[76] This comparability analysis, which seemingly includes a proportionality test, resembles, however, the approach in *Schumacker* (Case C-279/93)[77] and *X* (Case C-283/15),[78] wherein the Court also established comparability – from the source state's perspective – based on whether the other state is in a position to take certain tax benefits into account; in those cases, the Court effectively mingled the analytical levels of comparability and proportionality. Concerning comparability, the Court has already held that the situation of a resident company with a foreign PE is not different from that of a resident company with a domestic PE if the PE has ceased its activity and the losses attributable to the PE could not, and no longer can, be deducted from its taxable profits in the Member State in which it carried on its activity.[79]

5. The Statement

The Court's decision in *Bevola* represents a continuation of the Court's case law on cross-border use of losses. The CFE welcomes the Court's approach in *Bevola*, pursuant to which the comparability in territorial systems with regard to "definitive losses" is linked to the ability to pay. The Court's decision in *Bevola* reaffirms that its concept of "definitive losses", which was first established in *Marks & Spencer* and refined, inter alia, in *Commission v. United Kingdom* is still applicable to PEs. Rejecting a reading of *Nordea Bank Danmark* and *Timac Agro Deutschland* advanced by national governments, the European Commission and several national supreme tax courts, pursuant to which domestic and foreign PEs were deemed not comparable in territorial systems, the Court reiterated that the standard for testing comparability continues to be related to the aim pursued by the national provisions at issue. The CFE notes, however, the increasing difficulty of applying the comparability test in a coherent manner, despite the efforts of the Court in this respect.

The CFE welcomes that the Court in *Bevola* has linked the approach to comparability in territorial systems with regard to "definitive losses" to the idea of ability to pay. For the Court, if a loss is "definitive", the ability-to-pay principle requires such losses to be taken into account in the state of residence, as otherwise the enterprise would be taxed beyond its overall profits. It should be noted, however, that taking the loss into account when it is "final" or "definitive" in the source state implies that there are sufficient profits to offset the loss in the state of residence.

In applying the "final losses" doctrine, cross-border investing companies incurring losses are still at a disadvantage compared to a domestic company if the enterprise is overall profit-making: the purely national company can immediately deduct any losses, while a company that invests cross-border suffers at the very least an unfavourable "timing difference" on utilization of losses. It is doubtful whether this situation is really in line with the fundamental objective of the TFEU to create a Single Market without internal borders. The CFE, therefore, invites Member States to consider the introduction of immediate loss utilization with a recapture mechanism, and urges the European Commission to propose harmonizing measures in this respect.[80]

76. For a critical view regarding this duplication, *see* sec. 4.2. of this Opinion Statement.
77. DE: ECJ, 14 Feb. 1995, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*, ECJ Case Law IBFD.
78. NL: ECJ, 9 Feb. 2017, Case C-283/15, *X v. Staatssecretaris van Financiën*, ECJ Case Law IBFD.
79. *Bevola* (C-650/16), para. 38.
80. Such an idea is strongly supported by the CFE Tax Advisers Europe to the extent that its member organizations are in favour of the common corporate tax base itself (*see* CFE Tax Advisers Europe, Opinion Statement FC-1/2016 on the EU Public Consultation on the Relaunch of the CCCTB in Jan. 2016, available at http://taxadviserseurope.org/). *See* the (withdrawn) Commission Proposal COM(90)595 for the introduction of a cross-border loss relief mechanism and more recently, in the broader context of corporate tax base harmonization, art. 42 Proposed CCTB Directive, *supra* n. 68 on "Loss relief and recapture. *See also*, for example, AG Opinion in *Lidl Belgium* (C-414/06), para. 24: "Such a rule, which allowed the deduction of losses while providing for the recapture of the loss relief in future profitable periods, would manifestly be a less restrictive means of avoiding the risk that losses might be used twice than a rule altogether excluding relief for such losses. Although a deduction-and-recapture rule involves a loss of symmetry and hence does not wholly attain the objective of the balanced allocation of the power to tax, that asymmetry is merely temporary where the permanent establishment subsequently becomes profitable. Moreover provision could be made for automatic reincorporation of amounts previously deducted if reincorporation had still not occurred after, for example, five years, or if the permanent establishment ceased to exist in that form".