MONCKTON CHAMBERS

Case C-405/18
AURES Holdings a.s. v Odvolací finanční ředitelství ECLI:EU:C:2020:127

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A. Introduction

1. Unlike indirect taxation, direct taxation is not harmonised at EU level and in principle Member States are free to administer their direct tax systems as they wish. However, under EU law this freedom is not unlimited. Fifteen years ago, the judgment in *Marks & Spencer Plc v Halsey* (Inspector of Taxes) (C-446/03) EU:C:2005:763 held that tax rules preventing a company claiming relief for losses incurred by a non-resident subsidiary contravened Article 49 TFEU and the right to freedom of establishment where equivalent losses would have been deductible if incurred by a resident subsidiary. Although the Court had accepted that a restriction of this kind could be objectively justified in some circumstances to maintain fiscal autonomy, avoid double counting of losses and prevent tax avoidance, it found on the facts the measures there were disproportionate. Unsurprisingly, multinational companies have subsequently sought to extend the Marks & Spencer principle to other situations so as to benefit from cross-border group relief more generally; the present case represents the latest (unsuccessful) attempt to do so.

B. Factual background

2. AURES Holdings ("Aures") is a Dutch-registered motor company and was originally tax resident in the Netherlands too. In the 2007 tax year, it made a substantial loss which was assessed by the Dutch authorities accordingly. It subsequently established a Czech subsidiary, and in 2009 transferred its place of effective management (and thereby its tax residence) to the Czech Republic (though its registered seat continues to be in Amsterdam).

3. When its corporation tax liabilities for the 2012 tax year came to be assessed by the Czech authorities, Aures attempted to offset its Dutch losses from five years previously, but this was refused. Under Czech tax law, the company was liable for tax on its worldwide income, but could only deduct from its tax base a loss arising from previous years' economic

activity in the Czech Republic; as such it was not permitted to transfer a loss from another Member State.

C. National Court proceedings

4. Aures' domestic appeals were unsuccessful. It had relied on the *Mark & Spencer* principle to claim that preventing it from deducting its historic Dutch losses against its 2012 profits contravened the principle of freedom of establishment. The Prague City Court disagreed; rather it found that Aures' case was objectively different from the circumstances in the judgements that the company relied upon, and hence concluded that the *Marks & Spencer* principle did not apply.

5. Aures continued to maintain that the refusal to allow it to deduct its 2007 tax loss – for which it could no longer claim in the Netherlands following its relocation – amounted to an unjustified restriction on its freedom of establishment, and brought a further appeal before the Czech Supreme Court. The latter sought a preliminary ruling from the Court of Justice on the following questions:

    5.1. Firstly, did the principle of freedom of establishment apply to the case of a cross-border transfer of a company's place of effective management?

    5.2. Secondly, if it did, was national legislation that did not allow a company to transfer a loss incurred prior to the transfer compatible with that freedom?

D. CJEU decision

The first question

6. As to the first question, the Court of Justice agreed that a company transferring its tax residency and effective management (though not its registered seat) was exercising its freedom of establishment and therefore could in principle rely on Article 49 TFEU to challenge tax consequences resulting from that transfer. This was converse of the situation in *C-371/10 National Grid Indus* EU:C:2011:785, where the Court had allowed a company to rely on Article 49 to challenge its treatment in the Member State of origin following a similar transfer of effective management abroad. Any other interpretation, the Court said, '*would fall foul of the very wording of the provisions of EU law on freedom of establishment, which are, inter alia, aimed at ensuring that foreign nationals are treated in the host Member State in the same way as nationals of that State*.' The first question had therefore to be answered in the affirmative.

The second question

7. The second question was more complex and involved assessing whether any difference in treatment that arose under national law was justified either because the position of a transferring foreign company was not objectively comparable to that of a domestic company, or alternatively because overriding reasons of public interest prevailed.

8. The Court began by noting that while establishing a subsidiary in another Member State was indeed a manifestation of freedom of establishment, there was no requirement that a cross-border transfer of place of effective management need be tax neutral. Freedom of establishment did not require all disparities in national tax rules to be removed.

9. Turning more specifically to the case in hand, the ability to deduct a loss incurred in a previous tax year from the profits of a subsequent tax year represented a 'tax advantage', and making deductibility dependent on residence was in principle differential treatment which might thereby discourage a company from transferring its activities abroad. In this context, it was necessary to consider justifications.

10. As regards objective comparability of cross-border situations, the starting point was to examine the aim of the national measure in question. Preventing losses incurred by a company in a year when it had been tax resident in another country served to preserve the allocation of the power to impose taxes between Member States and prevent the risk of double deductions. As such, the loss incurred in a previous year when the company had been tax resident in its current host was not objectively comparable to a loss incurred in a previous tax year when it had been tax resident elsewhere. On the contrary, if companies were allowed to transfer losses in the manner sought, there was a greater risk that the relief due would be claimed twice.

11. The Court also noted a particular argument emphasised by the UK in its submissions, that comparability of the two situations depended on whether the loss was final or not. Unlike the situation in *Bevola and Jens W. Trock* (C-650/16) EU:C:2018:424, concerning losses attributable to a non-resident permanent establishment which had ceased activity and could no longer be deducted from the company's taxable profits in that Member State, here the situation involved a company transferring its tax residence but still seeking to deduct a loss incurred when it had fallen exclusively under the tax jurisdiction of the previous Member State.

12. Moreover, extending the *Bevola* principle further would be incompatible with Court's case law on exit taxation, which acknowledged that taxing unrealised capital gains upon transfer was permitted under Article 49 TFEU.

Conversely, then, the Member State of transfer could not be expected to take into account a loss incurred before the transfer and relating to years in which the company had been tax resident elsewhere.

13. As such, the Court was satisfied that tax resident companies which suffered a loss in their Member State of residence and companies which transferred their tax residence, having incurred a loss in another Member State during a tax year wherein they had been tax resident in the latter, were not in comparable situations. Such a result followed from the objectives of preserving the allocation of the power to impose taxes between the Member States and preventing the double deduction of losses.

E. Comment

14. This judgment will come as a relief to tax authorities across Europe (no less than seven national governments having intervened in the European proceedings). The Court has affirmed that Article 49 TFEU has relatively limited application to the field of direct taxation, preserving Member State autonomy in this area of competence and not allowing multinational companies to shift historic losses around Europe regardless of tax residency in order to benefit from more favourable rates or regimes. Conversely, the Court was clearly concerned to prevent companies being able to claim relief twice (first offsetting losses against profits in the Member State of tax residence in one year, then offsetting the same losses against profits made in the new Member State of tax residence in a subsequent tax year).

15. The *Marks & Spencer* case is not analysed in detail, notwithstanding that the Commission had argued that the proposed extension of the *Marks & Spencer* ruling on a temporal basis would only involve a limited expansion of the principle. In *Marks & Spencer*, the Court found that preventing the company from claiming group relief on the losses of its defunct foreign subsidiaries contravened the principle of freedom of establishment because the tax rules in question were not proportionate to the legitimate objectives pursued. There, the non-resident subsidiaries were no longer able to have their historic losses taken into account in the host Member State such that their losses were 'final' and determined losses, so prohibiting the parent claiming relief for them at home effectively ruled out the possibility of these losses benefiting from any relief at all. The requirement for final or determinative losses was repeated by the CJEU in the recent decisions in case C-607/17 *Skatteverket v Memira Holding AB* and case C-608/17 *Holmen*.

16. Although Aures has remained at all times a Dutch-registered company, it appears from paragraph 17 of the judgement that – similar to *Marks & Spencer* – it is now unable to claim relief for its 2007 losses in the Netherlands, so has equally been prevented from obtaining the benefit of

deductibility of those losses(and is not, by contrast, seeking to deduct the same losses twice in different Member States). However, there was no reason why those losses could not previously have been deducted in the Netherlands even if the value of those losses were insubstantial: losses could not be rendered final or determined losses because of the failure of the undertaking to use those losses at a time when such use was possible.

17. The important difference here is tax residency. In *Marks & Spencer*, the parent company was tax resident in the United Kingdom throughout, including during the period in which its subsidiaries' losses had been incurred; by contrast, Aures had been under the exclusive jurisdiction of the Dutch tax authorities during the 2007 tax year (and indeed had had no presence in Czech Republic at all in that period). Thus while Aures does appear to have been penalised in tax terms for transferring its place of effective management to the Czech Republic, the decision does still makes sense from the perspective of broader taxation principles: given that the Czech authorities would have no jurisdiction to impose any tax burden on the company for the 2007 tax year, they equally cannot be expected to grant it any tax benefit in respect of the same, when its activities were instead the exclusive preserve of the Dutch tax regime.

18. The force of the judgment is therefore to preserve the allocation of the power to impose taxes between Member States and to ensure that, save where losses were genuinely final losses which had no prospect of being used in the Member State in which they arose, Member State tax authorities should not bear the burden of tax losses in relation to trading where there was no possibility to levy tax on any associated trading or gains by that undertaking. The extension of the principle of final losses set out in *Marks & Spencer* to differing accounting periods in the different Member States concerned was also effectively rejected.

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