Question 1

Introduction

The aim of the European Union is the establishment of the internal market based on the removal of all restrictions to the free movement of goods, services, persons and capital (fundamental freedoms). Removal of those restrictions are so-called negative integration measures. And although the EU member states ("MSs") retained their competence in the direct tax area, the taxpayers often invoke fundamental freedoms in order to remove barriers for their intra-EU trade.

The fiscal integration, or tax unity, regime is applied in several MSs. The regime is an exemption to the principle that only the taxpayer who incurred the loss can use it to offset its taxable income. As a result, companies which form fiscal unity with other entities can take advantage of using losses of some companies to offset taxable profits of others. Fiscal unity regimes are generally limited to the entities resident in the same MS.

In the context of the creation of the internal market, taxpayers invoke their freedom of establishment to challenge the application of fiscal unity regimes only domestically. The Court of Justice of the EU ("CJEU" or "the Court") was therefore faced with the question on the cross border loss relief for subsidiaries located in other MSs (loss relief of foreign permanent establishments is not relevant in the case of fiscal unity regimes).

Marks & Spencer

The landmark case on cross-border loss relief is Marks & Spencer (C-446/03), which concerned the request by Marks & Spencer, tax resident in UK, to UK tax authorities to deduct from its taxable profits in UK losses incurred by its subsidiaries established in Belgium, France and Germany. The CJEU found the situations of UK company with local subsidiaries and UK company with foreign subsidiaries comparable, in which case it mean that the UK companies with foreign subsidiaries, by not being granted group relief, were put at a disadvantage compared to the UK companies with local subsidiaries. Thus the CJEU found that the freedom of establishment of Marks & Spencer was restricted (the fiscal unity regime generally have high holding threshold requirements where top company can exercise control over subsidiary thus we are talking about freedom of establishment and not of capital).

The restriction such as this at issue was capable of being justified by imperative reasons of public interest, the measure has to be appropriate and proportionate (not go beyond what is necessary to achieve the objective).

In Marks & Spencer Court found the restriction by the UK justified by free cumulative justifications: balanced allocation of taxing rights (used for a first time by the Court), risk of tax avoidance and risk of double-dipping of losses.

Nevertheless for the justifications to be proportionate in certain cases MSs have to allow the deduction of losses of foreign subsidiary, in particular when the foreign subsidiary exchausted all possibilities to use the losses in MS where it is resident, including for future periods (par 55 of the judgement). Therefore, the Court accepted that the use of losses of subsidiaries in other MSs does not have to be automatic.

Oy AA (C-231/05)

Another case concerning cross-border transfer of losses concerned finish company OY AA, which intended to make a financial transfer in favor of its parent company in the UK to compensate the losses of UK entity. Such transfers were allowed in a domestic context, but in this case was denied by the Finish tax authorities.

Similarly as in Marks& Spencer, the Court found that there indeed was restriction on the freedom of establishment. However, the Court accepted the justifications given by the Finish tax authorities, such as advanced by the UK tax authorities in Marks & Spencer, and the measures were considered proportionate.

X Holding

The case where the question of tax unity was approached the most directly was X Holding (C- 337/08), where Dutch resident company wanted to form a "single entity" with its Belgian subsidiary, and was denied this by Dutch tax authorities, while forming a "single entity" with the domestic subsidiary would have been allowed.

The Court made reference to Marks & Spencer, OY AA and Lidl Belgium to again accept the measure of Dutch legislation as justified.

Conclusion

Based on the above, on the EU law as it currently stands and the CJEU case law, MSs are not obliged to automatically allow their residents to offset losses of their subsidiaries resident in other MSs. This now seems to be a well-established case-law of the Court. As such, the application of tax unity regimes only to resident companies is not contrary to the internal market, since while the countries apply different treatment for cross-border and domestic situations which constitutes restriction on the freedom of establishment, such measures taken by MSs are accepted as justified.

Question 2

Introduction

Article 18 of the Treaty on the Functioning of the European Union ("TFEU") prohibits all discrimination in the EU on grounds of nationality (within the scope of the treaty and unless special provisions of TFEU apply). The special provision for free movement of workers is laid out in article 45 TFEU, which provides for abolishion of any discrimination on grounds of nationality between workers of MSs.

In the area of taxation, however, it is an accepted international principal and the taxation systems of countries are based on the concept of *resident* rather than *national*. Such a distinction is also enshrined in the OECD model tax convention. It is therefore accepted that countries may apply one set of rules to its residents (as a rule, tax them on their worldwide income) and another set of rules on non-residents (as a rule, tax them on income which is sourced within that country).

Schumacker

The Court addressed the question of treatment of resident s and non-residents in EU context extensively in Schumaker case (C-279/93), where it stated in par.31 that in relation to direct taxes, the situations of residents and of non-residents are not, as a rule, comparable.

The case concerned Mr Schumacker, resident in Belgium, who was employed in Germany.

However, the Court accepted that from the host MS perspective, the non-resident may become comparable to the resident where the non-resident obtains a major part of his income from the state of employment, with the result that the State of residence is not in a position to grant him the benefits relating to taking into account his personal and family circumstances. In Mr Schumacker case, his income earned in Germany formed almost an entire income of his household and neither him nor his spouse earned any significant income in Belgium.

It was concluded that there was discrimination due to the fact that Mr Schumacker's personal and family circumstances were not taken into account neither in the state of employment nor in the state of residence.

Here the Court established two main principles:
- The non-resident becomes comparable to the resident taxpayer when he earns majority of his income in the state of employment, where other state cannot take into account personal and family circumstances, in which case the discrimination of such non-resident is not permitted by internal market; and
- The principle echoed in later case law that the personal and family circumstances have to be taken into account somewhere (i.e. they cannot be ignored by both - employment and residence - state).

However, the Schumacker case left an important question unanswered: how much income constitutes the *majority* of income?

Some MS amended their domestic legislation to take into account Schumacker case and set specific thresholds of how much income should be earned in employment state in order to treat the non-resident as resident for tax purposes. E.g. in Luxembourg the threshold is set at 90%.

Gshwind

Similar situation was considered by the Court in the case of Gshwind (C-391/97). The Court, however, found the situation clearly different from the situation in Schumacker: Gschwind and his spouse received nearly 42% of their total income in their state of residence. As a result, the
Court concluded that the residence state is in a position to take into account Mr Gshwind's personal and family circumstances.

In Gshwind case, therefore, the situation of non-resident was not comparable with that of a resident.
Debate and conclusion

Based on the above referred case law of CJEU, the Court has taken the "all-or-nothing" approach: one state has to take into account personal and family circumstances to the full extent, while another state where the person might earn a significant amount of income does not have to take account to personal and family circumstances at all as long as income threshold is not reached (although the CJEU has not clearly established the threshold itself, it is rather being defined by the MSs).

The Court took the same approach in De Groot case, which is different from above cases because it is origin (outbound) and not host MS situation, but nevertheless the approach was the same: Netherlands, the residence MS, was not allowed to take into account personal and family circumstances of Mr De Groot only in proportion to his income earned in Netherlands, but had to take it into account in full. Some scholars argue that such approach as was envisaged by Netherland would be fairer to the MS and would divide the burden of tax allowances more equitably.

Question 3

The establishment of the European internal market has as one of its aims the removal of obstacles for freedom of establishment. Freedom of establishment is provided in article 49 TFEU, according to which national of a MS can choose to establish subsidiaries or branches.

In accordance to the case law of CJEU, the treatment of branches of companies incorporated in another MS and subsidiaries should not be different from the host MS perspective (Avoir Fiscal, Saint-Gobain). However, differences in treatment are accepted from the origin MS perspective (outbound), considering the nature of subsidiaries and permanent establishments: while subsidiary has a personality which is separate from its foreign parent and is subject to the worldwide taxation in the host MS, a permanent establishment does not have a separate legal personality from its foreign head office and is taxed only on limited income.

The important case concerning the deductibility of currency losses in relation to the foreign permanent establishment ("PE") is Deutsche Shell (C-293/06). In this case a German company established a PE in Italy (at the time Germany and Italy had different currencies). Upon repatriation of the start-up capital from the Italian PE, German company suffered currency loss which was not allowed to be deducted by Germany.

Although the capital was allocated to the Italian PE, it was not able to deduct the loss because it didn't suffer any accounting-wise (by their nature, currency losses could not be suffered by the PE). It was German company who suffered the loss and the Court emphasized that it was only Germany who was capable of taking the losses into account and thus refusal of deduction constituted restriction on freedom of establishment and was not justified.

Similarly as to individuals, we can see that the Court establishes the principle that the losses arising due to intra-group trade should be taken into account somewhere.

Bosal (C-168/01) addresses the situation similar to Deutsche Shell in a way that it concerned losses suffered by the foreign parent in connection with financing the subsidiary (although the case was related to the application of the parent subsidiary directive). In this case the Court concluded that the MS of the parent company cannot preclude the deduction of financing costs in relation to a subsidiary even if that subsidiary is not taxable in the MS of the parent.

Question 5

The most favoured nation ("MFN") principle is known in the area of international taxation. The countries A and B may choose to include the provision on MFN in their double tax treaty between which would say that if country A or country B concludes a double tax treaty with another country, e.g. country C, which provides for a more favourable treatment as compared to the treaty between A and B (e.g. lower rate of withholding tax on dividends), such more favourable provision will also apply between A and B.

Since direct tax area is not harmonized in the EU, the MS have competence to conclude the double treaties between themselves and with the third parties. Since double tax treaties, although most of the time based on the OECD model tax convention, are the result of the individual negotiations and bargaining power, they may provide for the different treatment in relation to different MS. This can result in the so-called horizontal discrimination.

Scholars have argued, so far unseccessfully that the MFN principle should apply in the context of the EU, thus the MS A could not treat the national of the MS B worse than the national of MS C.

The case which indirectly addressed the MFN question was Matteuci: italian national established in Belgium who was requesting a grant from Germany based on the cultural agreement between Germany and Belgium. The Court concluded that the Matteuci was entitled to the grant, but only as a result of establishment (acquired freedom of workers' rights) in Belgium. In other words, by establishing itself in Belgium the Italian national became comparable to Belgian nationals and thus obtained the right to the grant. Matteuci could not obtain the grant based on Germany- Belgium treaty just by virtue of being Italian national (Germany was not required to automatically extend the same benefits to Italians as to Belgians).

The MFN principle was tried to be invoked in D case (C-376/03). Mr D was a German national subject to wealth tax in Netherlands, and he argued the application of Belgium-Netherlands double tax treaty in respect of personal allowance.

The Court did not accept the argument stating that the fact that those reciprocal rights and obligations apply only to persons resident in one of the two contracting states is an inherent consequence of bilateral double taxation conventions, and that the rule such as laid down in Belgiu-Netherlands double tax treaty cannot be regarded as a benefit separable from the remainder of the convention contributing to its overall balance.

It can therefore be concluded that at the current stage of development of the community law,
MFN principle cannot be invoked by the taxpayers in the context of the internal market.

Question 7

The merger directive is one of the few tax directives issued in accordance with article 115 TFEU as part of the secondary law of the EU. The purpose of the merger directive is to facilitate the reorganizations so that taxation would not become an obstacle.

The merger is not designed to avoid the taxation of latent capital gains, rather to defer the taxation to the point in time when the capital gains are actually realized.

Article 6 of the merger directive provides that where the MS would apply provisions allowing the receiving company to take over the losses of the transferring company which had not yet been exhausted for tax purposes, it shall extend these provisions to cover the takeover of such losses by the receiving company's PEs situated within its territory.

The question of use of subsidiary's losses in case of cross-border merger was analysed by the Court in A Oy (C-123/11). In this case, no PE was intended to be left in the subsidiary's country, the subsidiary had to be liquidated.

The Court confirmed the rules laid down in Marks & Spencer and concluded that also in case of merger the MS of receiving company may have to take the losses into account of subsidiary company if the losses of the subsidiary are final - i.e. there is no possibility of them being taken into account in the state of residence of the subsidiary in future years either by itself or by a third party. The Court also addressed the rules for calculation of such losses and concluded that such rules may not constitute unequal treatment.