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Press and Information

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Judgment of the Court of Justice in Case C-446/03

Marks & Spencer plc v *David Halsey (Her Majesty's Inspector of Taxes)*

A GROUP RELIEF SCHEME WHICH DOES NOT ALLOW A PARENT COMPANY TO DEDUCT THE LOSSES INCURRED BY ITS SUBSIDIARIES ESTABLISHED ABROAD FROM ITS TAXABLE PROFITS IS, IN PRINCIPLE, COMPATIBLE WITH COMMUNITY LAW

However, it is contrary to freedom of establishment to preclude the possibility for the resident parent company to deduct the losses incurred by non-resident subsidiaries from its taxable profits, if the parent company shows that those losses were not and could not be taken into account in the State of residence of those subsidiaries.

Marks & Spencer, a company registered in England and Wales, is one of the largest United Kingdom retailers of clothing, food, homeware and financial services. It had subsidiaries in the United Kingdom and in a number of Member States. In 2001 it ceased trading in Continental Europe owing to the losses recorded from the mid-1990s.

Marks & Spencer claimed group relief from the United Kingdom tax authorities for losses incurred by its Belgian, German and French subsidiaries. Under the United Kingdom provisions[1] the resident companies in a group may set off their profits and losses among themselves but are not allowed do so where the losses are incurred by subsidiaries which have no establishment in the United Kingdom and do not trade there.

Following the refusal of its claim, Marks & Spencer brought legal proceedings. The High Court of Justice (England and Wales), Chancery Division, asks the Court of Justice of the European Communities whether the United Kingdom provisions are compatible with the provisions of the EC Treaty on freedom of establishment.

The Court reiterates, first of all, that although direct taxation is within the competence of the Member States, the latter must exercise that competence with respect for Community law.

[1] The Income and Corporation Taxes Act 1988 (ICTA).

The Court then finds that the **United Kingdom provisions constitute a restriction on freedom of establishment.** In effect, the United Kingdom rules apply different treatment for tax purposes to losses incurred by a resident subsidiary and losses incurred by a non-resident subsidiary. They therefore discourage undertakings from setting up subsidiaries in other Member States.

Such a restriction is permissible only where it pursues a legitimate objective compatible with the Treaty and is justified by overriding reasons in the public interest. It is further necessary, in such a situation, that the restriction be apt to ensure the attainment of the objective in question and that it does not go beyond what is necessary to attain that objective.

In the light of the three justifications relied on by the Member States, namely:

– to protect a balanced allocation of the power to impose taxation between the various Member States concerned, so that profits and losses are treated symmetrically in the same tax system;

– to avoid the risk of the double use of losses which would exist if the losses were taken into account in the Member State of the parent company and in the Member States of the subsidiaries; and

– to avoid the risk of tax avoidance which would exist if the losses were not taken into account in the subsidiaries' Member States. Within a group of companies, losses might be transferred to the companies established in the Member States which apply the highest rates of taxation and in which the tax value of the losses is therefore the highest,

the Court considers that the United Kingdom provisions pursue legitimate objectives which are compatible with the EC Treaty and constitute overriding reasons in the public interest.

However, **the Court considers that the United Kingdom provisions do not observe the principle of proportionality**, that is to say, that they go beyond what is necessary to attain the objectives pursued, where:

– the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account in its State of residence for the accounting period concerned by the claim for relief and also for previous accounting periods, and

– there is no possibility for the foreign subsidiary's losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.

Consequently, where in one Member State the resident parent company demonstrates to the tax authorities that those conditions are fulfilled, it is contrary to freedom of establishment to preclude the possibility for the parent company to deduct from its taxable profits in that Member State the losses incurred by its non-resident subsidiary.

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