OPINION OF ADVOCATE GENERAL POIARES MADURO

delivered on 7 April 2005 [1]

1. In this case the Court is called upon to clarify the effect of the EC Treaty provisions concerning freedom of establishment on the tax regime governing groups of companies in a Member State. The question is whether Community law precludes legislation such as that in force in the United Kingdom on 'group relief' under which the transfer of losses within a group of companies is subject to the condition that those companies are resident or carry on an economic activity in the United Kingdom.

2. In order to reply to that question the Court will have to base itself on the provisions of the Treaty and the solutions devised by its case-law in the field of taxation, which is already highly developed. In this area secondary legislation enacted under the Treaty offers but little guidance. It is true that there is a Council Directive of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. [2] That directive clearly evinces the Community's desire to eliminate the disadvantage resulting from the fact that the tax provisions governing relations between parent companies and subsidiaries in Member States are in general less favourable than those applicable to relations between parent companies and subsidiaries in one Member State. [3] But it does not cover the question of the treatment of transnational losses within groups of companies. [4]

3. However, this is not a question with which the Community institutions are unfamiliar. On 6 December 1990 the Commission submitted a proposal for a Council directive concerning arrangements for the taking into account by enterprises of the losses of their permanent establishments and subsidiaries situated in other Member States. [5] Since that proposal was not successful the Commission decided to withdraw it and to initiate fresh

1 — Original language: Portuguese.

2 — Directive 90/435/EEC (OJ 1990 L 225, p. 6).

3 — As the Court pointed out in Case C-168/01 *Bosal* [2003] ECR I-9409, paragraph 22.

4 — A consolidated profit regime, taking into account the losses of subsidiaries of different Member States had been proposed by the Commission of the European Communities as early as 1969 (Proposal for a Council Directive on the common tax regime applicable to parent and subsidiary companies of different Member States (OJ 1969 C 39, p. 7)).

5 — 91/C 53/03 (OJ 1991 C 53, p. 30). Under that proposal two methods are advocated, for both subsidiaries and permanent establishments: deduction of losses with subsequent reintegration which enables deduction from the undertaking's taxable profits of the losses incurred by secondary establishments in other Member States provided that the profits of those establishments are subsequently reintegrated in the results of the undertaking in the amount of the losses deducted, or the imputation method, which is to include all the results of foreign establishments with those of the undertaking.

negotiations with the Member States. Currently, it is of the view that the absence of any provision on transnational offset of the losses of groups of companies in the Community constitutes a major obstacle to the proper functioning of the internal market. [6]

4. The Council probably has good reasons for not having followed the path advocated by the Commission. In those circumstances it is not for the Court to substitute itself for the Community legislature. However, the absence of harmonisation of the laws of the Member States cannot prevent it from performing its function which is to ensure that the fundamental principles and objectives of the Treaty are safeguarded.

5. Thus, contrary to the notion defended by the Netherlands Government, which intervened in this case, according to which the sole appropriate framework for dealing with this question is that provided for by the approximation of laws, the two following points should be carefully borne in mind. First, it may readily be deduced from the Court's case-law that the harmonisation of the tax laws of the Member States cannot be elevated into a condition precedent of the application of the freedom of establishment enshrined in Article 43 EC. [7] Moreover, the actual implementation of the fundamental freedoms assisting in the establishment of the internal market is not such as to render the approximation of laws devoid of substance and relevance. In fact legislative harmonisation may have the objective of facilitating the exercise of the freedoms of movement but it may also serve to correct the distortions resulting from the exercise of those freedoms.

6. Moreover, the Court has already had the opportunity to rule on cases akin to the present case, whether involving the treatment of the foreign losses of Community undertakings [8] or the tax regime of Community undertakings having secondary establishments in other Member States. [9] It is true that the present case undeniably has specific features proper to itself. However, in common with the preceding cases, it raises the same fundamental difficulty, namely the conflict between the *power* conferred on the Member States to tax income arising in their territory and the *freedom* conferred on Community nationals to establish them-

6 — Communication by the Commission to the Council, European Parliament and the Economic and Social Committee — An Internal Market without Company Tax Obstacles (COM (2003) 726 final).

7 — See by analogy concerning Article 39 EC, Case C-204/90 *Bachmann* [1992] ECR I-249, paragraph 11). See also Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 24, and Case 193/80 *Commission* v *Italy* [1981] ECR 3019, paragraph 17.

8 — See, for example, Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471; Case C-264/96 *ICI* [1998] ECR I-4695; Case C-200/98 *X and Y* [1999] ECR I-8261; and Case C-141/99 *AMID* [2000] ECR I-11619.

9 — See also Case C-330/91 *Commerzbank* [1993] ECR I-4017; Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651; Case C-307/97 *Saint-Gobain* [1999] ECR I-6161; Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727; and *Bosal*, cited above at footnote 3.

selves within the Community. This gives rise to a tension between two opposing systems and to the need to establish an equilibrium in the allocation of competences as between the Member States and the Community.

I — The main proceedings and the questions referred

7. Before dealing with these difficult questions of law, I would recall the facts which are simple.

8. Marks & Spencer plc ('M&S'), resident in the United Kingdom, is the principal trading company of a group specialising in general retail, clothing, food, homeware and financial services. Through the intermediary of a holding company established in the Netherlands, it has subsidiaries in Germany, Belgium and France. Consistently from the middle of the 1990s, those subsidiaries began to record losses. On 29 March 2001 M&S announced its intention to divest itself of its Continental European activity. By 31 December 2001 the French subsidiary had been sold to a third party, and the German and Belgian companies had discontinued trading operations.

9. In 2000 and 2001 M&S submitted to Mr Halsey (HM Inspector of Taxes) group relief claims in respect of losses incurred by certain of its EU subsidiaries for the four accounting periods ending in 1998, 1999, 2000 and 2001. United Kingdom tax legislation enables the parent company of a group, under certain circumstances, to effect an offset as between its profits and the losses incurred by its subsidiaries. However, those claims were rejected by decisions of 13 August and 2 November 2001 on the ground that the group relief scheme does not apply to subsidiaries which are neither resident nor economically active in the United Kingdom.

10. That rejection was immediately challenged by M&S before the Special Commissioners of Income Tax. The applicant thereby sought a declaration that the applicable United Kingdom tax rules were incompatible with Community law, in particular Articles 43 and 48 EC. That application was dismissed by decision of 17 December 2002. In that decision the Special Commissioners of Income Tax held that, since the principles established by the Court of Justice in the matter were clear, it was not necessary to refer a question to it for a preliminary ruling. Secondly, the United Kingdom tax regime was not contrary to Community law, with the result that the view of the Inspector of Taxes had to be upheld.

11. The applicant appealed against that decision to the High Court of Justice of England and Wales, Chancery Division, which considered it necessary to stay the proceedings and refer the following questions to the Court:

'1. In circumstances where:

— provisions of a Member State, such as the UK provisions on group relief, prevent a parent company which is resident for tax purposes in that State from reducing its taxable profits in that State by setting off losses incurred in other Member States by subsidiary companies which are resident for tax purposes in those States, where such set off would be possible if the losses were incurred by subsidiary companies resident in the State of the parent company;

— the Member State of the parent company:

— subjects a company resident within its territory to corporation tax on its total profits, including the profits of branches in other Member States, with arrangements for the availability of double taxation relief for those taxes incurred in another Member State and under which branch losses are taken account of in those taxable profits;

— does not subject the undistributed profits of subsidiaries resident in other Member States to corporation tax;

— subjects the parent company to corporation tax on any distributions to it by way of dividend by the subsidiaries resident in other Member States while not subjecting the parent company to corporation tax on distributions by way of dividend by subsidiary companies resident in the State of the parent;

— grants double taxation relief to the parent company by way of a credit in respect of withholding tax on dividends and foreign taxes paid on the profits in respect of which dividends are paid by subsidiary companies resident in other Member States;

is there a restriction under Article 43 EC, in conjunction with Article 48 EC? If so, is it justified under Community law?

2. (a) What difference, if any, does it make to the answer to Question 1 that, depending on the law of the Member State of the subsidiary, it is or may be possible in certain circumstances to obtain relief for some or all of the losses incurred by the subsidiary against taxable profits in the State of the subsidiary?

(b) If it does make a difference, what significance, if any, is to be attached to the fact that:

— a subsidiary resident in another Member State has now ceased trading and, although there is provision for loss relief subject to certain conditions in that State, there is no evidence that in the circumstances such relief was obtained;

— a subsidiary resident in another Member State has been sold to a third party and, although there is provision under the law of that State for the losses to be used under certain conditions by a third party purchaser, it is uncertain whether they were so used in the circumstances of the case;

— the arrangements under which the Member State of the parent company takes account of the losses of UK resident companies apply regardless of whether the losses are also relieved in another Member State?

(c) Would it make any difference if there were evidence that relief had been obtained for the losses in the Member State in which the subsidiary was resident and, if so, would it matter that the relief was obtained subsequently by an unrelated group of companies to which the subsidiary was sold?

II — The national legislation at issue

12. The subject-matter is governed by the Income and Corporation Taxes Act 1988 (hereinafter 'ICTA'). It is appropriate briefly to recall the provisions of that Act which are relevant for the purposes of the interpretation requested.

13. The United Kingdom has opted for a system of taxation of worldwide company profits. Under section 8 of ICTA, UK resident companies are charged to corporation tax in respect of the totality of their worldwide profits. It follows that the results achieved by their branches and permanent establishments abroad form a direct part of the basis of taxation of those companies. In order to avoid double taxation, a tax credit is granted to them in respect of foreign tax suffered on profits earned abroad. Conversely, non-resident companies are liable to corporation tax in the United Kingdom only in regard to income from national sources which is attributable to profits realised by their establishments in the United Kingdom.

14. The tax treatment of groups of companies is governed by a special regime. In a group each company is taxed separately in respect of its own profits under the principle of legal personality applicable in the field of taxation. Under United Kingdom tax law, results of group companies are not in principle consolidated.

15. However, there are two facets to this issue.[10] First of all, foreign subsidiaries are permitted to distribute their profits in the form of dividends to the parent company established in the United Kingdom. In that situation all the profits distributed by the subsidiaries are deemed to have been made by the company resident in the United Kingdom. Double taxation is avoided by the grant of a tax credit. Secondly, a special regime for the tax treatment of group losses has been established. This regime, known as group relief, authorises any company in a group ('the surrendering company') to surrender its losses to another company in the same group ('the claimant company') so that the latter may deduct those losses from its taxable profits. However, the surrendering company thereby loses any right to use the losses surrendered for tax purposes and, in particular, may not carry them forward to set against profits made in subsequent financial years. This is the regime at issue in the present case.

16. What is the purpose of group relief? It is to limit the negative effects from a tax point of view of establishing groups of companies. The purpose is to avoid penalising companies which, rather than establishing branches, decide to expand their activities by setting up subsidiaries. The provision for transfer of losses is specifically intended to make the taxation of groups of companies as neutral as possible by allowing the losses of one company to be transferred to another company in the same group in a given tax year.

17. Although this regime *neutralises* certain of the effects of the legal separation of companies within a group, it does not *equalise* the conditions under which the various types of company are charged to

10 — A reservation must be made in regard to the regime governing controlled foreign companies under which it is permissible, by way of exception and in certain circumstances, to include the profits of foreign subsidiaries with those of the parent company resident in the United Kingdom, quite apart from any distribution of dividends. The application of those rules is called in question in a case pending before the Court (C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas*).

tax. Unlike the system applicable to companies with permanent establishments, the regime applicable to groups of companies gives no entitlement to consolidation for tax purposes. Such consolidation means that all the results of group operations, profits as well as losses, are subsumed within the results of the parent company for tax purposes. The group may therefore be regarded as a single entity for tax purposes. That is not the situation in the case of the group-relief scheme. Group relief merely means imputing losses of the subsidiaries to the parent company during a given tax year. Those subsidiaries must consent to the transfer of losses and further agree not to carry forward the losses surrendered to other tax years. Therefore, although the group relief regime may be said to treat the group of companies as an actual economic entity, it does not however create a single entity for tax purposes. Under this regime, the subsidiaries retain not only their legal autonomy but also some measure of fiscal autonomy.

18. The conditions for applying the regime have evolved. Under the system established by ICTA the application of group relief was subject to the condition that the companies concerned be resident in the United Kingdom. However, that condition was called in question by the judgment in *ICI* in so far as it ran counter to Article 43 EC guaranteeing freedom of establishment to companies established in the Community.[11] Following that judgment, the United Kingdom legislation was amended to enable group relief to be available to non-resident companies pursuing a commercial activity in the United Kingdom through the intermediary of a branch or agency.[12] Under section 402 of ICTA, as amended, group relief is not available unless the following condition is satisfied in the case of both the surrendering company and the claimant company. The condition is that the company is 'resident in the United Kingdom or is a non-resident company carrying on trade in the United Kingdom through a branch or agency'. The benefit of this regime is therefore not available to non-resident companies which carry on no economic activity in the United Kingdom. The subsidiaries of M&S are in that category.

III — Analysis

19. In this case the national court is essentially referring three questions to the Court. Does excluding a company with subsidiaries in other Member States from the benefit of consolidation for tax purposes applicable to a company with branches in other Member States constitute a restriction on freedom of establishment? Does excluding a company with subsidiaries in other Member States from the benefit of the group relief regime applicable to a company with subsidiaries established in the same Member

11 — Cited above at footnote 8.

12 — On the details of the amendment see J.B. Hickley, 'Worldwide groups and UK taxation after the Finance Act 2000', *European Taxation*, 2000, p. 466.

State constitute a restriction on freedom of establishment? In the event that the United Kingdom legislation does create a restriction which is prohibited by the Treaty, can that restriction be justified on legitimate grounds recognised by Community law?

20. The observations submitted to the Court reveal a certain hesitancy as to the approach to be followed in dealing with these questions. It is true that the Court has progressively developed its approach to this matter. It would therefore appear appropriate briefly to recall the principles established by the Court in interpreting the fundamental provisions of the Treaty. In light of that analysis, the three questions raised by the referring court will be dealt with in turn.

A — *Principles of Interpretation*

1. Premisses

21. 'Although, as Community law stands at present, direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law.' That is the now classic statement of the Court in its judgment in *Schumacker*. [13]

22. In that statement the Court is reaffirming that a reserved competence of the Member States is not an unlimited competence. It must be exercised in a manner which observes undertakings made on accession to the EC Treaty including the prohibition on restricting the freedom of establishment of nationals of one Member State in another Member State. That freedom is enshrined in Article 43 EC which, the Court has stated, constitutes 'one of the fundamental provisions of Community law'. [14] It guarantees to Community nationals access to and the pursuit of activities as a self-employed person as well as the right to set up and manage undertakings under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected and, under Article 48 EC, it ensures that companies constituted according to the law of one Member State and having their registered office, central administration or principal place of business within the Community, are entitled to carry on their business in the Member State concerned through the intermediary of a subsidiary, branch or agency. [15]

13 — Case C-279/93 *Schumacker* [1995] ECR I-225, paragraph 21. See, most recently, Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 19.

14 — Case C-9/02 *De Lasteyrie du Saillant* [2004] ECR I-2409, paragraph 40.

15 — *Saint-Gobain*, cited above at footnote 9, paragraph 35.

23. At the same time the Court is also specifying the scope of the limits thus imposed on the Member States. First, the limits flowing from Community law apply only to the competences *exercised* by the Member States. The Member States thus remain free to determine the organisation and conception of their tax system [16] and to determine the need to allocate between themselves the power of taxation. [17] Secondly, in the absence of harmonisation of national laws in this field, the difficulties ensuing for economic operators as a result of mere differences in tax regimes as between Member States are outside the scope of the Treaty. [18] In particular it is well established that the differences in treatment resulting from legislative disparities as between the Member States do not constitute discrimination prohibited by the Treaty. [19]

24. Thus, there is no doubt that the Member States as a matter of principle retain extensive competences in tax matters. [20] However, they can no longer disregard the constraints imposed on their activities. They must endeavour to ensure that the choices made in tax matters take due account of the consequences which may flow therefrom for the proper functioning of the internal market. Under those circumstances the Court has the task of ensuring that transnational situations associated with the exercise of the freedoms of movement between the Member States are not disadvantaged owing to the choices made by the national legislature. [21]

2. State of the Court's case-law in regard to direct taxation

25. In this area the concern to maintain a balance between respect for national competences and the requirements of the internal market from the beginning compelled the Court to opt for an approach centred on the principle of non-discrimination on the ground of nationality. According to that approach freedom of establishment is essentially no more than the rule of national treatment whereby the Member States must accord to nationals of the other Member States the same tax treatment as they do to their own nationals. [22]

16 — *Bachmann*, cited above at footnote 7, paragraph 23.

17 — *Saint Gobain*, cited above at footnote 9, paragraph 57. See also Case C-451/99 *Cura Anlagen* [2002] ECR I-3193, paragraph 40.

18 — See, by way of analogy, in regard to technical rules, Case C-379/92 *Peralta* [1994] ECR I-3453, paragraph 34. See, in regard to tax matters, Case C-336/96 *Gilly* [1998] ECR I-2793, paragraph 47.

19 — See, in that connection, Case 1/78 *Kenny* [1978] ECR 1489, paragraph 18. In the new context of the rights of European citizenry see to the same effect Case C-365/02 *Lindfors* [2004] ECR I-7183, paragraph 34.

20 — In general, Case 55/83 *Italy* v *Commission* [1985] ECR 683, paragraph 11.

21 — The concept of transnational situations is preferred here to that of transnational situations or operations for the reasons set out in point 46 et seq. of my Opinion in Case C-72/03 *Carbonati Apuani* [2004] ECR I-8027.

22 — In the words of the Court, 'the essential aim of [Article 43 EC] is to implement, in the field of self-employment, the principle of equal treatment laid down in Article [12 EC]' (*Royal Bank of Scotland*, cited above at footnote 9, paragraph 21).

26. For a long time that view was in keeping with the general approach adopted by the Court in regard to freedom of establishment.[23] That entailed that any discrimination, based either directly or indirectly on nationality, was to be prohibited.[24] However, the Court broke with that approach in 1993. In its judgment in *Kraus* the Court ceased to interpret Article 43 as imposing only an obligation not to discriminate between the nationals of the Member States. In fact it acknowledged that 'Articles 48 and 52 preclude any national measure governing the conditions under which an academic title obtained in another Member State may be used, where that measure, even though it is applicable without discrimination on grounds of nationality, is liable to hamper or to render less attractive the exercise by Community nationals, including those of the Member State which enacted the measure, of fundamental freedoms guaranteed by the Treaty.'[25] However, it is noteworthy that the Court delayed in extending that case-law to the sphere of direct taxation.[26]

27. At present it accepts that there may be fiscal restrictions on freedom of establishment irrespective of any discrimination founded on nationality. Thus in *ICI* it held that 'even though, according to their wording, the provisions concerning freedom of establishment are directed mainly to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation'.[27]

28. In all the subsequent judgments in which the Court considered it necessary to go beyond the rule on national treatment, the non-discrimination rule is not absent.[28] Yet it is no longer linked to the criterion of nationality. It is based on the use of the right to freedom of movement.[29] What is called in question in the national measure concerned is that it imposes a specific disadvantage on operators desirous of moving or establishing themselves within the Community. It is therefore a matter of pursuing *discrimination against Community nationals wishing to assert their rights derived from the freedoms of movement.*

29. Although there are reasons for accepting that the preferred approach is that founded on non-discrimination on the ground of

23 — See, for example, Case 2/74 *Reyners* [1974] ECR 631, paragraph 16, and Case 197/84 *Steinhauser* [1985] ECR 1819, paragraph 14. In his Opinion in Case C-288/89 *Collectieve Antennevoorziening Gouda* [1991] ECR I-4007 Advocate General Tesauro further infers from the Court's case-law that the prohibition of discrimination based on nationality plays an absolute and decisive role in regard to the right of establishment (point 13).

24 — In that connection, see in particular *Schumacker*, cited above at footnote 13, paragraph 26.

25 — Case C-19/92 *Kraus* [1993] ECR I-1663, paragraph 32.

26 — See, in that connection, point 17 of the Opinion of Advocate General Leger in Case C-80/94 *Wielockx* [1995] ECR I-2493.

27 — *ICI*, cited above at footnote 8, paragraph 21. See also earlier judgment in Case 81/87 *Daily Mail and General Trust* [1988] ECR 5483, paragraph 16.

28 — See, inter alia, *X and Y*, cited above at footnote 8, paragraph 27; *Bosal*, cited above at footnote 3, paragraph 27; *AMID*, cited above at footnote 8, paragraph 23; *De Lasteyrie du Saillant*, cited above at footnote 14, paragraph 45; and in regard to free movement of capital, Case C-35/98 *Verkooijen* [2000] ECR I-4071, paragraph 34; *Manninen*, cited above at footnote 13, paragraph 22, Case C-315/02 *Lenz* [2004] ECR I-7063, paragraph 20.

29 — See in that connection point 21 of the Opinion of Advocate General Fennelly in Case C-190/98 *Graf* [2000] ECR I-493.

nationality, it cannot be regarded as exclusive. Certainly, such an approach may have appeared more respectful of the integrity of national tax systems. It did not impose on them greater limits than those already stemming from constraints accepted in international tax law. [30] In fact, in appearance it is like the non-discrimination clause contained in all the international tax conventions. [31] In any event it appears less severe than the concept of a restriction on freedom of establishment.

30. It is, however, an inaccurate analysis. The comparison manifests itself more in formal terms than in actual fact. There is in fact an appreciable gap between the restrictive approach to non-discrimination adopted by international tax conventions and the extensive application made of it by the Court in its case-law on taxation. That is attested, in particular, by the *Schumacker* case under which regard must be had to the 'objective differences' between the situations considered. [32] Far from being satisfied with a merely formal distinction between residents and non-residents, the Court requires the Member States to have regard to the actual situation of the persons concerned. In that way the Community principle of non-discrimination appears much more stringent that the usual requirements of tax conventions. [33]

31. Furthermore, a reduction of freedom of establishment merely to the rule of non-discrimination on the ground of nationality entails in practice two major defects.

32. First, it is not easy to conduct a review of the application of that rule. It presupposes that the comparability of the situations at issue may be established. However, the principle remains that 'in relation to direct taxes, the situations of residents and of non-residents are generally not comparable.' [34] If the comparison is substantiated, the purpose of the measure at issue must then be examined before verifying that the difference laid down by that measure is necessary for the purpose pursued by it and that it has been applied proportionately to the perceived difference existing between the situations concerned. That review calls for delicate assessments to be made and for the justificatory grounds of the measure to apply at the time when discrimination is established. Moreover, it is particularly difficult in the case of a restriction imposed by a Member State on one of its nationals making use or wishing to make use of rights derived from the fundamental freedoms. In such a

30 — See on this point the critical analysis by P.J. Wattel, 'The EC Court's attempts to reconcile the Treaty freedoms with International Tax Law', *Common Market Law Review*, 1996, p. 223.

31 — Thus the OECD model tax convention on income and on capital, in its version published on 29 April 2000, provides at Article 24(1) that 'nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected'.

32 — *Schumacker*, cited above at footnote 13, paragraph 37. To the same effect is *Wielockx*, cited above at footnote 26, and Case C-107/94 *Asscher* [1996] ECR I-3089.

33 — In this connection see B.J.M. Terra and P.J. Wattel, *European Tax Law*, Deventer, 3rd Edition, 2001, p. 46.

34 — See lastly Case C-169/03 *Wallentin* [2004] ECR I-6443, paragraph 15.

case the comparison must be made between different nationals of the same Member State according to whether they reside in it or move within the Community. That is the situation in the present case in which the discrimination alleged concerns the contrast between two parent companies resident in the United Kingdom whose situation is differentiated only by the place of establishment of their subsidiaries.

33. Secondly, that approach gives rise to a certain amount of confusion in regard to the grounds justifying the rules likely to impede freedom of movement. Advocate General Leger has already had occasion to recall that, in the area of tax, the Court accepts that 'discriminatory national rules may be justified for imperative public-interest requirements other than those set out in the Treaty and in particular in the name of the cohesion of the tax system.'[35] However, those judgments contradict a more general approach taken by the Court which applies also in tax matters[36] whereby it affirms that a discriminatory measure can be justified only on the basis of derogating provisions expressly provided for in the Treaty.[37] It would be useful for the Court to put an end to these uncertainties.[38]

34. Irrespective of the practical considerations, I consider that the principle of non-discrimination on the ground of nationality is not sufficient to safeguard all the objectives comprised in the establishment of an internal market. The latter seeks to secure for the citizens of the Union all the benefits inherent in the exercise of the freedoms of movement. It thus constitutes the trans-national dimension of European citizenship.

35. All these reasons explain the need to retain in tax matters the same concept of restriction on freedom of establishment which is applicable in the other areas. Thus 'all measures which prohibit, impede or render less attractive the exercise of that freedom' must be regarded as restrictions.[39] It remains necessary, however, to give actual

35 — Opinion in *Wielockx*, cited at footnote 26 above, point 31 (see case-law cited). To the same effect see point 49 of the Opinion of Advocate General Tesauro in Case C-120/95 *Decker* [1998] ECR I-1831.

36 — See, for example, *Royal Bank of Scotland*, cited above at footnote 9, paragraph 32. However, in his Opinion in that case Advocate General Alber accounts for the case-law cited in the preceding footnote by the fact that the measures called in question constituted indirect discrimination. As a matter of principle, direct discrimination cannot be justified on overriding public-interest grounds (paragraph 39).

37 — See, first, in regard to free movement of goods Case 113/80 *Commission* v *Ireland* [1981] ECR 1625, paragraph 11. However, it is true that in this same area the Court's case-law provides examples of reasoning which diverges from that principle: see, in regard to waste, Case C-2/90 *Commission* v *Belgium* [1992] ECR I-4431.

38 — See, in that connection, the proposals put forward by Advocate General Jacobs in his Opinion in Case C-136/00 *Danner* [2002] ECR I-8147.

39 — See, most recently, Case C-442/02 *CaixaBank France* [2004] ECR I-8961, paragraph 11 and order in Case C-250/03 *Mauri* [2005] ECR I-1267, paragraph 40.

shape to that concept in the context of the different freedoms of movement,[40] regard being had at the same time to the specific nature of the areas to which those freedoms are to apply.

36. Thus, in the present case regard must be had to the particular respect which is due to the tax competences of the Member States. However, it seems to me that in that regard the Court's case-law already provides adequate means of appraisal: on the one hand, sound restrictive criteria and, on the other, a concept of justification founded on the cohesion of the tax regimes of the Member States.[41]

3. Criteria for restricting freedom of establishment

37. In an internal market 'characterised by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital',[42] the Member States are no longer at liberty to ignore the constraints imposed by those matters on the definition and application of their national policies. In that context the task of the Court is not to engage in challenging every rule of State origin having an indirect or wholly uncertain effect on the exercise of the freedoms of movement.[43] It is not for it to review the political choices made by the Member States. Judicial review of measures likely to prohibit, impede or render less attractive the exercise of the freedoms of movement rather seeks to ensure that those choices take account of the impact which they may have on transnational situations. The policies adopted must not result in less favourable treatment being accorded to transnational situations than to purely national situations. Such, it seems to me, must be the objective and the context of the review. Only that interpretation is such as to reconcile the principle of respect for State competences and the safeguarding of the objective of establishing an internal market in which the rights of European citizens are protected.

38. This interpretative framework does not itself provide a specific criterion applicable to the analysis of the restrictions on the freedoms of movement. However, it must provide pointers to the establishment and interpretation of the criteria adopted by the Court.

39. Moreover, it appears that the different criteria established by the Court are capable of being subsumed within this interpretative

40 — See in favour of a specific approach in regard to freedom of establishment, Mischo, J., 'Les restrictions à la liberte d'établissement: la nécessité d'une clarification', *Mélanges en homage a F. Schockweiler*, Nomos, Baden-Baden, 1999, p. 445.

41 — See points 65 et seq. hereof.

42 — Article 3(1)(c) EC.

43 — See in the same connection Opinion of Advocate General Tizzano in *CaixaBank France*, cited above at footnote 39.

framework. This is true of the criterion of non-discrimination on the ground of nationality,[44] the criterion of additional costs imposed on Community nationals,[45] or the criterion of access to the market.[46] Those various criteria are applicable in different circumstances. But they all spring from the same source of inspiration which appears to me to be to prevent Member States from creating or maintaining in force measures promoting internal trade to the detriment of intra-Community trade. Such a restriction may take several forms. It may be the effect of discrimination in favour of nationals. It may be the consequence of a measure protecting positions acquired by economic operators established on the national market by restricting the entry of new operators. Such a restriction may further stem from legislation rendering trade between the Member States more difficult than internal trade within a Member State.[47]

40. It seems to me that it is to such a restriction on Community trade which the Court is alluding when it seeks to pursue 'all measures prohibiting, impeding or rendering less attractive *the exercise of the freedoms of movement*'. I would mention in this connection that not every restriction on economic or commercial freedom is a restriction on the exercise of the freedoms of movement.[48] In fact that restriction always entails a kind of 'discrimination' owing to Member States' elaborating measures without taking account of their effects on transnational situations. Only the latter restrictions are prohibited by the Treaty.

B — *Application of the criteria applicable to restriction of freedom of establishment*

41. In the present case the United Kingdom tax legislation is doubly called in question; first, because it does not accord the same advantages in the case of parent companies with foreign subsidiaries and parent companies with foreign branches; secondly, it places groups of companies wishing to establish themselves abroad at a disadvantage in relation to groups resident in the United Kingdom. In order correctly to apply the criteria adopted by the Court, a clear distinction must be drawn between these two questions.

44 — See for example *Commission* v *France*, cited above at footnote 7.

45 — See for example Case C-470/93 *Mars* [1995] ECR I-1923.

46 — See for example *CaixaBank France*, cited above at footnote 39.

47 — For freedom to provide services see for example Case C-70/99 *Commission* v *Portugal* [2001] ECR I-4845, paragraphs 25 to 27.

48 — In this connection see Joined Cases C-267/91 and C-268/91 *Keck and Mithouard* [1993] ECR I-6097; Opinion of Advocate General Tesauro in Case C-292/92 *Hünermund and Others* [1993] ECR I-6787 and Opinion of Advocate General Tizzano in *CaixaBank France*, cited above at footnote 39, points 62 and 63.

1. The disadvantage connected to the choice of the legal form of the foreign establishment

42. A part of the first question referred by the High Court of Justice in this case relates to the disadvantage alleged to flow from the fact that M&S chose to locate establishments in the other Member States in the form of subsidiaries rather than in the form of branches.

43. I would recall that the Court has already held that freedom of establishment entailed the obligation not to discriminate between the different forms of establishment likely to be adopted by economic operators. That appears to be the conclusion in particular of *Commission* v *France*,[49] *Royal Bank of Scotland*,[50] and *Saint Gobain* [51] but it is noteworthy that in those cases the national legislation at issue treated the different forms of establishment concerned in the same way for tax purposes.

44. In the first case, the contested French legislation related to the conditions under which a tax credit was granted to recipients of dividends distributed by French companies. It was established that the French system made no distinction in regard to the detailed rules regarding taxation of profits between French companies and the French subsidiaries and agencies of foreign companies. Under circumstances determined by the principle of territoriality of taxation it was likewise appropriate to accord similar treatment to the two forms of establishment for the purposes of the grant of the tax credit. In that context, the Court affirmed that the 'freedom of choice [of the appropriate legal form in which to pursue their activities in another Member State] must not be limited by discriminatory tax provisions'.[52]

45. In the *Royal Bank of Scotland* case which involved the Greek legislation on corporate taxation the Court began by noting that 'the Greek tax legislation, ... for the purposes of taxing income, does not establish, as between companies having their seat in Greece and companies which, having their seat in another Member State, have a permanent establishment in Greece, any distinction such as to justify, in relation to the same taxation, a difference in treatment between the two categories of companies'. Even if in Greece those companies were subject to different tax obligations, it was established that the method of determining the taxable basis was identical. Accordingly any difference in the rate of taxation was prohibited and the argument based on the differing legal forms had to be rejected.[53]

49 — Cited above at footnote 7.

50 — Cited above at footnote 9.

51 — Cited above at footnote 9.

52 — Paragraph 22 of *Commission* v *France*, cited above at footnote 7.

53 — Paragraphs 29 and 30 of *Royal Bank of Scotland*, cited above at paragraph 9

46. In the third case, *Saint Gobain*, the Court similarly decided that 'the difference in treatment to which branches of non-resident companies are subject in comparison with resident companies must be regarded as constituting an infringement of Articles 52 and 58 of the Treaty'.[54] The German legislation accorded the benefit of certain tax advantages relating to taxation on shareholdings and the distribution of dividends solely to companies resident in Germany, to the exclusion of non-resident companies operating German branches. Such difference in treatment was discriminatory in so far as resident and non-resident companies were in objectively comparable situations in regard to the chargeability to tax in Germany of dividends.[55]

47. It is clearly apparent that in all those cases discrimination in the choice of form of establishment is inextricably bound up with discrimination as to the choice of place of residence. That is owing to the fact that the State concerned chose to place the different forms of establishment on the same footing for the purposes of taxation in its territory. If in such a case a difference of treatment is none the less established it is because it in fact conceals a case of discrimination on the ground of nationality as against the companies operating those establishments.

48. In the present case foreign subsidiaries and branches are indeed governed by different tax regimes. However, that difference in treatment is not due solely to the fact that they are subject to different tax obligations but to the United Kingdom system of corporate taxation. Under that system the difference in tax treatment is determined by the legal form of the secondary establishment. Groups of companies are not entitled to consolidation for tax purposes which applies to the income of permanent establishments. In that connection, although the group relief system modifies the rule of separate taxation of group companies, it cannot have the effect of assimilating the situation of subsidiaries to that of branches. Under that regime the transfer of losses is treated in a specific way. There is no consolidated joint taxation. That is because subsidiaries are always treated as independent legal and fiscal entities. Accordingly, the difference in treatment of those two categories of establishment does not merely comprise loss of a specific benefit as a result of the option being made in favour of the establishment of foreign subsidiaries. It stems from a difference in the tax regimes applicable to the different types of establishment.

49. However, the provisions on freedom of establishment do not preclude different tax treatment from being accorded to legal or natural persons in different legal situations. It is not the purpose of those provisions to impose uniformity in the regimes applicable to the different types of establishment. They merely seek to ensure tax neutrality in the exercise of the right to freedom of establish-

54 — Paragraph 44 of *Saint-Gobain*, cited above at paragraph 9.
55 — Paragraph 48.

ment within the Community. Any other solution would have the effect of calling in question the more stringent tax regimes among the Member States even though no transnational situation was specifically contemplated. That cannot be the purpose of the Treaty rules on freedom of movement.

50. Plainly, moreover, United Kingdom tax legislation does not prohibit a United Kingdom company from establishing itself in the other Member States by means of subsidiaries. Accordingly, the question in this case is merely whether the establishment of subsidiaries in another Member State entails for the group and its parent company resident in the United Kingdom a specific disadvantage which they would not incur if the parent opted to establish its subsidiaries in its country of residence.

2. The disadvantage attendant upon the place of establishment of subsidiaries

51. The Court's case-law instructs us that the refusal of a tax advantage may be regarded as a restriction contrary to the Treaty if it appears to be principally associated with the exercise of the right to establishment. [56]

52. Although the questions raised by the national court refer solely to the situation of the parent company, the applicant in the main proceedings, it is the situation of the group which has to be contemplated for the purposes of a ruling on the compatibility with freedom of establishment of legislation such as that at issue. In that regard there is no doubt that the application of the United Kingdom group relief scheme constitutes a tax advantage for the group benefiting from it. The resulting benefit for the claimant company, which is the recipient of the transfer of losses, is merely a consequence of the advantage conferred on the group. The taxable profit of the group companies is reduced during the course of a given tax year. However, under the national legislation at issue a group whose principal establishment is resident in the United Kingdom, and which wishes to establish subsidiaries in another Member State, is deprived of that advantage. In the circumstances of the case, that refusal stems from the sole fact that M&S has availed itself of the right to freedom of establishment.

53. This kind of restriction may readily be characterised. It is a type with which the Court is acquainted. It is to be found in a series of judgments prohibiting any measure of a Member State restricting the use by nationals of that State of the right to move freely within the Community. [57] The refusal at issue in the present case constitutes an

56 — See also Case C-251/98 *Baars* [2000] ECR I-2787, paragraphs 30 and 31, and *Asscher*, cited at footnote 32 above, paragraph 42.

57 — See in that connection Joined Cases C-286/82 and 26/83 *Luisi and Carbone* [1984] ECR 377; Case 143/87 *Stanton* [1988] ECR 3877; *Daily Mail and General Trust*, cited above at footnote 27; Case C-370/90 *Singh* [1992] ECR I-4265; Case C-18/95 *Terhoeve* [1999] ECR I-345; and Case C-224/98 *D'Hoop* [2002] ECR I-6191.

'exit restriction' which is characterised by unfavourable treatment of companies wishing to establish subsidiaries in other Member States. [58] At this juncture, it is not important to know whether the subsidiaries of M&S derive other advantages from their establishment in the host States concerned. It is sufficient to note that the United Kingdom legislation by itself creates an obstacle such as to dissuade companies established in the United Kingdom from establishing subsidiaries in other Member States.

54. Nor, accordingly, is it appropriate to examine the question whether that legislation constitutes an indirect form of discrimination on the ground of nationality. Since the measure at issue is well established as constituting an obstacle, it is of no use inquiring, as do the various parties to the dispute, whether non-resident subsidiaries, on distribution of part of their profits to the parent company, are in regard to it in a situation comparable to that of subsidiaries established in the United Kingdom.

55. However, it remains to examine whether that restriction may be justified under Community law. In fact, it is clear from settled case-law that a restrictive measure is not prohibited by Article 43 EC if that measure pursues a legitimate objective compatible with the Treaty and is justified on overriding public-interest grounds. It is further necessary, in such circumstances, for the measure to be apt to ensure attainment of the objective at issue and for it not to exceed what is necessary in order to attain that objective. [59]

C — *Search for justification of the restrictive measure*

56. At the outset the German Government's argument that the taking into account of the losses by the State concerned cannot be permitted because it would lead to a reduction in tax revenue, and thus to major budgetary difficulties for that Member State, cannot be upheld. The Court has repeatedly held that 'reduction in tax revenue cannot be regarded as an overriding reason in the public interest which may be relied on to justify a measure which is in principle contrary to a fundamental freedom'. [60]

57. Conversely, the arguments concerning the risk of a loss of competence or of control on the part of the tax system of the State concerned must be taken more seriously. Two justifications are advanced in that connection: the first is derived from application of the fiscal principle of territoriality and the other on the necessity of ensuring the cohesion of the United Kingdom tax system.

58 — See Opinion of Advocate General Tesauro in *ICI*, cited above at footnote 8, paragraph 18.

59 — *Futura Participations and Singer*, cited above at footnote 8, paragraph 26.

60 — See in particular *Manninen*, cited at footnote 13 above, paragraph 49.

1. Justification based on the fiscal principle of territoriality

58. The United Kingdom Government maintains that the refusal to grant the tax advantage at issue is in conformity with the principle of territoriality upheld in international tax practice and recognised by the Court's case-law. According to it, that principle means that it cannot offer a tax advantage where it has no power of taxation. Since it has no power to charge to tax the income of subsidiaries not resident in the United Kingdom, it is not allowed to take account of the losses of those subsidiaries in order to offer an advantage to the group to which they belong. It infers therefrom that the relief can concern only companies established or carrying on an economic activity within its territory.

59. Such reasoning betrays an erroneous understanding of the Community principle of territoriality. It is true that in its judgment in *Futura Participations and Singer* [61] the Court recognised the applicability of the fiscal principle of territoriality in Community law. On that basis the Court considered that the Luxembourg regime making the carrying forward of previous losses, requested by a taxpayer which has a branch in that Member State but is not resident there, subject to the condition that the losses must be economically linked to the income earned by that taxpayer in that State cannot be regarded as entailing discrimination prohibited by the Treaty.

60. However, one should not mistake the precise meaning attached by the Court to that principle. The Court thereby recognises merely the need to take account of constraints resulting from the fact that Member States are equally sovereign in tax matters. [62] Those constraints require each Member State to reach an accommodation with States enjoying equal sovereignty in tax matters. [63] In accordance with the requirements of international law the exercise of the fiscal competence of any Member State necessitates connection either to the nationality of the taxable person or to the localisation of taxable income in its territory. It follows that, although a State is entitled to make taxpayers resident on its territory liable to unlimited tax obligations, it can only charge foreign taxpayers to tax on income arising on its territory. Thus, in *Royal Bank of Scotland*, the Court stated that the fact that the companies resident in Greece were not subject to the same tax obligation merely stems from 'the limited fiscal sovereignty of the State in which the income arises in relation to that of the State in which the

61 — Cited at footnote 8 above.

62 — On the limits of the fiscal sovereignty of the Member States see also *Gilly*, cited at footnote 18, paragraph 48.

63 — 'The politically and fiscally sovereign State may therefore exercise absolute fiscal power within its territory which constitutes a kind of ring-fence. In particular, it may decide that two or more tax systems will coexist on its territory both enjoying more or less extensive autonomy and maintaining between themselves relations defined in an appropriate case by way of conventions or agreements under domestic law only. Conversely the State may not exercise any fiscal power outwith its territory. Such are the positive and negative facets of the concept of fiscal sovereignty' (G. Gest, and G. Texier, *Droit Fiscal International*, PUF Paris, 2nd ed., 1990, page 17)

company has its seat'.[64] Yet it is neither the intention not the avowed aim of Community law to call in question the limits inherent in any power of taxation or to disturb the order of priority of the allocation of tax competences as between Member States. It should be recalled that, in the absence of Community harmonisation, the Court is not competent to interfere in the *conception* or *organisation* of the tax systems of the Member States.[65]

61. The *Futura Participations and Singer* case put in issue the operation of the income tax system in Luxembourg. Under the Luxembourg system, losses may be carried forward to be set against taxpayers' subsequent profits. However, in accordance with well established rules of international law no Member State is competent to charge to tax income arising abroad received by non-resident taxpayers. Consequently, that Member State refused to carry forward losses arising abroad incurred by those taxpayers. Thus, it was imposing a condition that an economic relationship had to be established between the losses carried forward and the income realised in the State imposing a charge to tax. That condition was perfectly justified. It stemmed from the need to coordinate the power of taxation of the State imposing the charge to tax with that of the State in which the taxpayer concerned is established.

62. The fiscal principle of territoriality prevents conflicts in tax jurisdiction as between the Member States. It cannot be invoked to enable the Member States to evade their obligations under Community law. Under Community law fiscal sovereignty cannot be construed as meaning 'fiscal autarchy'. By subscribing to the Treaty the Member States agreed to submit to the regime of freedom of movement of persons within the Community; this gives rise to specific constraints. That regime specifically requires the Member States to take account of transnational situations when applying their tax rules and to adapt those rules accordingly.

63. In those circumstances the United Kingdom cannot claim that the conferral of a tax advantage is subject to there being a corresponding power of taxation and to the possibility of deriving an advantage therefrom. That interpretation runs counter to the fundamental principle of freedom of establishment. At this stage, it is important merely to inquire whether the grant of that advantage is such as to compromise the enjoyment of sovereignty in tax matters by all the Member States. Yet in the present case there is nothing to prevent the United Kingdom from extending the relief to parent companies with non-resident subsidiaries. The claim is made in the context of a regime applicable to groups adopted by the United Kingdom. It does not concern the imposition of a charge to tax on a sole taxpayer resident and carrying on its main activities abroad but a transfer of losses between companies forming part of the same group.[66] Within the group the claim is made by the parent company resident in the United Kingdom

64 — Cited above at footnote 9, paragraph 29.

65 — See *Bachmann*, cited above at footnote 7, paragraph 23.

66 — See to the same effect *Bosal*, cited above at footnote 3, paragraphs 38 to 40.

which is subject under that head to unlimited fiscal obligations in that country.[67] In regard to it the tax competence of that Member State is not limited. In those circumstances the United Kingdom is not entitled to rely on the principle of territoriality in order to refuse to a company within a group resident in its territory the grant of an advantage connected with the transfer of losses.

64. In actual fact, the United Kingdom Government appears to be arguing that it should be accepted that the advantage cannot be conferred on the parent company if it is not offset by the possibility of taxing the surrendering subsidiary. In the opinion of the United Kingdom Government itself, that argument based on the principle of territoriality is in fact an aspect of the principle of fiscal cohesion upheld by the Court in *Bachmann*. Accordingly, that question may appropriately be dealt with in the context of the second justificatory ground put forward.

2. Justification founded on the need to ensure cohesion of the tax system

65. In its case-law the Court acknowledges that the need to ensure cohesion of the tax system may justify the enactment of rules restrictive of the Community freedoms.[68]

66. The concept of fiscal cohesion performs an important corrective function in Community law. It serves to correct the effects of the extension of the Community freedoms to the tax systems whose organisation is in principle a matter for the sole competence of the Member States. In fact, the application of the freedoms of movement has to be prevented from giving rise to unwarranted interference with the internal logic of national tax regimes. In the words of the Court, the conception of the tax system is 'a matter for each Member State'.[69] In those circumstances, plainly, the Member States have a legitimate interest in ensuring the integrity and the equity of their tax systems. However, it does not follow that that concept can be used as an argument to be deployed against the objectives pursued in the context of the internal market. It cannot be accepted that a tax system be arranged in such a way as to favour national situations or traders. The function performed by fiscal cohesion is the protection of the *integrity* of the national tax systems provided that it does not impede the *integration* of those systems within the context of the internal market.

67. The delicate nature of this equilibrium may be conveyed by the idea of a twofold neutrality. On the one hand, the national tax

67 — See to the same effect *Manninen*, cited above at footnote 13, paragraph 38.

68 — *Bachmann*, cited above at footnote 7, and Case C-300/90 *Commission* v *Belgium* [1992] ECR I-305.

69 — *Bachmann*, cited above at footnote 7, paragraph 23.

rules must be neutral in regard to the exercise of the freedoms of movement. In that connection, it should be recalled that Article 43 EC lays down a requirement of fiscal neutrality in regard to the establishment of undertakings in the Community. On the other hand, the exercise of the freedoms of movement must be as neutral as possible in regard to the tax arrangements adopted by the Member States. The right of establishment cannot be used by traders with the sole purpose of endangering the equilibrium and the cohesion of national tax systems. That would be the case if use were made thereof either abusively to evade national laws or artificially to exploit differences between those laws. [70] The concept of fiscal cohesion seeks to ensure that Community nationals do not use Community provisions to secure advantages from them which are unconnected with the exercise of the freedoms of movement. [71]

68. In those circumstances the Court points out that 'the argument based on the need to preserve the coherence of a tax system must be verified having regard to the aim pursued by the tax legislation in question'. [72] If in accordance with the logic of such legislation there appears to be a direct and necessary connection between the grant of a fiscal advantage and the offsetting of that advantage by a specific charge to tax, the advantage can be refused on the ground that there cannot be an offsetting charge to tax. Thus, in *Bachmann* the Court was able to find that there was a direct link under Belgian legislation between the deductibility for tax purposes of insurance contributions and the taxation of sums payable by insurers pursuant to those contracts of insurance. Since Mr Bachmann had taken out contracts of insurance in Germany whose performance could not attract a charge to tax in Belgium, the refusal by the Belgian authorities to allow the deduction for tax purposes of the contributions paid under those contracts was justified.

69. What is the situation in the present case? The governments intervening in this case are unanimous in claiming that it would be consistent to grant group relief only where there is a possibility of charging to tax the profits of the companies participating in that scheme for relief. Under the scheme at issue a link is said to be established between the relief granted to the claimant company and the possibility of taxing the income of the surrendering company.

70. The applicant in the main proceedings disputes that line of argument. It relies on settled case-law of the Court under which a direct link can exist only in the context of the same tax and in the case of the same taxpayer. [73] Yet there is no such link in the present case. The advantage conferred on

70 — See in particular Opinion of Advocate General Fenelly in *Metallgesellschaft and Others*, cited above at footnote 9.

71 — In other words, it is a matter of preventing 'free movers' from being transformed, thanks to the freedoms conferred on them by the single market, into 'free riders' (A. Cordewener, M. Dahlberg, P. Pistone, E. Reimer, C. Romano, 'The tax treatment of foreign losses: *Ritter*, *M&S* and the Way Ahead', *European Taxation*, 2004, p. 221).

72 — *Lenz*, cited above at footnote 28, paragraph 37.

73 — See in particular *Bosal*, cited above at footnote 3, paragraph 30 (and case-law cited therein).

parent companies and the tax chargeable to subsidiaries concern different taxpayers in the context of distinct tax schemes.[74]

71. If those are in fact the limits within which the fiscal-cohesion argument can be deployed, there is no doubt that in the present case it must be rejected. However, there are grounds for questioning that use of the concept of fiscal cohesion. As Advocate General Kokott pointed out in her Opinion in *Manninen*, cited above, that conception of fiscal cohesion rests on over-rigid criteria which are not always germane, regard being had to the objective pursued by the rules at issue.[75] It follows that the margin of manoeuvre granted to the Member States in order to justify their tax regimes is excessively reduced. For that reason, it seems to me, necessary, as Advocate General Kokott recommended, to relax those criteria. To that end I propose to revert to the criterion of the aim of the legislation at issue. Cohesion must first and foremost be adjudged in light of the aim and logic of the tax regime at issue.

72. It should be recalled that the aim of the United Kingdom scheme of group relief is to ensure *fiscal neutrality of the effects of the creation of a group of companies*. Such creation must not entail any specific disadvantage under the general rules of corporation tax. The means of arriving at that situation is to permit the circulation of losses within a group. Nor, however, is it permissible for a supplementary advantage to arise for the group. That accounts for the prohibition on making use twice of the losses surrendered. That scheme thus establishes a correlation within the group between the transfer of losses within the group and the impossibility of using those same losses for tax purposes. Losses are transferred from one company for the benefit of another company in exchange for which the surrendering company loses the right to use those losses again for corporation tax purposes. The advantage conferred on the claimant is supposedly neutralised by the tax to be charged to the surrendering company.

73. Accordingly, it is for the United Kingdom to demonstrate that the systematic refusal to take account, under its group system, of the losses of foreign subsidiaries is such as to preserve the rationale of its system.

74. In that regard it is plain that if the losses of foreign subsidiaries are capable of being transferred or carried forward in the State of establishment, to accord group relief in the United Kingdom risks jeopardising the aim of the group system. A transfer or carry forward of those losses in the State of establishment is in fact capable of giving an

74 — See, *mutatis mutandis*, *Bosal*, cited above at footnote 3, paragraph 30.

75 — In her Opinion in that case, cited above at footnote 13, Advocate General Kokott recalls that the Court has construed the concept of fiscal cohesion narrowly since its judgment in *Bachmann*, cited above at footnote 7, point 53. It follows that 'strict adherence to the criterion of the same taxpayer may have arbitrary consequences' (point 57 and examples given in the ensuing paragraphs)

equivalent benefit to the whole of the group. The consequent benefit may be a twofold taking into account of the losses in favour of the group. Yet such advantage is contrary to the neutrality sought by that regime. Thus, in such a case the prohibition of the transfer of foreign losses to the results of the parent company appears to me to be justified.

75. The fact remains that the existence of such a risk must be verified. The Member State concerned cannot merely prohibit any transfer of losses on the sole ground that it is impossible to tax foreign subsidiaries. If it acts in that way the restriction applied goes well beyond what is necessary in order to protect the cohesion of its group system. In fact it results in the addition of objectives foreign to its rationale, whether that involves protection of the revenue of the Member State concerned or the favouring of groups carrying on all their economic activity in its territory. Such objectives would in any event be contrary to Community law.

76. In circumstances such as those of the present case the Member State concerned must therefore take account of the treatment applicable to losses of subsidiaries in the States in which they are resident. [76] Justification based on cohesion of the system of relief can be accepted only if the foreign losses may be accorded equivalent treatment in the State in which those losses arise.

77. A solution of that kind based on the comparison and equivalence of the treatment accorded in various Member States has already been developed by the Court in regard to health services in the context of national social security systems. [77] That solution, it seems to me, is entirely capable of being transposed to tax matters which are governed by the same premisses. [78] To have useful effect Article 43 EC thus requires the authorities competent to grant the tax advantage at issue in this case to take account of the advantages likely to be afforded by the legislation of the State in which the subsidiaries of the group are established. [79] Though it is consistent in certain cases for group relief to be able to be refused, such refusal must be justified and based on account being taken of the situations of the subsidiaries in their State of residence.

78. However, the Kingdom of the Netherlands raises an objection to this solution. It takes the view that authorisation to transfer foreign losses in the context of group

76 — For analogous reasoning see *Manninen*, cited above at footnote 13, paragraph 54, and the Opinion of Advocate General Fenelly in *Metallgesellschaft and Others*, cited above at footnote 9, point 32.

77 — See Case C-56/01 *Inizan* [2003] ECR I-12403 and Case C-157/99 *Smits and Peerbooms* [2001] ECR I-5473.

78 — That is to say: competences retained by the Member States, absence of Community harmonisation, requirements flowing from the fundamental freedoms of Community law (see points 21 to 24 hereof).

79 — See by analogy Opinion of Advocate General Lenz in Case C-1/93 *Halliburton Services* [1994] ECR I-1137, point 40.

regimes adopted by the Member States may entail a general disruption of national systems. In its view, it may legitimately be believed that the transfer of losses will be systematically organised within groups of companies and directed solely to companies of the group established in Member States with higher rates of taxation. The reason for that is that in those States the losses transferred will have a higher value. Accordingly, there are grounds for fearing the likely development of a genuine 'trafficking in losses' at Community level. [80] Such a solution would in the end threaten not only the trustworthiness of those group relief schemes but also the budgetary equilibrium of the States concerned. It would have a deleterious effect on their economic and social systems.

79. Certainly this risk must not be overlooked. Nor, however, should it be overestimated. It is readily dealt with by the requirement that the benefit of the relief is subject to the condition that the losses of foreign subsidiaries *cannot* receive advantageous tax treatment in the State in which those subsidiaries are resident. Where the State in which the foreign subsidiaries are established enables those subsidiaries to impute their losses to another person or to carry them forward to other financial years, the United Kingdom is entitled to oppose a claim for the transnational transfer of those losses. Relief will then have to be sought in the State in which the subsidiary is established. Consequently, the companies will not be at liberty to choose the place of imputation of their losses.

80. Such a condition can be justified under Article 43 EC. In fact it is legitimate to accord priority to the rules of the State of establishment where such rules afford equivalent treatment to group losses. First, it is accepted that establishment, which involves the ability 'to participate, on a stable and continuous basis, in the economic life of a Member State', [81] imposes specific constraints to which the economic operator in principle remains subject. [82] Provided that the treatment of losses is equivalent as regards the group, those constraints do not affect freedom of establishment. Under those conditions the differences in treatment which might arise for the group are caused only by the disparities existing as between national tax laws. Second, such a condition permits the cohesion and integrity of national tax systems allowing group relief to be maintained.

81. It may perhaps be objected that it will be excessively difficult for the United Kingdom to ascertain that there is a possibility of group relief in another Member State. In that connection it should be recalled that the

80 — This term is taken from J.-C. Goldsmith, 'Integration et consolidation des resultats en droit fiscal compare (a propos de la fiscalite des groupes de societes et des societes a vocation internationale)', *La semaine juridique (Edition commerce et industrie)*, 1971, p. 456.

81 — Case C-55/94 *Gebhard* [1995] ECR I-4165, paragraph 25.

82 — To that effect *Peralta*, cited above at footnote 18, paragraph 52.

Member States have available to them instruments of enhanced cooperation under Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation.[83] Under those provisions the competent authorities of one Member State have the power to request the competent authorities of another Member State to provide them with all information enabling them to establish the correct amount of corporation tax. In fact that instrument of administrative cooperation 'provides for ways of obtaining information comparable to those existing between tax authorities at national level'.[84] Nor does it seem to me to be ruled out that the Member State concerned may impose on a company claiming group relief a duty of information as to the tax situation of the group to which it belongs and in particular the possibility of dealing with the losses of the subsidiaries in the State in which they are established. In such a case it will none the less be necessary to ensure that those requirements do not exceed what is necessary in order to attain the objective of securing the information sought.[85]

IV — Results of the analysis

82. It follows from that analysis that Articles 43 and 48 EC do not preclude the legislation of a Member State, such as that at issue in the main proceedings, which prohibits a parent company with subsidiaries in other Member States from benefiting from the regime applicable to companies with foreign branches. Conversely, those provisions preclude the tax legislation of a Member State, such as that at issue in the main proceedings, inasmuch as it deprives a company established in that Member State of the right to benefit from group relief on the ground that its subsidiaries are resident in other Member States, which would not be the case if those subsidiaries were resident or carried on an economic activity in the territory of that State. However, those same provisions do not preclude national legislation from making entitlement to such relief subject to the condition that it is established that the losses of subsidiaries resident in other Member States cannot be accorded equivalent tax treatment in those other Member States. It should be noted that that treatment may take the form of a transfer of losses to a third party or the carrying forward of losses by the same taxpayer to another tax year.

83. Doubtless such a solution appears complex. It is a solution which requires the authorities of the Member State concerned to take account of the tax situation of companies not resident in its territory. Yet it seems to me that, in the absence of Community harmonisation, only a solution of this kind allows a balance to be maintained between the tax competences retained by the Member States and the requirements

83 — OJ 1983 L 336, p.15. That directive was recently amended by Council Directive 2004/56/EC of 21 April 2004 (OJ 2004 L 127, p. 70).

84 — *Schumacker*, cited above at footnote 13, paragraph 45.

85 — *Futura Participations and Singer*, cited above at footnote 8, paragraph 36.

of freedom of movement flowing from the internal market. In such circumstances, it is not for the Court to determine a uniform scheme for all the Member States, basing its model on one national tax system or another or on a proposal which may be adopted by the Community institutions. Its task is simply to delimit the obligations on the Member State concerned stemming from its involvement within the Community.

V — Conclusion

84. In light of those considerations, I propose that the Court should reply as follows to the questions referred to it in this case by the High Court of Justice of England and Wales, Chancery Division (United Kingdom):

(1) Articles 43 and 48 EC preclude the tax legislation of a Member State, such as that at issue in the main proceedings, which prohibits a parent company established in a Member State from benefiting from the right to group relief on the ground that its subsidiaries are established in other Member States, whereas that relief would be granted if those subsidiaries were resident in that Member State.

(2) Those provisions do not preclude national legislation from making entitlement to group relief, such as that provided for by the Member State concerned in the main proceedings, subject to the condition that it be established that the losses of subsidiaries resident in other Member States cannot be accorded equivalent tax treatment in those Member States.