Case C-538/20

Summary of the request for a preliminary ruling pursuant to Article 98(1) of the Rules of Procedure of the Court of Justice

Date lodged:

21 October 2020

Referring court:

Bundesfinanzhof (Germany)

Date of the decision to refer:

6 November 2019

Defendant and appellant in the appeal on a point of law:

Finanzamt B

Applicant and respondent in the appeal on a point of law:

W AG

Subject matter of the main proceedings

Freedom of establishment – Article 43 EC – Corporation tax – Local business tax – Resident company – Non-resident permanent establishment – Closure – Losses – Taking account of the losses of the non-resident permanent establishment – Final losses – Possibility of opening a new permanent establishment – Ability to carry forward losses earlier – Relevant rules for calculating profits

Subject matter and legal basis of the reference

Interpretation of EU law, Article 267 TFEU

Questions referred

1. Is Article 43, in conjunction with Article 48, of the Treaty establishing the European Community (now Article 49, in conjunction with Article 54, of the Treaty on the Functioning of the European Union) to be interpreted as

precluding legislation of a Member State which prevents a resident company from deducting losses incurred by a permanent establishment in another Member State from its taxable profits where, first, the company has exhausted the possibilities to deduct those losses available under the law of the Member State in which the permanent establishment is situated and, second, it has ceased to receive any income from that establishment, so that there is no longer any possibility of account being taken of the losses in that Member State ('final' losses), if the legislation in question concerns an exemption for profits and losses under a bilateral convention for the avoidance of double taxation between the two Member States?

2. If the first question is answered in the affirmative: Is Article 43, in conjunction with Article 48, of the Treaty establishing the European Community (now Article 49, in conjunction with Article 54, of the Treaty on the Functioning of the European Union) to be interpreted as also precluding the legislation under the German Gewerbesteuergesetz (Law on local business tax) which prevents a resident company from deducting from its taxable business earnings 'final' losses of the type referred to in the first question of a permanent establishment in another Member State?

3. If the first question is answered in the affirmative: In the event of the closure of the permanent establishment in the other Member State, can there be 'final' losses of the type referred to in the first question, even though there is at least a theoretical possibility that the company might once more open in the Member State concerned a permanent establishment, any profits of which could be offset against the previous losses?

4. If the first and third questions are answered in the affirmative: Can the losses of the permanent establishment which, under the law of the State in which that establishment is situated, could have been carried forward to a subsequent tax period on at least one occasion also be considered to be 'final' losses of the type referred to in the first question of which account is to be taken by the State in which the parent establishment is resident?

5. If the first and third questions are to be answered in the affirmative: Is the obligation to take account of cross-border 'final' losses limited as to amount by the amounts of losses which the company could have calculated in the State in which the permanent establishment is situated, were the taking account of losses not precluded there?

Provisions of Community law cited

Article 43 EC (now Article 49 TFEU)

Article 48 EC (now Article 54 TFEU)

Provisions of national law cited

Grundgesetz für die Bundesrepublik Deutschland (Basic Law of the Federal Republic of Germany, 'the GG') (in the revised version published in the *Bundesgesetzblatt*, Part III, subsection number 100-1, most recently amended by Article 1 and second sentence of Article 2, of the Law of 29 September 2020 [BGBl. I p. 2048]), in particular the third sentence of Article 28(2), Article 72(2), Article 105(2) and the first, second and fourth sentences of Article 106(6)

Convention between the Federal Republic of Germany and the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion of 26 November 1964 (BGBl. 1966 II p. 359) (as amended by the revising Protocol of 23 March 1970 [BGBl. 1971 II p. 46]), in particular the first and second sentences of Article III, paragraph 1, and Article XVIII, paragraph 2, the first and second sentences of subparagraph (a) and subparagraph (b)

Einkommensteuergesetz (Law on income tax, 'the EStG') (in the version applicable to the 2007 assessment period), in particular Paragraph 4(1)

Körperschaftsteuergesetz (Law on corporation tax, 'the KStG'), (in the version applicable to the 2007 assessment period), in particular point 1 of Paragraph 1(1) and Paragraph 8(1) and (2)

Gewerbesteuergesetz (Law on local business tax, 'the GewStG') (in the version applicable to the 2007 assessment period), in particular Paragraph 1, the first and third sentences of Paragraph 2(1), and the first sentence of Paragraph 2(2), the first sentence of Paragraph 5(1), the first sentence of Paragraph 7, Paragraphs 8 and 9, the first, second, sixth and seventh sentences of Paragraph 10a, the first and second sentences of Paragraph 11(1), Paragraph 14 and Paragraph 16(4)

Abgabenordnung (Tax Code, 'the AO') (in the version published on 1 October 2002 [BGBl. I p. 3866; 2003 I p. 61], last amended by Article 7 of the Law of 12 August 2020 [BGBl. I p. 1879]), in particular Paragraph 3(2)

Brief summary of the facts and procedure

1 The applicant and respondent in the appeal on a point of law is an *Aktiengesellschaft* (public limited company). Its registered office and place of management are located in Germany. A branch in the United Kingdom that had been opened in August 2004 was closed in the first half of 2007 after having incurred losses.

2 The applicant and respondent in the appeal on a point of law has a financial year not based on the calendar year, ending on 30 June of each year. Due to the closure, the losses of the branch from the 2004/2005, 2005/2006 and 2006/2007 financial years could no longer be carried forward in the United Kingdom. The

applicant and respondent in the appeal on a point of law therefore wishes to have account taken of those losses, which it calculated in accordance with the German rules for calculating profits, as final losses in Germany in the 2007 tax period for the purposes of determining the income relevant for corporation tax and local business tax (taxable income or business earnings). The Finanzamt B (tax office of B, 'the Finanzamt') refuses to allow this.

3 The applicant and respondent in the appeal on a point of law brought an action against that refusal. It was successful at first instance.

4 The referring court is now called upon to rule on the appeal on a point of law brought by the Finanzamt against the judgment at first instance. The Bundesministerium der Finanzen (Federal Ministry of Finance), which joined the proceedings as an intervener, supports, in substance, the position taken by the Finanzamt.

Brief summary of the grounds for the reference

5 Under German law it is not possible to take account of the losses of a branch, as the applicant and respondent in the appeal on a point of law seeks to do. The losses incurred in the United Kingdom are excluded, from the outset, from the basis of assessment for corporation tax under the double taxation convention concerned and therefore do not form part of the business earnings, which are based on the profit to be calculated under the provisions of the Law on corporation tax.

6 The first sentence of Article III, paragraph (1), of the DBA-Great Britain 1964/1970 (Double Taxation Convention – Great Britain) provides that the industrial or commercial profits of an undertaking of one of the territories are to be subject to tax only in that territory unless the undertaking carries on a trade or business in the other territory through a permanent establishment situated therein. If, through a permanent establishment in the other territory, the undertaking carries on a trade or business through a permanent establishment situated therein, the profits of the undertaking may be taxed in the other territory, but only to the extent to which they are attributable to that permanent establishment (second sentence of Article III, paragraph 1, of the DBA-Great Britain 1964/1970). Under the first sentence of Article XVIII, paragraph 2(a), of the DBA-Great Britain 1964/1970, in the case of a person resident in Germany there is to be an exclusion from the basis of assessment of German tax in respect of income from sources within the United Kingdom (Great Britain) and capital situated within Great Britain, which in accordance with that Convention can be taxed in Great Britain, unless Article XVIII, paragraph 2(b), of the DBA-Great Britain 1964/1970 applies, which is indeed not so in the present case. However, Germany retains the right to take such excluded income and capital into account when setting the tax rate (second sentence of Article XVIII, paragraph 2(a), of the DBA-Great Britain 1964/1970).

7 Although in the first sentence of Article III, paragraph 1, of the DBA-Great Britain 1964/1970 only profit from industrial or commercial activity is expressly mentioned, under Article XVIII, paragraph 2(a), of the DBA-Great Britain 1964/1970 negative income is also to be excluded from the basis of assessment for corporation tax in the State of residence. Under settled case-law, even if the concept of income applied in accordance with the convention rules on distribution refers to a net amount, losses are also to be excluded from the basis of assessment of German tax (the so-called 'symmetry theory').

8 For the applicant as a public limited company subject to unlimited corporation tax, in relation to which, in accordance with Paragraph 8(2), in conjunction with point 1 of Paragraph 1(1), of the KStG, all income is to be treated as income from industrial or commercial activity, the starting point for determining the business earnings is consequently the profit determined in accordance with the provisions of the Law on corporation tax for the year 2007. Income, including such negative income, which under an agreement on avoidance of double taxation is to be excluded from the basis of assessment for corporation tax, therefore does not form part of the business earnings as provided for in Paragraph 7(1) of the GewStG from the outset. Use of the provision in Paragraph 9(3) of the GewStG, in accordance with which the basis of assessment for local business tax of a domestic undertaking is to be reduced by the amount of the business earnings, which is allocated to a non-domestic permanent establishment, is not required in situations involving exemption from tax under a convention

9 EU law could require account to be taken of the branch's losses, as sought by the applicant and respondent in the appeal on a point of law , in terms of freedom of establishment (Article 43 EC, now Article 49 TFEU) if

– the situation of the applicant and respondent in the appeal on a point of law (cross-border situation) is objectively comparable to the situation of a company with a branch in Germany (purely domestic situation), and

– the restriction of the freedom of establishment is not justified (final losses).

10 The referring court cites the following judgments of the Court of Justice in that regard:

– of 13 December 2005, *Marks & Spencer* (C-446/03, EU:C:2005:763);

– of 15 May 2008, *Lidl Belgium* (C-414/06, EU:C:2008:278);

– of 17 December 2015, *Timac Agro Deutschland* (C-388/14, EU:C:2015:829);

– of 12 June 2018, *Bevola and Jens W. Trock* (C-650/16, EU:C:2018:424).

Whether it is objectively comparable

Corporation tax (question 1)

11 In the present case, the cross-border situation differs from a purely domestic situation primarily due to the fact that, by virtue of the double taxation convention, the losses concerned are from the outset not subject to the tax jurisdiction of the Federal Republic of Germany.

12 However, in accordance with the judgment of the Court of Justice of 12 June 2018, *Bevola and Jens W. Trock* (C-650/16, EU:C:2018:424), objective comparability must be assessed with regard to the purpose of the national provisions at issue. The application of different tax rules of national law to a domestic company depending on whether it has a resident permanent establishment or a non-resident permanent establishment is not in itself a decisive factor.

13 The purpose of the double taxation convention is, amongst other things, to prevent the double deduction of losses. Thus, the situation of a company with unlimited tax liability which maintains a non-resident branch with final losses does not differ from that of a company with unlimited tax liability whose resident branch has incurred such losses.

14 The question is whether it makes a difference in that regard whether the difference in treatment (account not taken of losses) is based on a unilateral provision of national law – as in the case underlying the Court of Justice's judgment of 12 June 2018 in *Bevola and Jens W. Trock* (C-650/16, EU:C:2018:424) – or on a bilateral convention – as in the present case. In that context, it is stated in the case-law and legal literature that the purpose of the double taxation convention also consists in allocating taxation powers between countries. It is also stated that, by virtue of the double taxation convention, Germany waived its taxation right in relation to the losses at issue in the present case.

15 As regards the purpose of the double taxation convention, it should be noted in general that, in order to achieve the objective of avoiding double taxation, the contracting States chose, in respect of income from permanent establishments, the exemption method, by which the right to tax is attributed to only one of the contracting States, namely the State in which the permanent establishment is situated.

16 In contrast to the credit method, under which both contracting States retain their respective powers of taxation and the State of residence merely undertakes to offset the tax incurred in the source State against its own tax, under the exemption method the State of residence completely waives its right to tax based on its own sovereignty. That waiver is comprehensive and does not depend on actual taxation in the source State. It therefore applies even if the source State does not tax the income.

17 The exemption method is based on the concept that the State from which the income originates has a ‘better’ right to tax; the exempting State therefore gives way. In economic terms, the exemption method should bring about a level playing field in the source State among investors from different countries (capital import neutrality).

18 The objective of taxation on the basis of the ability to pay tax, as referred to in the judgment of the Court of Justice of 12 June 2018, *Bevola and Jens W. Trock* (C-650/16, EU:C:2018:424), is a general, abstract principle of taxation. It is not appropriate to add to the exemption method under the convention an additional purpose that is not already expressed in the specific objectives of avoiding double taxation and the double deduction of losses.

Local business tax (question 2)

19 As regards local business tax also, the cross-border situation in the present case differs from the purely domestic situation primarily due to the fact that, by virtue of the double taxation convention, the losses concerned are, from the outset, not subject to the tax jurisdiction of the Federal Republic of Germany. Like corporation tax, local business tax falls within the scope of the double taxation convention. Owing to the reference to the rules for calculating profits that are applicable to corporation tax, income – including negative income – which under the double taxation convention is to be excluded from the basis of assessment for corporation tax does not form part of the basis of assessment for local business tax from the outset either.

20 There appears therefore to be no reason why the requirements of EU law and the primacy of those requirements should not also apply to local business tax.

21 Regarding the purposes of local business tax, it should be noted that it is an object-related municipal tax that is payable in addition to income tax or corporation tax.

22 Historically, local business tax is based on the principle of equivalence. It is intended to provide compensation for the specific burdens imposed on municipalities by industry, trade and crafts, such as the development of land for construction, the creation of traffic areas, the operation of local public transport, the construction and maintenance of roads, hospitals and cultural and other municipal establishments.

23 The basis of assessment for local business tax is the profits deriving from industrial or commercial activity, calculated in accordance with the provisions of the Law on income tax or the Law on corporation tax. However, that is increased by certain additions and reduced by certain deductions, resulting in a difference in the profit calculated in accordance with the provisions of the Law on income tax or the Law on corporation tax and therefore also in a difference in the subjective concept of ability to pay tax.

24 The main argument put forward against taking account of final losses within the framework of local business tax is that that tax has a structural domestic connection (principle of territoriality) and is object-related.

25 Unlike corporation tax, which is based on the principle of taxing companies on their worldwide profits, local business tax does not in fact require any symmetrically applied protection by means of a double taxation convention.

26 Moreover, the United Kingdom does not actually have a non-personal tax that is comparable to the German local business tax. The exclusion of the deduction of losses in local business tax is based primarily on the fact that, from the outset, the source State, the United Kingdom, did not permit the deduction of losses for local business tax purposes. Germany was not obliged under EU law to bear the consequences of that decision of the source State. That follows from the judgment of the Court of Justice of 23 October 2008, *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt* (C-157/07, EU:C:2008:588).

Final losses

Finality

– *Possibility of opening a new permanent establishment (question 3)*

27 The referring court has to date considered that the losses of a foreign permanent establishment are final within the meaning of the case-law of the Court of Justice if, for factual reasons, account can no longer be taken of the losses in the source State or if, although it is theoretically still possible to deduct them in that State, it is virtually impossible to deduct them for factual reasons and a subsequent deduction nevertheless carried out, contrary to expectations, could still be reviewed retrospectively under procedural law in the domestic territory.

28 Accordingly, it must be found that final losses exist in the present case. By dismissing the employees and transferring the lease for the rented premises, the applicant and respondent in the appeal on a point of law did everything to terminate its activity in the United Kingdom and to convince the court that it was unlikely that any income and, above all, any profit would be realised by a branch in the United Kingdom from which the losses incurred until the closure could be deducted in the future.

29 According to the most recent case-law of the Court of Justice, namely the judgments

– of 19 June 2019, *Memira Holding* (C-607/17, EU:C:2019:510, paragraph 25 et seq.) and

– of 19 June 2019, *Holmen* (C-608/17, EU:C:2019:511, paragraph 37 et seq.),

30 it is however unclear

– whether it is not also necessary to examine whether, under the law applicable in the State in which the permanent establishment is situated, it would have been conceivable for third parties to exploit the losses, for example after the permanent establishment had been incorporated into a corporation and the shareholding subsequently sold; and

– whether the theoretical possibility that the company could at any time one more open in the Member State concerned a permanent establishment, any profits of which could be offset against the previous losses, does not preclude an assessment that there are final losses.

– *Ability to carry forward losses earlier (question 4)*

31 In addition to the losses incurred in the tax period in which the permanent establishment was closed (2007 tax period, 2006/2007 financial year), the applicant and respondent in the appeal on a point of law claims that account should also be taken of those losses which were incurred in the previous tax periods (2005 and 2006, 2004/2005 and 2005/2006 financial years) and in respect of which it is to be assumed that, under United Kingdom tax law, they could be carried forward to the subsequent tax period in each case.

32 The Federal Ministry of Finance takes the view that a loss which could have been carried forward at a certain point in time but was not carried forward can no longer be regarded as a final loss.

33 It cites the following judgment of the Court of Justice in that respect:

– of 3 February 2015, *Commission* v *United Kingdom* (C-172/13, EU:C:2015:50).

34 The view taken by the Federal Ministry of Finance is in line with the view taken by Advocate General Kokott in the following Opinions:

– of 10 January 2019, *Memira Holding* (C-607/17, EU:C:2019:8, point 57 et seq.);

– of 10 January 2019, *Holmen* (C-608/17, EU:C:2019:9, point 50 et seq.).

Applicable rules for calculating profits (question 5)

35 The applicant and respondent in the appeal on a point of law calculated the alleged losses of the United Kingdom branch on the basis of the German rules for calculating profits.

36 That is in line with the existing case-law of the referring court and the Court of Justice. According to that case-law, the domestic rules for calculating profits are

applicable, because the obligation to take account of cross-border losses on an exceptional basis under EU law is to be derived from the need for equal treatment of companies operating only in Germany and companies that also have permanent establishments in other Member States.

37 The referring court cites the following judgment of the Court of Justice in that respect:

– of 21 February 2013, *A* (C-123/11, EU:C:2013:84).

38 However, the question arises as to whether the obligation to take account of cross-border losses is not limited as to amount by the amounts of losses which the company could have calculated in the State in which the permanent establishment is situated were the taking account of losses not precluded there.

39 The reason for this is that, had it been possible to take account of the losses in the State in which the permanent establishment is situated, the State in which the parent establishment is resident would not have been obliged, on the grounds of equal treatment, to allow a deduction of losses in respect of the difference from the (higher) loss amount resulting from its own rules for calculating profits.

40 It is questionable whether freedom of establishment requires the State in which the parent establishment is resident, where there are final losses, to place the company in a better position than it would have otherwise have been in if the losses could have been claimed in the State in which the permanent establishment is situated.

41 In the situation where the losses to be taken into account are limited by the amount of losses resulting under the [UK] rules for calculating profits, the dispute would have to be referred back to the Finanzgericht, so that it may rule on the determination of the calculation of profits required under [UK] tax law.