[2020] UKFTT 476 (TC)

**TC07950**

*Income tax/Corporation Tax – Group relief – Whether s 403D(1)(c) Income and Corporation Taxes Act 1988 unlawful restriction on freedom of establishment – If so, whether it should be disapplied or a conforming construction applied – Appeals allowed*

| | |
|---|---|
| **FIRST-TIER TRIBUNAL**<br>**TAX CHAMBER** | **Appeal numbers: TC/2019/01687**<br>**TC/2019/01690**<br>**TC/2019/01692**<br>**TC/2019/01694** |

**BETWEEN**

**(1) VOLKERRAIL PLANT LIMITED**
**(2) VOLKERRAIL POWER LIMITED**
**(3) VOLKERFITZPARTICK LIMITED**
**(4) VOLKERRAIL LIMITED** **Appellant**

**-and-**

**THE COMMISSIONERS FOR**
**HER MAJESTY'S REVENUE AND CUSTOMS** **Respondents**

**TRIBUNAL: JUDGE BROOKS**

**The hearing took place on 5 – 7 October 2020 by way of a video hearing on the Tribunal Video Platform**

**Nicola Shaw QC and Kelly Stricklin-Coutinho, instructed by Ernst & Young LLP, for the Appellant**

**Mark Fell and Harry Winter, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents**

## DECISION

### INTRODUCTION

1. These appeals concern claims for group relief, totalling £36,595,011, in respect of the losses incurred by the United Kingdom branch or resident permanent establishment ("PE") of a Dutch resident company in the VolkerWessels ("VW") group of companies, the same Dutch multi-national corporate group as the Appellants. However, unlike that company, the Appellants are United Kingdom resident members of the VW group.

2. It is common ground that, because the losses were deductible (and in large part deducted) in the Netherlands, the Appellants are precluded from claiming group relief. This is because the condition in s 403D(1)(c) of the Income and Corporation Taxes Act 1988 ("ICTA"), that no loss of a non-resident company carrying on trade in the United Kingdom through a resident PE shall be treated as available for surrender by way of group relief if any part of it is deductible from or otherwise allowable against non-United Kingdom profits of the company or any other person, has not been satisfied.

3. Nicola Shaw QC and Kelly Stricklin-Coutinho, for the Appellants, rely on the decision of the Court of Justice of the European Union ("CJEU")[1] in Case C-18/11 *HMRC v Philips Electronics UK Limited* [2013] STC 41 ("*Philips Electronics*") to contend that s 403D(1)(c) ICTA constitutes an unlawful restriction on the freedom of establishment in circumstances in which the losses of the United Kingdom PE have been taken into account in the Netherlands. As such, they submit that s 403D(1)(c) ICTA should be disapplied.

4. Mark Fell and Harry Winter, for the Respondents ("HMRC") contend that the later decision of the CJEU in Case C-28/17 *NN A/S v Skatteministeriet* ("*NN*"), overrules *Philips Electronics*. Accordingly, they say, that as the prevention of a double deduction of losses by cross-border groups is a legitimate public policy objective, s 403D(1)(c) ICTA is not an unlawful restriction on the freedom of establishment but if that is not the case they contend that s 403D(1)(c) ICTA should not be disapplied but given a conforming interpretation.

5. While I am grateful to counsel for their detailed submissions, both written and oral, which have been carefully considered, it has not been necessary to address each and every argument advanced on behalf of the parties in reaching my conclusions.

### FACTS

6. The facts giving rise to these appeals were not disputed. The parties produced the following Statement of Agreed Facts:

> **The VW Group**
>
> (1) VolkerRail Plant Limited, VolkerRail Power Limited, VolkerFitzpatrick Limited) and VolkerRail Limited are UK incorporated and resident companies within the VW group of companies.
>
> (2) The ultimate parent company of the VW group is Koninklijke VolkerWessels NV ("KVW NV"), a company incorporated and resident in the Netherlands, which is listed on the Euronext NV stock exchange in Amsterdam.
>
> (3) The VW group primarily undertakes building and construction projects for the residential, commercial, mobility, energy and telecoms sectors and has operations in the Netherlands, the United Kingdom, Germany, Canada and the United States of America.

[1] Although throughout this Decision I have referred to the CJEU this should be read where appropriate as a reference to the European Court of Justice or ECJ

(4) The Appellants form part of a UK sub-group within the VW group, the intermediate parent company of which is Volker Stevin International BV, a company incorporated and resident in the Netherlands. Prior to November 2008, VolkerRail Limited, VolkerRail Plant Limited and VolkerRail Power Limited were jointly owned by Volker Wessels UK Ltd (as to 50%) and Corus UK Limited (as to 50%). On 26 November 2008, VolkerWessels UK Limited acquired Corus UK Limited's 50% interest in these companies such that the VolkerRail UK sub group (shown in the structure chart in the Appendix) became wholly owned by the VW group (ultimate parent company KVW NV). VolkerFitzpatrick Limited was 100% owned by the VW group in all periods.

(5) At all material times, Volker Stevin Construction Europe BV ("VSCE"), a company incorporated and resident in the Netherlands, had a UK branch ("the VSCE UK Branch").

(6) An extract of the group structure during the relevant period appears as an Appendix to this Decision.

**The Claims**

(7) In the relevant period, the VSCE UK Branch incurred UK trading losses as follows:

| Accounting Period | Amount |
|---|---|
| 31 December 2007 | £13,106,635 |
| 31 December 2008 | £17,707,913 |
| 31 December 2009 | £6,832,701 |

(8) Those losses were attributable to two operational projects: the construction of a liquified natural gas facility at the Dragon LNG Terminal (a joint venture with Whessoe Oil & Gas Limited, and the construction of the new Tyne Tunnel (a joint venture with VolkerStevin Limited).

(9) Claims in respect of the UK trading losses for consortium relief (in the case of the claims by VolkerRail Limited, VolkerRail Plant Limited and VolkerRail Power Limited[2]) and group relief (in the case of the claims by VolkerFitzpatrick Limited) were made as follows:[3]

| Accounting Period | Claimant | Amount | Date of Claim |
|---|---|---|---|
| 31 December 2007 | VolkerFitzpatrick Ltd | £9,819,850 | December 2009 |
| 31 December 2007 | VolkerRail Ltd | £2,390,773 | December 2009 |
| | | | |
| | | **Total = £12,210,623** | |

[2] The claims for consortium relief were for 50% of the losses of the VSCE UK Branch.

[3] The Appellants' UK corporation tax returns for the years ended 31 December 2007 and 31 December 2008 were submitted without claiming group relief for the VSCE UK Branch losses. However, in December 2009, following the First-tier Tribunal (FTT) decision in *HMRC v Philips Electronics UK Limited* ([2009] UKFTT 266 (TC)) (*Philips Electonics*), amendments to the corporation tax returns and computations of the Appellants and the VSCE UK Branch were made for the years ending 31 December 2007 and 2008 so as to include the claims for group relief in respect of these losses.

| | | | |
|---|---|---|---|
| 31 December 2008 | VolkerRail Plant Ltd | £735,451 | December 2009 |
| 31 December 2008 | VolkerRail Power Ltd | £185,894 | December 2009 |
| 31 December 2008 | VolkerFitzpatrick Ltd | £14,918,696 | December 2009 |
| 31 December 2008 | VolkerRail Ltd | £1,712,452 | December 2009 |
| | | | |
| | | **Total = £17,552,493** | |
| 31 December 2009 | VolkerFitzpatrick Ltd | £6,831,895 | December 2010 |
| | | | |
| | | **Total = £6,831,895** | |

(10) No payments were made by the Appellants to the VSCE UK Branch for the losses.

(11) VolkerWessels UK Limited[4] received the following corporation tax refunds;

- £1,738,537.85 on 24th December 2009
- £4,023,911.51 on 15th March 2010
- £1,494,990.00 on 24th September 2010

(12) In the accounting period ending 31 December 2010, the VSCE UK Branch made a loss of £19,030.

**Dutch Corporate Tax (applicable rules in the years 2004-2010)**

(13) Dutch Corporate Income Tax Act permits the formation of a fiscal unity between a Dutch resident parent company and any 95% Dutch resident subsidiaries: Article 15 of the Dutch Corporate Income Tax Act ("CITA") 1969.

(14) The parent company and qualifying subsidiaries must apply to form/join a fiscal unity, and there is no minimum period of application for a fiscal unity.

(15) The effect of being in a fiscal unity is that for Dutch tax purposes all companies that are part of the fiscal unity are treated as one single taxpayer. Corporate income tax is assessed in the name of the parent company that heads the fiscal unity: Article 24(2) CITA 1969. Once a company leaves a fiscal unity, it becomes a standalone taxpayer again.

(16) Dutch resident companies are taxed on their worldwide profits, which includes the results of branches or PEs outside the Netherlands. For a fiscal unity a consolidated return consolidates the results of the single entities into one return.

(17) However, pursuant to Article 22 of the DTC 1980 or Article 21 of the DTC 2008, as applicable, the Netherlands grants relief for double taxation. This is given effect to under Dutch domestic law by Articles 31 to 33 of the Double Taxation (Avoidance) Decree of 2001 ("the Decree"), which provides for the exemption of foreign sourced profits which have already been subjected to tax as follows: (i) the profits of the foreign PE are included in the Dutch tax base; (ii) the Dutch tax rate is applied to the Dutch tax base, thereby establishing the amount of Dutch tax payable; and (iii) the amount of Dutch tax payable is reduced by:

[4] VolkerWessels UK Ltd received the refund as the entity that is in charge of the group payment arrangements

| | | |
|---|---|---|
| An amount equal to the amount of tax that would have been payable without the application of the Decree | X | The foreign profit / The worldwide income (profit) of the taxpayer |

(18) Foreign sourced losses are not, however, exempted. They are included within the Dutch tax base. Instead, Article 35 of the Decree establishes a recapture mechanism which applies in the event that foreign profits from the same jurisdiction as the foreign losses are subsequently generated. The recapture mechanism works by disallowing double taxation relief against those foreign profits until the foreign losses have been effectively set off against those foreign profits.

**The VW Group**

(19) VSCE BV was included in a fiscal unity from 1 January 1974. In the period 1 January 2007 until 16 May 2007, VSCE BV belonged to the fiscal unity Victor Holdings BV. As from 16 May 2007, VSCE BV became part of the fiscal unity Storm Investments BV.

(20) In December 2009, VW filed a request to exclude VSCE BV from the fiscal unity to which it belonged at the time with effect from 1 January 2010, in order to limit the impact of the recapture mechanism on the fiscal unity, as other members of the fiscal unity operated in the UK from time to time.

(21) VSCE BV left the fiscal unity as per 1 January 2010. Through correspondence with the Dutch tax authority dated 24 November 2014 the VW group set out its view of the tax consequences in the Netherlands. The Dutch tax authority provided confirmation to the VW group on 1 October 2015 in which it confirmed that the 2010 tax assessment for the fiscal unity would be issued in accordance with the tax return that was filed. The burden of the recapture mechanism in relation to the UK losses incurred by VSCE BV remained with VSCE BV as a single entity tax-payer as from 1 January 2010.

(22) The effect of removing VSCE BV from the fiscal unity was, therefore, that it became a single entity taxpayer and the recapture mechanism was restricted to any subsequent UK profits of VSCE BV (which were unlikely to arise as VSCE BV had also ceased trading and was unlikely to have future operations or profits in the UK).

**The Dutch Tax Position - Utilisation of UK Losses and the Recapture Mechanism**

(23) For Dutch accounting purposes, the results of VSCE UK Branch were reported in the VSCE BV annual accounts, drawn up in accordance with Dutch GAAP. The results of VSCE BV have been included in the fiscal unity's consolidated tax returns.

(24) The results were reported as follows:

| | 31 December 2004 | 31 December 2005 | 31 December 206 |
|---|---|---|---|
| **Total** | **(€3,977,000)** | **(€3,526,000)** | **(€5,535,000)** |

| | 31 December 2007 | 31 December 2008 | 31 December 209 |
|---|---|---|---|
| **Total** | **(€17,361,000)** | **(€15,567,000)** | **€1,709,000** |

(25) For the tax years ending 31 December 2004-2008, the losses of the UK Branch have been included in the corporate income tax return of the fiscal unity. The total

amount of VSCE UK Branch losses utilised by the VW fiscal unity in the years ending 31 December 2004 to 2008 was €45,966,000.

(26) In the year ending 31 December 2009, VSCE BV UK Branch reported a profit of €1,709,000.

(27) In the year ending 31 December 2010, VSCE BV filed a single entity tax return. The tax return included a profit of €173,000 profit relating to the VSCE UK Branch.

(28) Of the total amount of UK losses (€45,966,000), €1,882,000 has been recaptured: in the tax year ending 31 December 2009, €1,709,000 of the losses were recaptured and in the tax year ending 31 December 2010, a further €173,000 of the losses was recaptured (the losses of €173,000 being recaptured against the profits of VSCE BV, rather than against the profits of the fiscal unity to which VSCE BV belonged at the time those UK losses were incurred).

(29) This analysis accords with VSCE BV's tax return for the year ending 31 December 2010, which states that a total amount of UK losses of €44,084,000 is still subject to recapture against any future UK branch profits of VSCE BV.

### The Enquiry

(30) Following the claims, HMRC opened protective enquiries into the Appellants' Corporation Tax Returns for:

(a) the accounting period ended 31 December 2007, under letter of enquiry dated 22 December 2009;

(b) the accounting period ended 31 December 2008, under letter of enquiry dated 13 December 2010;

(c) the accounting period ended 31 December 2009, under letter of enquiry dated 15 December 2011.

(31) On 8 February 2010, HMRC wrote to the VW group to confirm that its enquiries were to be suspended pending the outcome of *HMRC v Philips Electronics UK Limited* ([2009] UKFTT 266 (TC)).

(32) On 12 February 2019, HMRC issued closure notices to the Appellants amending their tax returns so as to disallow the claims for consortium and group relief.

**LAW**

## Relevant United Kingdom legislation

7. The relevant United Kingdom legislation applicable to the Appellants' claims was originally contained in Part X of ICTA.

8. Section 402 ICTA, as amended, applicable from 1 April 2006 to 1 April 2010, provided:

> **402 Surrender of relief between members of groups and consortia**
>
> (1) Subject to and in accordance with this Chapter and section 492(8)—
>
> (a) relief for trading losses and other amounts eligible for relief from corporation tax, or
>
> (b) losses and other amounts not eligible for relief from corporation tax, may, in the cases set out in subsections (2) and (3) below, be surrendered by a company ("the surrendering company") and, on the making of a claim by another company ("the claimant company") may

be allowed to the claimant company by way of a relief from corporation tax called “group relief “.

(2) In respect of amounts falling within subsection (1)(a) above, group relief shall be available in a case where—

(a) the surrendering company and the claimant company are both members of the same group,

(b) the surrendering company is resident in the United Kingdom or is not so resident but carries on a trade there through a permanent establishment, and

(c) the claimant company is resident in the United Kingdom or is not so resident but carries on a trade there through a permanent establishment, and, in respect of amounts falling within subsection (1)(b) above, group relief shall be available in a case where the condition in subsection (2A) below is satisfied.

A claim made by virtue of this subsection is referred to as a “group claim”.

(2A) The condition in this subsection is satisfied if the surrendering company is within the charge to tax under the law of any EEA territory and—

(a) the surrendering company is a 75 per cent subsidiary of the claimant company and the claimant company is resident in the United Kingdom, or

(b) both the surrendering company and the claimant company are 75 per cent subsidiaries of a third company that is resident in the United Kingdom.

(2B) For the purposes of subsection (2A) above, the surrendering company is within the charge to tax under the law of any EEA territory if—

(a) it is a non-resident company which is resident in any EEA territory, or

(b) it is a non-resident company which is not resident in any EEA territory but which carries on a trade in any EEA territory through a permanent establishment.

(3) Group relief shall also be available in the case of a surrendering company and a claimant company either where one of them is a member of a consortium and the other is—

(a) a trading company which is owned by the consortium and which is not a 75 per cent subsidiary of any company; or

(b) a trading company—

(i) which is a 90 per cent subsidiary of a holding company which is owned by the consortium; and

(ii) which is not a 75 per cent subsidiary of a company other than the holding company; or

(c) a holding company which is owned by the consortium and which is not a 75 per cent subsidiary of any company;

or, in accordance with section 406, where one of them is a member of a group of companies and the other is owned by a consortium and another company is a member of both the group and the consortium.

A claim made by virtue of this subsection is referred to as "a consortium claim."

(3A) A consortium claim shall not be made unless the following condition is satisfied in the case of both the surrendering company and the claimant company.

(3B) The condition is that the company is resident in the United Kingdom or is a non-resident company carrying on a trade in the United Kingdom through a permanent establishment.

…

(5) Subject to the provisions of this Chapter, two or more claimant companies may make claims relating to the same surrendering company, and to the same accounting period of that surrendering company.

…

9. It is accepted that the conditions of s 402 ICTA are satisfied in respect of the various claims in the present case. It is also not disputed that s 403(1)(a) and (b) are satisfied in respect of these claims. This provided:

**403 Amounts which may be surrendered by way of group relief**

(1) If in an accounting period (the "surrender period") the surrendering company has—

(a) trading losses, excess capital allowances or a non-trading deficit on its loan relationships, or

(b) charges on income, Schedule A losses[, management expenses or a non-trading loss on intangible fixed assets] available for group relief,

the amount may, subject to the provisions of this Chapter, be set off for the purposes of corporation tax against the total profits of the claimant company for its corresponding accounting period.

10. Section 403D ICTA provided:

**403D Relief for or in respect of UK losses of non-resident companies**

(1) In determining for the purposes of this Chapter the amounts for any accounting period of the losses and other amounts available for surrender by way of group relief by a non-resident company carrying on a trade in the United Kingdom through a permanent establishment, no loss or other amount shall be treated as so available (but see also subsection (11) below) except in so far as—

(a) it is attributable to activities of that company the income and gains from which for that period are, or (were there any) would be, brought into account in computing the company's chargeable profits for that period for corporation tax purposes;

(b) it is not attributable to activities of the company which are made exempt from corporation tax for that period by any double taxation arrangements; and

(c) no part of—

(i) the loss or other amount, or

(ii) any amount brought into account in computing it,

> corresponds to, or is represented in, any amount which, for the purposes of any foreign tax, is (in any period) deductible from or otherwise allowable against non-UK profits of the company or any other person. …..

11. As stated above (paragraph 2), it is common ground that the condition in s 403D(1)(c) ICTA has not been satisfied.

12. I should also mention that the United Kingdom provisions by which a company can carry a loss forward or back to another accounting period from that in which it was incurred, s 393 and s 393A ICTA respectively, do not impose a restriction similar to s 403D(1)(c) ICTA with the result that a foreign owned PE is entitled to transfer losses to a later accounting period even if deductible against foreign profits.

13. Material provisions of the UK/Netherlands Double Taxation Convention and Protocol 2008 ("2008 DTC") provide:

> **ARTICLE 7**
>
> **Business Profits**
>
> (1) Profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.
>
> ...
>
> **ARTICLE 21**
>
> **Elimination of Double Taxation**
>
> (1) The Netherlands, when imposing tax on its residents, may include in the basis upon which such taxes are imposed the items of income which, according to the provisions of this Convention, may be taxed in the United Kingdom.
>
> (2) However, where a resident of the Netherlands derives items of income which according to…Article 7…of this Convention may be taxed in the United Kingdom and are included in the basis referred to in paragraph (1), the Netherlands shall exempt such items of income by allowing a reduction of its tax. This reduction shall be computed in conformity with the provisions of the Netherlands law for the avoidance of double taxation. For that purpose the said items of income shall be deemed to be included in the amount of the items of income which are exempt from Netherlands tax under those provisions.
>
> …

14. Articles 7 and 22(2) of the UK/Netherlands Double Taxation Convention and Protocol 1980 were in substantially the same terms as Articles 7 and 21 of the 2008 DTC.

## Relevant European Union principles

15. The relevant prohibitions regarding freedom of establishment currently appear in Chapter 1 of Title IV of the Treaty on the Functioning of the European Union ("TFEU").

16. Article 49 (formerly article 43) of the Treaty provides:

> Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by

> nationals of any Member State established in the territory of any Member State.
>
> Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.

17. The framework of Chapter 1 provides, in article 52 (formerly article 46):

> The provisions of this Chapter and measures taken in pursuance thereof shall not prejudice the applicability of provisions laid down by law, regulation or administrative action providing for special treatment for foreign nationals on grounds of public policy…

18. The question of whether a 'restriction' on the freedom of establishment, within the meaning of TFEU article 49, has been imposed is to be judged by reference to whether there is both:

(1) a difference in treatment between resident and non-resident taxpayers; and

(2) objectively comparable situations to which that difference relates (see Case C-123/11 *Proceedings brought by A Oy* [2013] STC 1960, at [33]).

It is necessary to consider, for example, whether there are differences which make it less attractive for a non-resident company to set up an establishment (see Case C-337/08 *X Holding BV v Staatssecretaris van Financien* Case [2010] STC 941 at [19]) and whether a situation is comparable which is to be assessed by reference to the aim pursued by the national provisions at issue (see *X Holding* at [22]).

19. Although a restriction may be justified in the public interest, any such justification must be proportionate and not go beyond what is necessary in the public interest to achieve the public interest in question (see *A Oy* at [47] and [48]).

20. The issue of whether the prevention of cross-border double deduction of losses was a legitimate public policy objective was considered by the CJEU in *Philips Electronics* and *NN* and it is to those cases that I now turn.

***Philips Electronics***

21. *Philips Electronics* concerned the claim by a company, incorporated in England and Wales and resident for tax purposes in the United Kingdom, for group relief in respect of the losses of a United Kingdom PE of a Dutch resident company, LG PD Netherlands, which was in the same corporate group. As in the present case, the company's claim was refused by HMRC on the basis that as the same loss was also deductible by the non-United Kingdom resident, LG PD Netherlands, the condition in s 403D(1)(c) ICTA had not been satisfied. This company appealed on the basis of an unjustified restriction on the freedom of establishment.

*First-tier and Upper Tribunal*

22. The First-tier Tribunal (Judges Avery Jones and Berner) noted at [5] of the decision (reported at [2009] SFTD 629) that s 403D(1)(c) ICTA was "extremely strict" and prevented relief of any losses if:

(1) any part of the losses, however small, is deductible abroad;

(2) in any period in the future, and

(3) even if the losses are not allowed abroad because of a rule that prevents losses being allowed if they are deductible in the United Kingdom.

At [21] the Tribunal observed:

> "We [ie the United Kingdom] tax a UK branch in exactly the same way as a UK subsidiary (or a separate UK company) so far as the branch profits or losses made in the UK are concerned, except in relation to group relief under s 403D(1)(c). Because we treat them in the same way generally the correct comparison is between the UK branch and a UK company. On this basis, the limitation on group relief is something that affects non-resident companies only and is therefore a restriction."

23. It continued, at [42], stating:

> "From a review of the ECJ cases, we conclude that, according to the present jurisprudence, a member state cannot rely solely on the prevention of the use of losses twice to justify a restriction, even one that is targeted at such double use."

24. At [60(2)] the Tribunal concluded that:

> "Section 403D contains a restriction that cannot be justified and so does not apply to prevent consortium relief from being available in these circumstances. If we are wrong about justification there is a more proportional method of restricting the double use of losses in the form of the no-possibilities test adopted in *Marks & Spencer* and s 403D should be interpreted so as to be in conformity with that test."

25. HMRC appealed to the Upper Tribunal which stayed the proceedings and referred the following questions to the CJEU for a preliminary ruling:

> "(1) Where a member state (such as the UK) includes in its tax base the profits and losses of a company incorporated and tax resident in another member state (such as the Netherlands) to the extent that the profits are attributable to a business carried on by the Netherlands company in the UK through a permanent establishment situated in the UK, is it a restriction on the freedom of a national of a member state to establish in the UK under art 49 TFEU ([formerly] art 43 EC) for the UK to prevent the surrender of the UK losses of a permanent establishment situated in the UK of a non-UK resident company to a UK company by way of group relief where any part of those losses or any amount brought into account in computing them "corresponds to, or is represented in, any amount which, for the purposes of any foreign tax is (in any period) deductible from or otherwise allowable against non-UK profits of the company or any person" ie to permit the surrender of UK losses in the case of a permanent establishment situated in the UK only where it is clear that at the time of the claim there can never be any deduction or allowance in any state outside the UK (including another member state (such as the Netherlands)), and it being insufficient that relief available overseas has not in fact been claimed, and in circumstances where there is no equivalent condition applicable to the surrender of UK losses of a UK resident company?
>
> (2) If so, is that restriction capable of being justified:
>
> > (a) solely on the basis of the need to prevent the double use of losses, or
> >
> > (b) solely on the basis of the need to preserve the balanced allocation of taxing powers between member states, or

> (c) on the basis of the need to preserve the balanced allocation of taxing powers between member states in conjunction with the need to prevent the double use of losses?
>
> (3) If so, is the restriction proportionate to such justification or justifications?
>
> (4) If any restriction on the rights of the Netherlands company is not justified or to the extent that it is not proportionate to any justification, does EU Law require the UK to provide the UK company with a remedy such as the right to claim group relief against its profits?"

*Advocate General*

26. Advocate General Kokott in her Opinion, having first set out the relevant United Kingdom domestic legislation, observed, at [18], that the question asked by the Upper Tribunal concerned the "interpretation of the freedom of establishment". She continued:

> "19 … The freedom of establishment is the relevant fundamental freedom in the present case. The court has already ruled that the creation and the ownership by a company of a permanent establishment situated in another member state falls within the scope of application ratione materiae of art 43 EC. The present case concerns a Netherlands company and the right to surrender losses of a branch which it maintains in the United Kingdom. Such a branch comes under the notion of 'permanent establishment' for tax purposes.
>
> 20. It must therefore be clarified hereinafter whether the freedom of establishment precludes a restriction of the right of a foreign company to surrender losses of its domestic permanent establishment (in the form of a branch).

27. Turning her attention to the first question, Advocate General Kokott said:

> "21. In accordance with the questions referred, I will first consider whether a provision such as s 403D(1)(c) of the ICTA restricts the freedom of establishment. Under that provision, a surrender of domestic losses of the permanent establishment of a foreign company by way of group relief is not possible where the losses, for the purposes of any foreign taxation, are allowable against non-UK profits.
>
> 22. It is settled case law that, while direct taxation falls within the competence of the member states, they must none the less exercise that competence consistently with European Union law. Against this background, it should be stated that under EU law the member states are, in principle, not required to provide in their corporation tax legislation for group relief for losses, as is granted by United Kingdom law in the present case. The formulation of the tax system is a matter for each member state. If, however, a member state provides for such a right, it must be regulated in accordance with the fundamental freedoms under EU law, in this case the freedom of establishment in particular."
>
> 23. Companies are accorded the freedom of establishment by art 43 EC and art 48 EC. The court has inferred, in summary, from the content of these provisions that companies established in a member state of the Community have the right to exercise their activity in another member state through a subsidiary, a branch or an agency.
>
> 24. In addition, as the second sentence of the first paragraph of art 43 EC expressly leaves traders free to choose the appropriate legal form in which to pursue their activities in another member state, that freedom of choice must not be limited by discriminatory tax provisions in the host member state. The

> freedom to choose the appropriate legal form in which to pursue activities in another member state primarily serves to allow companies having their seat in a member state to open a branch in another member state in order to pursue their activities under the same conditions as those which apply to subsidiaries.
>
> 25. This case law means that foreign companies may carry on commercial activity in the host member state under the same conditions as domestic companies. Furthermore, the host member state may not rely on the fact that the foreign company may prevent any detrimental difference in treatment by choosing another legal form for its activity in the host member state, for example a subsidiary rather than a branch."

28. The Advocate General then considered the difference in treatment of the tax provisions for United Kingdom resident companies, which could be foreign owned, and foreign owned companies with United Kingdom resident PEs to which the conditions in s 403D(1) ICTA apply, noting that:

> "28. Those conditions include s 403D(1)(c) under which foreign companies may surrender the losses of a UK-resident permanent establishment only where they cannot be used for the purposes of any foreign tax. Such a condition does not apply to companies resident in the United Kingdom.
>
> 29. Foreign companies suffer at least two disadvantages as a result of the difference in treatment. First, it becomes more difficult for them to form a consortium with UK companies. Because it may not be possible to surrender losses of UK-resident permanent establishments of foreign companies, they will tend to do their business in consortiums with domestic companies, which are not subject to these restrictions. Second, a foreign company suffers direct disadvantages through a refusal to surrender losses. The foreign company will—as in the present case—be unable to receive a payment from the company which benefits from the surrender of losses.
>
> 30. As has already been explained, it also follows from case law that the host member state may not rely on the fact that foreign companies may avoid disadvantages by carrying on their commercial activity in the host member state in the form of a subsidiary rather than a branch. Thus, the surrender of losses of a subsidiary of LG PD Netherlands in the United Kingdom would not be subject to any restrictions. However, foreign companies are free to exercise their right of establishment in the United Kingdom through a branch or a subsidiary."

29. In relation to HMRC's argument that a domestic company and a foreign company with a United Kingdom-resident PE were not in an objectively comparable situation as regards their tax treatment, the Advocate General observed, at [36], that:

> "In *Saint Gobain ZN* the court also recognised a comparable situation of resident and non-resident companies primarily because the difference in treatment applied only as regards the grant of the tax concessions in question. In the present case, the lower court in the main proceedings found in this regard that domestic companies and UK-resident permanent establishments of foreign companies are treated in exactly the same way, for the purposes of corporation tax, with regard to profits and losses made in the United Kingdom, with the exception of the group relief which is at issue here"

30. As such, Advocate General Kokott considered that a domestic company and a foreign company with a United Kingdom PE were objectively comparable as regards their tax treatment and a restriction of the freedom of establishment could not be rejected on the

ground that a domestic company and a foreign company with a United Kingdom-resident PE were not in an objectively comparable situation as regards their tax treatment. She concluded, at [38]:

> "The answer to the first question must therefore be that the special conditions laid down by s 403D(1)(c) of the ICTA for group relief in relation to companies established in a member state other than the United Kingdom constitute a restriction of the freedom of establishment."

31. Turning to the second question, whether such a restriction was justified, the Advocate General considered, at [42], it to be:

> "… clear that the crucial factor for the justification is ultimately that national legislation pursues the objective of preserving the allocation of the power to tax. Against this background, the objectives of preventing the double use of losses and tax avoidance do not constitute an end in themselves, but are relevant only in so far as they serve to preserve the allocation of the power to tax between the member states."

32. However, she concluded that such a justification was not available as:

> "50. It is irrelevant to safeguarding the power of taxation of the United Kingdom whether the losses to be surrendered can also be taken into account in the Netherlands. Taking the losses into account there has no bearing on the power of taxation enjoyed by the United Kingdom. That power can be impaired only if losses which are incurred within the scope of the exclusive power of taxation of another member state are taken into account. Such losses would reduce the tax revenue of the United Kingdom, even though the profits from the activity cannot be taxed.
>
> 51. Accordingly, the court has examined the need to prevent the double use of losses almost exclusively in cases where a member state refused to take into account losses incurred in another member state. On the single occasion so far when domestic losses were at issue, in *Papillon*, the court rejected reliance on the objective of preventing the double use of losses on the ground that losses recorded in one and the same member state were being taken into account.
>
> 52. In the present case, the profits from the domestic activity of the permanent establishment of LG PD Netherlands are subject to the power of taxation of the United Kingdom. Use of the losses from that activity cannot therefore be refused by relying on the preservation of the allocation of the power of taxation. As the court found in *Lidl Belgium*, that justification is intended only to safeguard symmetry between the right to tax profits and the right to deduct losses. Or, as the United Kingdom government itself put it in *Marks & Spencer*: profits and losses are two sides of the same coin."

33. The Advocate General then examined whether the objective of preventing the double use of losses can constitute an autonomous justification. Having acknowledged, at [59], that the losses were deductible in the Netherlands and therefore gave rise to a risk of at least a "temporary" double use of losses in the United Kingdom and the Netherlands (where they are subject to the recapture mechanism – see paragraph 6(18) above) she continued:

> "60. In *Lidl Belgium*, however, the court recognised that it is compatible with the freedom of establishment if a company cannot deduct losses relating to a permanent establishment situated in another member state, to the extent that, by virtue of a double taxation convention, its income is taxed in the other member state and losses can also be taken into account there in future accounting periods. If the member state in which the permanent

establishment is situated takes into account both profits and losses for tax purposes, the company's member state can therefore ignore the losses incurred by such a permanent establishment for tax purposes. The Kingdom of the Netherlands does not therefore exercise the powers which it enjoys according to that case law.

61. On the other hand, taking into account such losses of a foreign permanent establishment also does not breach the freedom of establishment. The member states may therefore take into account losses of foreign permanent establishments in the taxation of their domestic companies, but are not required to do so, as a rule, under EU law.

62. If the member state in which the company is established nevertheless takes into account the losses of the foreign permanent establishment, there is an—at least temporary—double use of the losses of a foreign permanent establishment. In such a case, however, it is not clear why the member state in which the permanent establishment is situated should have the power to rule out the use of the losses on the ground that they are already taken into account in the member state in which the company is established. As we have seen, the power of taxation of the member state in which the permanent establishment is situated is not affected. Its tax revenue is the same irrespective of whether losses of the permanent establishment are also taken into account in the company's home state.

63. Furthermore, the current international delimitation of taxation rights may even require a double use of losses. This is the case whenever the income is taken into account for tax purposes by two different states. If double taxation of the income of a foreign permanent establishment is countered through the credit procedure in the company's home state, its income will be subject to tax both in the state in which the permanent establishment is situated and in the company's home state. The double use of losses in such cases is a logical consequence of the double significance of one source of income.

64. Against this background, the prevention of the double use of losses cannot be an end in itself. The aspect of prevention of the double use of losses, as understood so far in the case law, solely concerns the question whether a member state has the right, in the context of the balanced allocation of the powers of taxation, not to take into account a loss in the taxation of its taxpayer. That right may stem from the fact that the loss is taken into account in another member state under whose fiscal jurisdiction the taxation of the profits from the relevant activity falls. The loss is attributed to that other member state because it taxes the relevant profits. Use in a further member state which does not tax the profits would possibly be 'double'.

65. The use of the losses of a permanent establishment in the United Kingdom whose profits are taxed in the United Kingdom is therefore not 'double', but 'single'. This is also provided for, in principle, by United Kingdom law in so far as the losses of the permanent establishment may be transferred to earlier or subsequent tax periods.

66. For this reason, even if the prevention of the double use of losses were to be recognised as an autonomous justification, the tax rules in the United Kingdom would not, in any case, be capable of preventing double use. As the court has pointed out, national legislation is appropriate for ensuring attainment of the objective pursued only if it genuinely reflects a concern to attain it in a consistent and systematic manner.

> 67. This is clearly not the case in the United Kingdom with regard to the double use of losses of UK-resident permanent establishments of foreign companies. The condition under s 403D(1)(c) of the ICTA applies only to group relief. However, carrying losses forward and back over different tax periods is permitted for permanent establishments situated in the United Kingdom irrespective of whether such losses are also taken into account in the company's member state. The tax rules on the deduction of losses do not therefore, on the whole, pursue in a consistent manner the objective of preventing the double use of losses."

34. The Advocate General in answer to the second question concluded, at [68], that the restriction on freedom of establishment was not capable of being justified on the basis of the preservation of the allocation of taxing powers, even if this was in combination with the prevention of the double use of losses. In addition, she considered that as it did not constitute an "autonomous restriction" s 403D(1)(c) ICTA was not capable of being justified solely on the basis of the prevention of the double use of losses.

35. The third question, whether, if there was justification for the restriction it was proportionate, would only have arisen if s 403D(1)(c) ICTA was capable of justification. Although she did not consider it was capable of justification, the Advocate General, not knowing whether the CJEU would reach the same conclusion, nevertheless addressed this issue. Her conclusion, at [77], was that even if s 403D(1)(c) ICTA could be said to be justified, on the basis that it prevented the double deduction of losses, it would not have been a proportionate restriction on the freedom of as it "goes beyond what is necessary to prevent the double use of losses."

36. The Advocate General was of the view that the fourth and final question, the appropriate remedy, "must be answered" because "a provision such as s 403D(1)(c) of the ICTA breaches the freedom of establishment". In response to an argument raised by HMRC that it had been the Dutch company rather than the appellant that had exercised its freedom of establishment and as such the appellant's freedom of establishment had not been restricted, she said:

> "82. Article 43 EC has direct effect. The national court must therefore disapply any provision of national law which may be to the contrary.
>
> 83. The first sentence of the first paragraph of art 43 EC prohibits restrictions on the freedom of establishment. There is no need to clarify, in the present case, whether that prohibition regulates a purely individual right or whether it has objective regulatory content which is independent of the person who exercises his right of establishment under that provision. In any case, the court has stated on several occasions in connection with various fundamental freedoms that persons other than those who enjoy the fundamental freedom directly may also benefit from the freedom if that freedom cannot otherwise be fully effective.
>
> 84. In the present case, it is clear, in my view, that the freedom of establishment can be fully effective only if the taxpayer in the main proceedings can also rely on the breach of the freedom of establishment by the national provision.
>
> 85. The contested restriction of the surrender of losses is prohibited by art 43 EC. …"

Having, at [85] – [88], referred to the factual context of the appeal, the Advocate General continued, at [89]:

"Against this background, it is irrelevant that the taxpayer in the main proceedings does not exercise its right of establishment itself. Article 43 EC and art 48 EC also require that the contested provision contained in s 403D(1)(c) of the ICTA be disapplied in the main proceedings"

37. At [90] the Advocate General set out her conclusions:

> "In the light of the foregoing, I suggest that the court answer the questions asked by the Upper Tribunal (Tax and Chancery Chamber) as follows:
>
> (1) It is a restriction on the freedom of establishment granted by art 43 EC and art 48 EC for a member state to prevent the surrender of the losses incurred in that member state by a resident permanent establishment of a non-resident company to a resident company by way of group relief where any part of those losses, for the purposes of any foreign tax, is in any period deductible from or otherwise allowable against non-domestic profits of the company or any other person.
>
> (2) That restriction is not capable of being justified on the basis of either the preservation of the allocation of taxing powers between member states or the prevention of the double use of losses, or by a combination of both objectives.
>
> (3) In a situation like that in the main proceedings, a member state is required to disapply a provision which is contrary to art 43 EC and art 48 EC also for the benefit of the taxpayer who is claiming group relief.

*CJEU*

38. On 6 September 2012 the CJEU delivered its judgment in this case.

39. In relation to the first question, whether there is a restriction, the CJEU referred, at [12] to [15] of its judgment, to the freedom of traders to choose the appropriate legal form in which to pursue their activities in another member state which must not be limited by discriminatory tax provisions stating, at [14]:

> "The freedom to choose the appropriate legal form in which to pursue activities in another member state serves, inter alia, to allow companies having their seat in a member state to open a branch in another member state in order to pursue their activities under the same conditions as those which apply to subsidiaries (*CLT-UFA SA v Finanzamt Köln-West* (Case C-253/03) [2007] STC 1303, [2006] ECR I-1831, para 15)."

40. Like the Advocate General, the CJEU, at [19] rejected HMRC's argument that the situation of a non-resident company with only a permanent establishment in the United Kingdom, which is taxable only on the amount of profits generated in the United Kingdom and attributable to that permanent establishment, was not comparable to that of a resident company. Accordingly, and in essence agreeing with the Advocate General, the CJEU concluded on the first question, at [20] that:

> " … that art 43 EC must be interpreted as meaning that where, under the national legislation of a member state, the possibility of transferring, by means of group relief and to a resident company, losses sustained by the permanent establishment in that member state of a non-resident company is subject to a condition that those losses cannot be used for the purposes of foreign taxation, and where the transfer of losses sustained in that member state by a resident company is not subject to any equivalent condition, those

> provisions constitute a restriction on the freedom of a non-resident company to establish itself in another member state."

41. Having noted, at [22], that a restriction on freedom of establishment may be permissible if it is justified by overriding reasons in the public interest, the CJEU observed, citing its decision in Case C-446/03 *Marks & Spencer plc v Halsey (Inspector of Taxes)* [2006] STC 237, that such a restriction must also be appropriate to ensuring the attainment of the objective at issue and not go beyond what is necessary to attain that objective. It continued:

> "23. It must be recalled, first, that preserving the allocation of powers of taxation between the member states is a legitimate objective recognised by the court (see, inter alia, *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam* (Case C-371/10) [2012] STC 114, [2012] All ER (EC) 883, para 45).
>
> 24. That objective, as observed by the court, is designed, inter alia, to safeguard the symmetry between the right to tax profits and the right to deduct losses (see *Lidl Belgium GmbH & Co KG v Finanzamt Heilbronn* (Case C-414/06) [2008] STC 3229, [2008] ECR I-3601, para 33).
>
> 25. However, in a situation such as that in the main proceedings, the power of the host member state, on whose territory the economic activity giving rise to the losses of the permanent establishment is carried out, to impose taxes is not at all affected by the possibility of transferring, by group relief and to a resident company, the losses sustained by a permanent establishment situated in its territory.
>
> 26. That situation must be distinguished from that where the issue would be whether losses sustained in another member state could be used and would be linked, for that reason, to that other member state's power to impose taxes, and where the symmetry between the right to tax profits and the right to deduct losses would not be safeguarded. In a situation such as that in the main proceedings, where the issue is that of transferring to a resident company the losses sustained by a permanent establishment situated in the territory of the same member state, the power of that member state to tax the profits (if any) arising from the activity, in its territory, of the permanent establishment is not affected.
>
> 27. It follows that the host member state, on whose territory the economic activity giving rise to the losses of the permanent establishment is carried out, cannot, in a situation such as that at issue in the main proceedings, use the objective of preserving the allocation of the power to impose taxes between the member states as justification for the fact that, under its national legislation, the possibility of transferring, by means of group relief and to a resident company, losses sustained by the permanent establishment in that member state of a non-resident company is subject to a condition that those losses cannot be used for the purposes of foreign taxation, while the transfer of losses sustained in that member state by a resident company is not subject to any equivalent condition."

42. The CJEU then considered the objective of preventing the double use or deduction of losses and, at [28] to [33], agreed with the Advocate General that the prevention of double deduction of losses cannot be an independent justification for the restriction on freedom of establishment as the use of losses in the Netherlands does not have any effect on the United Kingdom's power of taxation. It concluded, at [35], that:

> "… the answer to the second question is that a restriction on the freedom of a non-resident company to establish itself in another member state, such as that at issue in the main proceedings, cannot be justified by overriding

> reasons in the public interest based on the objective of preventing the double use of losses or the objective of preserving a balanced allocation of the power to impose taxes between member states or by a combination of those two grounds."

43. Given its conclusion in relation to question 2, the CJEU did not consider it necessary to consider or indeed answer question 3.

44. With regard to question 4, what consequences should follow from the answer given to the second question, the CJEU concluded:

> "38. It is settled case law that any national court, hearing a case within its jurisdiction, has, as an organ of a member state, the obligation, pursuant to the principle of co-operation set out in art 10 EC, fully to apply the directly applicable European Union law and to protect the rights which the latter confers upon individuals, disapplying any provision of national law which may be to the contrary, whether the latter is prior to or subsequent to the rule of European Union law (see, to that effect, inter alia, *Amministrazione delle Finanze dello Stato v Simmenthal SpA* (Case 106/77) [1978] ECR 629, paras 16 and 21, and *R v Secretary of State for Transport, ex p Factortame Ltd (No 2)* (Case C-213/89) [1991] 1 All ER 70, [1990] ECR I-2433, para 19).
>
> 39. It is, in the present case, of no relevance in that regard that it is not the taxpayer, a company established in the United Kingdom, whose freedom of establishment has been unjustifiably restricted, but rather the non-resident company with a permanent establishment in the United Kingdom. In order to be effective, freedom of establishment must also entail, in a situation such as that in the main proceedings, the possibility that the taxpayer may have the benefit of the group relief set against its profits.
>
> 40. Accordingly, the answer to the fourth question is that, in a situation such as that in the main proceedings, the national court must disapply any provision of the national legislation which is contrary to art 43 EC."

***NN***

45. NN, a Danish resident company, was the parent company of a Danish group with two Swedish resident subsidiaries, Sverige 1 and Sverige 2, each of which had a PE in Denmark known respectively as C and B. In 2006 the two branches merged, B having been transferred to Sverige 1 in exchange for shares, to form a new branch, A.

46. In Sweden the group opted for the merger to be treated as a tax-free restructuring with the result that the transfer to A of the goodwill built up in B could not be written off in Sweden. In Denmark, the merger was treated as a taxable transfer of assets at market value and entered in its accounts as part of its taxable income. This allowed A to write off the acquisition cost of the goodwill built up by B, which produced a loss in Denmark for 2008. NN applied for A's losses to be deducted from the group's profits in the year 2008. The application was refused on the basis that, under Danish law, the losses could only be set off if they were not deductible under Swedish law, ie the law of the foreign state in which the owner of the PE was resident.

47. The Østre Landsret (High Court of Eastern Denmark) made an application to the CJEU to arising for a preliminary ruling on the following questions:

> "(1) What factors are to be taken into account in assessing whether resident companies in a situation such as the present one are subject to an "equivalent condition" within the meaning of paragraph 20 of the judgment of 6 September 2012, *Philips Electronics UK*, C-18/11, EU:C:2012:532, with

> respect to the setting off of losses, to that applicable to branches of non-resident companies?
>
> (2) If it is presumed that the Danish tax rules do not contain a difference of treatment as dealt with in the judgment of 6 September 2012, *Philips Electronics UK*, C-18/11, EU:C:2012:532, does a prohibition of setting off similar to that described — in a case in which the loss in the non-resident company's permanent establishment is also subject to the host country's power of taxation — in itself constitute a restriction of the right of freedom of establishment under Article 49 TFEU, which has to be justified by reference to overriding reasons of the public interest?
>
> (3) If so, can such a restriction then be justified by the interest in preventing the double use of losses, the objective of ensuring a balanced distribution of powers of taxation between the Member States, or a combination of both?
>
> (4) If so, is such a restriction proportionate?"

*Advocate General*

48. Advocate General Campos Sánchez-Bordonas in his initial observations, at [3] of his Opinion, noted that

> "… the subject matter of the request for a preliminary ruling was once again, the contrast between the Danish tax legislation and the freedom of establishment. The Østre Landsret (High Court of Eastern Denmark) bases its uncertainties on the interpretation of the judgment in *Philips Electronics*, the facts of which are so similar to those in the main proceedings that, at first sight, it would be possible simply to transpose the solutions in that judgment to this case."

49. Having described the relevant Danish legislation the Advocate General turned to the argument of the EU Commission:

> "31. The Commission submits that tax relief which enables the losses of one company to be offset against the gains of other companies within the same group constitutes a tax advantage and, in accordance with paragraph 20 of the judgment in *Philips Electronics*, Paragraph 5G of the LTA creates a restriction of freedom of establishment by establishing a measure liable to make the setting up of a PE in Denmark less attractive for companies from other Member States. Companies established in other Member States which have subsidiaries or PEs in Denmark therefore suffer discrimination compared with exclusively Danish groups which do not carry on cross-border activities.
>
> 32. The Commission contends that, in accordance with the legislation at issue, the situation of PEs is comparable to that of resident companies.
>
> 33. The Commission, citing the judgment in *Philips Electronics*, contends that neither the balanced allocation of the exercise of the power to impose taxes between the Member States nor the prevention of the double deduction of losses justify the restriction."

He then set out his reasoning saying, at [48]:

> "In the context of this dispute, in order to determine whether a difference in treatment exists between a purely internal situation and a cross-border situation it is necessary to examine, first, whether or not the existence of a PE, and not a subsidiary company, is relevant".

50. At [49] the Advocate General referred to his Opinion in *Bevola and Jens W. Trock,* in which he had observed that the "essential difference" between a subsidiary and a PE is that a subsidiary has legal personality whereas a PE does not. He continued:

> "54. …, it is necessary to examine whether, in providing that, under the conditions set out above, losses may not be deducted by groups of companies carrying on cross-border activities, the LCT and the LTA restrict the freedom of establishment of such groups and whether their situation is comparable to that of wholly Danish groups which are governed by more favourable tax rules.
>
> 55. From a formal point of view, the advantage conferred on the wholly Danish group and the associated restriction placed on the Danish group which has non-resident subsidiaries seems to me to be undeniable: the parent company of the latter may deduct the losses of one of its foreign entities only if the conditions laid down in Paragraph 31(2)(2) of the LCT or Paragraph 5 of the LTA are satisfied; however, the wholly Danish group may deduct the losses of any of its subsidiaries from the consolidated profits without being subject to any of those conditions. In principle, such a difference in treatment makes it less attractive for groups to exercise freedom of establishment through companies established in other Member States.
>
> 56. Are the two groups in comparable situations? In order to address this matter, it is essential to have regard to the objective of the provision concerned, which in this instance is to prevent double deduction.
>
> 57. The Court replied in the affirmative to that same question in paragraphs 19 and 20 of the judgment in *Philips Electronics*, rejecting the opposing argument put forward by the United Kingdom. The Court's decision was that there was a restriction on the freedom of a non-resident company to establish itself in another Member State and that the situations were objectively comparable where, 'under the national legislation of a Member State, the possibility of transferring, by means of group relief and to a resident company, losses sustained by the permanent establishment in that Member State of a non-resident company is subject to a condition that those losses cannot be used for the purposes of foreign taxation, and where the transfer of losses sustained in that Member State by a resident company is not subject to any equivalent condition'.
>
> 58. As the Commission contends – a contention which has not been rebutted convincingly by the Danish Government – the assessment of comparability conducted in the judgment in *Philips Electronics* can be transposed to this case, also from the perspective of the aim of the Danish provision. In relation to the aim of preventing the double deduction of losses, the provisions which relate to purely domestic situations and those which relate to the existence of cross-border elements seek to ensure that the same expenditure or loss is taken into account only once.
>
> 59. Since the Danish provisions at issue create, in respect of comparable situations, a difference in treatment which may deter non-resident companies from setting up an establishment in Denmark, and vice versa, the next step requires consideration of whether there is any justification for that restriction which might make it compatible with Article 49 TFEU."

51. After noting, at [60], that the existence of overlapping taxation provisions of two or more states, as was the case in *NN*, could be explained by the prevention of double deduction of losses, the Advocate General considered that it did not necessarily follow that such an explanation was always justification for the restriction on the ability to exercise freedom of

establishment. At [61] the Advocate General observed that any justification required the existence of overriding reasons in the public interest and that the CJEU had accepted reasons such as safeguarding the exercise of the taxation powers of the Member States, maintaining the coherence of the tax system and the prevention of tax evasion as meeting that criteria.

52. He continued:

> "62. In the Danish Government's submission, the prevention of the double deduction of losses can be added to the list of acceptable justifications. However, its position does not initially appear to be compatible with that set out in the judgment in *Philips Electronics*, in which the Court:
>
> – Instead created a link between the double deduction of losses and the exercise of the taxation powers of the PE's State of residence.
>
> – Pointed out that that objective did not 'as such, allow the Member State in which the permanent establishment is situated to exclude the use of losses on the ground that those losses may also be used in the Member State in which the non-resident company has its seat.'
>
> – Declared that 'the host Member State, in whose territory the permanent establishment is situated, therefore cannot, in order to justify its legislation in a situation such as that in the main proceedings and in any event, plead as an independent justification the risk of the double use of losses.'
>
> 63. It is difficult, therefore, based on the judgment in *Philips Electronics*, to classify the prevention of the double deduction of losses as an overriding reason in the public interest."

53. However, he then went on to say:

> "64. However, perhaps the time has arrived to moderate those assertions made in the judgment in *Philips Electronics*, in view of the fact that the EU legislature has paid special attention to the fight against double deduction since that judgment was delivered.
>
> 65. After the OECD issued its conclusions of 13 and 14 March 2013 in relation to Base Erosion and Profit Shifting (BEPS), the final reports on which were published on 5 October 2015, the Commission and the Council addressed the need to find common, and also flexible, solutions at EU level which are in keeping with the OECD's BEPS conclusions.
>
> 66. According to Directive 2016/1164, 29 adopted as a result of the ensuing legislative process, 'it is essential for the good functioning of the internal market that, as a minimum, Member States implement their commitments under BEPS and more broadly, take action to discourage tax avoidance practices and ensure fair and effective taxation in the Union in a sufficiently coherent and coordinated fashion.' In particular, the directive stresses that it is essential 'to lay down rules in order to strengthen the average level of protection against aggressive tax planning in the internal market.
>
> 67. An important part is played in that regard by so-called hybrid mismatches; in accordance with Article 2(9) of Directive 2016/1164, a hybrid mismatch is 'a situation involving a taxpayer or … an entity where … (g) a double deduction outcome occurs.' The latter is defined, in the same article as 'a deduction of the same payment, expenses or losses in the jurisdiction in which the payment has its source, the expenses are incurred or the losses are suffered (payer jurisdiction) and in another jurisdiction (investor jurisdiction).'

68. To the extent that a hybrid mismatch results in a double deduction, the outcome, according to Article 9(1) of Directive 2016/1164 is that '(a) the deduction shall be denied in the Member State that is the investor jurisdiction; and (b) where the deduction is not denied in the investor jurisdiction, the deduction shall be denied in the Member State that is the payer jurisdiction.'

69. One of the objectives of the amendment of Directive 2016/1164 by Directive 2017/952 is to regulate hybrid PE mismatches: 'Hybrid permanent establishment mismatches occur where differences between the rules in the jurisdictions of permanent establishment and of residence for allocating income and expenditure between different parts of the same entity give rise to a mismatch in tax outcomes and include those cases where a mismatch outcome arises due to the fact that a permanent establishment is disregarded under the laws of the branch jurisdiction. Those mismatch outcomes may lead to a double deduction or a deduction without inclusion, and should therefore be eliminated.'

70. Naturally, I am not proposing that the provisions of a directive whose transposition deadline has not yet expired should be applied to this case. I do believe, however, that Directive 2016/1164 reflects a widespread concern, the strength of which was probably not evident – and, of course, was not expressly reflected in legislation – when the judgment in *Philips Electronics* was given."

54. The Advocate General then considered further "guidance" from the CJEU in support of a justification on the basis of the prevention of double deduction stating:

"71. The Court did provide some guidance in its case-law on the link between the prevention of double deduction and the fight against tax evasion. In the judgment in *Brisal and KBC Finance Ireland*, the Court stated that 'the desire to prevent double deduction of [in that case] business expenses' 'may be linked to the fight against tax evasion'.

72. However, the prevention of double deduction should also be considered in relation to conduct where there is no reason why any fraudulent intent should exist. Thus, in the judgment in *Marks & Spencer*, after declaring that 'Member States must be able to prevent that from occurring', the Court acknowledged that the danger that losses would be used twice did not always correspond to the justification relating to the fight against tax evasion.

73. Using losses twice may, therefore, be the result of the combined application of different tax provisions, including where no intention to defraud exists. However, it remains conduct which, in line with the school of thought favoured by the OECD, must also be rejected under EU law. That is why, as I pointed out above, the aim of preventing such conduct may perhaps be categorised as an (independent) overriding reason in the public interest, without necessarily having to be linked to the fight against tax evasion."

55. Finally, at [74] to [83], the Advocate General, considered whether the Danish provisions were disproportionate. He concluded that, to the extent that they precluded the deduction of Danish losses hypothetically rather than actually deductible against foreign profits, the provisions were disproportionate.

*CJEU*

56. The CJEU first described the effect of the relevant provisions of Danish law:

> "5. Under Paragraph 31(1) of the Selskabsskattelov (Law on corporation tax), Danish companies belonging to a group are subject to compulsory national group taxation. The group tax is paid by the ultimate parent company (or group parent company) if it is subject to tax in Denmark or, otherwise, by a resident company belonging to the group, known as an 'administration company'.
>
> 6. National group taxation is based on the principle of territoriality of taxation in Denmark. Pursuant to that principle, the profits of the group's subsidiaries and permanent establishments established outside Denmark are not included in the group's profits taxed in Denmark, unless the group has opted for international group taxation, pursuant to Paragraph 31 A of the Law on corporation tax. By contrast, the scope of the group taxation includes all of the companies and permanent establishments belonging to the group and established in Denmark.
>
> 7. That scope also includes permanent establishments, established in Denmark, of companies belonging to the group but registered abroad. However, in that case, the setting-off of the losses sustained by the Danish branch of a company with its registered office in another Member State against the group's combined taxable profits is subject to special rules, laid down in Paragraph 31(2)(2) of the Law on corporation tax, under which:
>
>> 'A loss in a permanent establishment may be set off against the income of other companies only if the rules in the foreign State … in which the company is resident provide that a loss cannot be set off in the calculation of the company's income in the foreign State … or if group taxation has been chosen pursuant to Paragraph 31 A ...'
>
> 8. It is apparent from the explanatory memorandum to the Law on corporation tax, cited by the referring court, that the purpose of that provision is to prevent tax losses from being deducted more than once in cross-border situations.
>
> 9. Paragraph 5 G of the Ligningslov (Law on assessment) states:
>
>> 'Taxable persons covered by Paragraph 1 of the Kildeskatteloven [(Law on tax at source)], Paragraph 1 of the Law on corporation tax or Paragraph 1 of the Fondsbeskatningsloven [(Law on taxation of investment funds)] cannot claim a deduction for expenditure which under foreign tax rules can be deducted from income that is not included in the calculation of Danish taxable income. The same applies if the deduction for expenditure can be transferred under foreign tax rules to a deduction from the income calculated by companies etc. in the group [see Paragraph 3B of the Skattekontrolloven (Law on tax supervision)] if the income is not included in the calculation of Danish taxable income.'"

57. Having set out the applicable legislation and summarised the facts of the case, the CJEU noted, at [16]:

> "By its questions, the referring court is asking, in essence, whether Article 49 TFEU must be interpreted as precluding national legislation concerning group taxation, pursuant to which resident companies in a group are permitted to deduct, from their overall profits, the losses of a resident permanent establishment of a non-resident subsidiary of the group only in the case where the rules applicable in the Member State in which the

subsidiary has its registered office do not permit those losses to be deducted from the subsidiary's taxable profits."

58. The CJEU continued, under the sub-heading 'Difference in treatment':

> "19. Pursuant to Paragraph 31(1) of the [Danish] Law on corporation tax, resident companies in the same group are subject to group taxation. According to the explanations of the referring court, that national group taxation also applies, in principle, to Danish permanent establishments of foreign companies belonging to the group.
>
> 20. Nevertheless, in application of Paragraph 31(2)(2) of the Law on corporation tax, a loss sustained by a permanent establishment, situated in Denmark, of a non-resident company belonging to the group can be set off against the group income, taxable in Denmark, only in the case where that loss cannot be taken into account for the calculation of the taxable income of the non-resident company pursuant to the legislation of the State in which it is established. That provision also states that that condition is not enforceable in situations – not covered by the questions referred for a preliminary ruling – in which the group has opted for international group taxation.
>
> 21. The question of whether the rule laid down in Paragraph 31(2)(2) of the Law on corporation tax establishes a difference in treatment that is unfavourable to the exercise of the freedom of establishment is the subject of diverging assessments by the parties to the case in the main proceedings.
>
> 22. According to the Danish Government, such a question must be answered in the negative, as is apparent from an a contrario reading of the judgment of 6 September 2012, *Philips Electronics UK* (C-18/11, EU:C:2012:532).
>
> 23. In that regard, in the case giving rise to that judgment, the referring court was uncertain as to the compatibility with freedom of establishment of provisions of UK legislation making the possibility of transferring, by means of group relief and to a resident company, losses sustained by the permanent establishment in that Member State of a non-resident company subject to a condition comparable to that laid down in Paragraph 31(2)(2) of the Danish Law on corporation tax.
>
> 24. In that judgment, the Court ruled that such a condition was contrary to the freedom of establishment, since the transfer of losses sustained by a resident company to another resident company in the same group was not subject to any equivalent condition.
>
> 25. The Danish Government points out that, quite to the contrary, Danish legislation sets down an equivalent condition for resident companies. Paragraph 5G of the Law on assessment provides that companies may not deduct charges which, pursuant to the tax legislation of another State, are already deductible from taxable income in that State. That paragraph thus precludes the setting off, against the profits of a group taxed in Denmark, of the losses of the resident subsidiary of a non-resident company in the group, in the case where the setting-off of those losses is possible pursuant to the law of the Member State in which the non-resident company is established.
>
> 26. Consequently, the Danish Government takes the view that national law does not establish a difference in treatment, between permanent establishment and subsidiary, akin to that which the Court held to be contrary to freedom of establishment in the judgment of 6 September 2012, *Philips Electronics UK* (C-18/11, EU:C:2012:532).

> 27. The applicant in the main proceedings points out, however, that Paragraph 31(2)(2) of the Law on corporation tax does establish a difference in treatment of another nature.
>
> 28. NN explains that the losses of a permanent establishment, situated in Denmark, of a resident company in the group are deductible without restriction from the group's taxable profits in Denmark. In the case in the main proceedings, NN points out that, if the Danish permanent establishment had been owned by one of its Danish subsidiaries, its losses could, in any event, have been set off against the group's profits.
>
> 29. In that regard, it should be noted that the tax legislation at issue in the main proceedings does indeed establish such a difference in treatment. The tax treatment of a Danish group which owns a permanent establishment in Denmark through a non-resident subsidiary is, under Paragraph 31(2)(2) of the Law on corporation tax, less favourable than that of a group in which all of the companies have their registered offices in Denmark.
>
> 30. That difference in treatment is liable to render less attractive the exercise of freedom of establishment through the creation of subsidiaries in other Member States. It is, however, incompatible with the provisions of the Treaty only if it concerns situations which are objectively comparable."

59. Having concluded that there was a difference in the treatment of a Danish owned PE and a wholly Danish group the CJEU went on to consider whether those two situations were objectively comparable. It observed, at [32], that the purpose of the provision was to prevent the double deduction of losses and continued, finding contrary to the Opinion of the Advocate General:

> "33. The Court has held that, with regard to measures laid down by a Member State in order to prevent or mitigate the double taxation of a resident company's profits, companies which have a permanent establishment in another Member State are not, in principle, in a situation comparable to that of companies which have a resident permanent establishment (judgment of 12 June 2018, *Bevola and Jens W. Trock*, C-650/16, EU:C:2018:424, paragraph 37).
>
> 34. By analogy, the view must therefore be taken, as regards the measures intended to prevent the double deduction of losses, that a group whose non-resident subsidiary has a resident establishment is also not in a situation comparable to that of a group whose subsidiary, and the latter's permanent establishment, are also resident.
>
> 35. It is nevertheless important to make an exception for the situation in which there is no other possibility of deducting the losses of the non-resident subsidiary attributable to the permanent establishment which is resident in the Member State in which the subsidiary is established. In that situation, the group whose subsidiary is situated in another Member State is not in a different situation to that of the purely national group, in the light of the objective of preventing the double deduction of its losses. The tax-paying capacity of the two groups is then affected in the same way by the losses of their resident permanent establishment (see, to that effect, judgment of 12 June 2018, *Bevola and Jens W. Trock*, C-650/16, EU:C:2018:424, paragraph 38).
>
> 36 Admittedly, Paragraph 31(2)(2) of the Law on corporation tax removes the difference in treatment 'if the rules in the foreign State … in which the company is resident provide that a loss cannot be set off', by accepting, in

> that case, that the losses of the resident permanent establishment of the non-resident subsidiary may be set off against the group's income.
>
> 37 However, it cannot be excluded that such a deduction, even when permitted by the legislation of the foreign State, may not be possible in practice, particularly in the case where the non-resident subsidiary has definitively ceased all activity.
>
> 38 Thus the difference in treatment mentioned in paragraph 29 of the present judgment may, at least in that case, concern objectively comparable situations.

60. The judgment continued by considering whether the difference in treatment could be justified by the objective of ensuring a balanced distribution of powers of taxation between the Member States or by that of preventing the double deduction of losses. The CJEU stated:

> "40. In that regard, it should be noted that the former ground does not constitute a relevant justification. If the loss attributable to the permanent establishment could be deducted both from the group's taxable profits in the Member State in which that establishment is situated, and from the profits, taxable in the other Member State, of the group's non-resident subsidiary, that possibility of double deduction would favour neither of the two Member States concerned to the detriment of the other. Thus, the balanced distribution of powers of taxation between them would not be affected. The absence of a rule such as that laid down in Paragraph 31(2)(2) of the Law on corporation tax would simply entail a loss of tax revenue for one of the two States.
>
> 41 The second justification, based on preventing the double deduction of losses, is the one which is highlighted by the Danish Government.
>
> 42. In that respect, the Court has already ruled that Member States must be able to prevent the risk of losses being taken into account twice (judgments of 13 December 2005, *Marks & Spencer*, C-446/03, EU:C:2005:763, paragraph 47, and of 15 May 2008, *Lidl Belgium*, C-414/06, EU:C:2008:278, paragraph 35).
>
> 43. It is true that, in a situation in which a permanent establishment's income is taxed by two Member States, it appears justified that the charges borne by that establishment should be capable of being deducted from that income in one and the other tax systems, in accordance with national rules.
>
> 44. However, the existence of such a situation cannot simply be inferred from the fact that two Member States concurrently exercise their power of taxation over the profits of the same permanent establishment, as is the case, in the dispute in the main proceedings, with regard to the Kingdom of Denmark and the Kingdom of Sweden.
>
> 45. The tax agreements between Member States specifically designed to prevent double taxation cannot be disregarded. In that regard, as is apparent from the European Commission's written observations and the answers given by NN's representative during the hearing, relations between the Kingdom of Denmark and the Kingdom of Sweden are regulated by the Nordic Convention.
>
> 46. Under Article 25 of that convention, if a person residing in Sweden receives income that is taxable in another contracting State, the Kingdom of Sweden allows the deduction from income tax of a sum corresponding to the income tax paid in the other State.

> 47. In the light of that mechanism, the parallel exercise of the powers of taxation of the Kingdom of Denmark and the Kingdom of Sweden does not entail an obligation for the Swedish company which has a permanent establishment in Denmark to pay income tax twice. In those circumstances, the ability, claimed by the Danish group to which the Swedish company belongs, to deduct the losses of such an establishment twice, that is to say, in one and the other national tax systems, does not appear to be justified.
>
> 48. Paragraph 31(2)(2) of the Law on corporation tax is specifically intended to prevent the group concerned from exploiting the same loss twice. In the absence of such a provision, as noted by the Advocate General in point 75 of his Opinion, cross-border situations would confer an unjustified advantage over comparable national situations, in which a double deduction is not possible. The difference in treatment established by national legislation thus appears to be justified."

**ISSUES**

61. There are two issues for determination in the present case:

(1) Whether s 403D(1)(c) ICTA constitutes an unlawful restriction on the freedom of establishment in circumstances where the UK losses of VSCE UK Branch have, in large part, been taken into account in the Netherlands;

(2) If so, what is the appropriate remedy.

**Unlawful restriction/legitimate public policy objective**

62. Unless, as HMRC contend, *Philips Electronics* has been overruled by *NN*, the answer to the first issue is that s 403D(1)(c) ICTA does indeed constitute an unlawful restriction on the freedom of establishment.

63. Ms Shaw contends that it cannot tenably be suggested that *Philips Electronics* has been overruled. She says that nowhere in its decision in *NN* did the CJEU indicate that it was doing so notwithstanding its, albeit brief, reference to *Philips Electronics*. She submits, citing Case C-267/95 *Merck v Primecrown* and Case C-127/08 *Blaise Metock and others v Minister for Justice, Equality and Law Reform* ("*Blaise Metock*") in support, that although the CJEU is not bound by its previous decisions it does, in the absence of compelling reasons not to do so, in practice follow them and where it does depart or overrule an earlier decision it does so expressly.

64. *Merck v Primecrown* concerned an alleged patent infringement in relation to a hypertension drug which Primecrown had imported into the United Kingdom from Spain and Portugal. The defence to the claim sought to invoke a particular principle of European patent law which had been interpreted by the CJEU in a previous case which also involved Merck. The following propositions can be derived from the Opinion of Advocate General Fennelly in that case:

(1) the CJEU, as a matter of practice, ordinarily follows its previous case law (see Advocate General's Opinion in *Merck v Primecrown* at [142]);

(2) where the CJEU has previously held that a particular provision of national law is void it is a sufficient reason to dispense a national court from any obligation to refer a question concerning the same provision, ie a national court should regard a ruling by the CJEU on a specific provision of domestic law as authoritative on any subsequent case concerning the same legislative provision; (see Advocate General's Opinion in *Merck v Primecrown* at [142]);

(3) where the CJEU did reconsider its previous case law, as is clear from the examples given by the Advocate General (*Parliament v Council ('Chernobyl')* [1990] 1 ECR I 2041 Case C 70/88, *Keck and Mithouard* [1993] ECR I 6097 joined Cases C 267/91 and C 268/91and *HAG II* [1990] ECR I-3711 Case 10/89 ), it did so expressly (see Advocate General's Opinion in *Merck v Primecrown* at [143] – [145]).

This was the approach adopted by the CJEU in *Merck v Princetown* where the Court, before continuing by identifying important changes that had occurred since its earlier decision, stated:

> "27. In substance, the High Court is seeking to ascertain whether it is necessary to reconsider the rule in [the previous decision in] *Merck v Stephar* or whether, having regard to the specific circumstances mentioned, its scope should be limited.
>
> 28. Merck and Beecham consider that there are weighty reasons for departing from the rule in *Merck v Stephar*…";

(4) even in cases where the CJEU does reconsider its earlier case law it is exceptional for it to do so with retroactive effect (see Advocate General's Opinion in *Merck v Primecrown* at [147]).

65. In *Blaise Metock*, a case concerning the free movement of persons in relation to the spouses of EU nationals, the CJEU did depart from a previous decision but not before stating, at [58]:

> "It is true that the Court held in paragraphs 50 and 51 of [its earlier decision in] *Akrich* that, in order to benefit from the rights provided for in Article 10 of Regulation No 1612/68, the national of a non-member country who is the spouse of a Union citizen must be lawfully resident in a Member State when he moves to another Member State to which the citizen of the Union is migrating or has migrated. However, that conclusion **must be reconsidered**. The benefit of such rights cannot depend on the prior lawful residence of such a spouse in another Member State (see, to that effect, *MRAX*, paragraph 59, and Case C-157/03 *Commission v Spain*, paragraph 28)." [emphasis added]

66. However, Mr Fell contends that, as the CJEU is not subject to the doctrine of *stare decisis* (see Opinion of Advocate General La Pergola in Case C-262/96 *Sürül v Bundesanstalt für Arbeit* at [36]), rather than look for a "magic form of words" it is necessary to consider the reasoning deployed by the CJEU to ascertain whether it has departed from a previous decision. He submits that as the reasoning of the CJEU in *NN* differs from that in *Philips Electronics*, cases with extremely similar factual and legal matrices, it is clear that *Philips Electronics* was overruled by the later decision in *NN*.

67. In this regard he cites the following passage from the Chernobyl case, a decision of the CJEU to which the Advocate General referred in *Merck v Primecrown* as an example of the CJEU reconsidering and overruling its previous case law:

> "15. In the judgment in Case 302/87, after having stated the reasons why the Parliament did not have capacity to bring an action under Article 173 of the EEC Treaty, the Court pointed out that various legal remedies were available to ensure that the Parliament's prerogatives were defended. As was observed in that judgment, not only does the Parliament have the right to bring an action for failure to act, but the Treaties provide means for submitting for review by the Court acts of the Council or the Commission adopted in disregard of the Parliament's prerogatives.

> 16. However, the circumstances and arguments adduced in the present case show that the various legal remedies provided for both in the Euratom Treaty and in the EEC Treaty, however effective and diverse they may be, may prove to be ineffective or uncertain."

After discussing the various deficiencies of those remedies, the Court continued:

> "20. It follows from the foregoing that the existence of those various legal remedies is not sufficient to guarantee, with certainty and in all circumstances, that a measure adopted by the Council or the Commission in disregard of the Parliament's prerogatives will be reviewed."

68. Mr Fell submits that this shows, rather than expressly state that it was departing from its previous decision, that the CJEU in the Chernobyl case simply proceeded to set out a different piece of reasoning which is inconsistent with that advanced in its earlier decision. However, I disagree.

69. Shortly before the passage cited by Mr Fell, the CJEU, at [12], had noted:

> "As is evident from the judgment in Case 302/87, cited above, the Parliament does not have the right to bring an action for annulment under Article 173 of the EEC Treaty or under Article 146 of the Euratom Treaty, which are identical in content."

The CJEU then continued, at [15] and [16], referring to the Court's reasoning in the previous case (Case 302/87) that there were various remedies available to ensure the defence of the Parliament's prerogatives before concluding, at [20], that these were defective and the previous decision would be reviewed. While I agree with Mr Fell that the CJEU in the Chernobyl case did not expressly state it was departing from its previous decision it is nevertheless abundantly clear from the language used that it was doing just that.

70. Similarly the language used by the Advocate General in *NN* clearly indicated that, in his view, it was "perhaps the time … to moderate those assertions made in the judgment in *Philips Electronics*", ie depart from the decision in a case he considered as being "so similar" to *Philips Electronics* that "at first sight it would be possible simply to transpose the solution in that judgment." While the CJEU did refer to the decision in *Philips Electronics* in its judgment in *NN*, particularly in relation to the argument of the Danish Government on an "a contrario" or opposite reading of it, the Court did not adopt the language of the Advocate General and either expressly, or by use of the type of language it had adopted in the Chernobyl case, depart from or overrule its previous decision in *Philips Electronics*.

71. As such, and in the light of the observations of the Advocate General in *Merck v Primecrown*, particularly that the CJEU as a matter of practice follows its previous case law and that a national court should regard a ruling by the CJEU on a specific provision of domestic law as authoritative on any subsequent case concerning the same legislative provision, I have come to the conclusion that the CJEU in *NN* did not overrule *Philips Electronics* and its decision in that case should be applied. It therefore follows that s 403D(1)(c) ICTA constitutes an unlawful restriction on the freedom of establishment in the circumstances of the present case.

72. Alternatively, I consider that *Philips Electronics* can be distinguished from *NN* on the basis of the difference in the domestic provisions with which each case was concerned and accordingly that *NN* cannot properly be taken to have overruled *Philips Electronics*.

73. Under the Danish provisions, with which the CJEU was concerned in *NN*, the restriction on the use of domestic losses by a Danish PE (under Paragraph 31(2)(2) of the Selskabsskattelov) was matched by a similar restriction on Danish resident companies

(Paragraph 5 G of the Ligningslov) whereas, as the CJEU observed, at [23] in *NN*, the transfer of losses sustained by a United Kingdom resident company to another United Kingdom resident company (including those that are foreign owned and subsidiaries of foreign owned companies), was not subject to the same the restriction imposed on a United Kingdom PE of a non-United Kingdom resident company by s 403D(1)(c) ICTA.

74. Therefore, unlike *Philips Electronics* in which the comparison was between a PE of a non-United Kingdom resident Company and a United Kingdom resident company, which could be foreign owned or a subsidiary of a non-United Kingdom resident company, because foreign owned Danish subsidiaries and foreign owned Danish PEs are subject to the same restriction, the comparison in *NN* was between a Danish owned PE and a wholly owned Danish group.

**Remedy**

75. Having concluded that the CJEU did not overrule *Philips Electronics* in *NN* (or that the cases can be distinguished) and that *Philips Electronics* remains good law, if Ms Shaw is right, the appropriate remedy is straightforward, namely that s 403D(1)(c) ICTA should be disapplied.

76. However, notwithstanding the clear statement of the CJEU at [40] in *Philips Electronics*, that, "the national court must disapply any provision of the national legislation which is contrary to Article 43 EC", Mr Fell submits that rather than disapply s 403D(1)(c) ICTA it should be given a conforming construction.

77. Article 4 of the Treaty on European Union requires Member States to "take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties." This obligation imposes a duty on the courts of the Member States to interpret domestic law in conformity with EU law (see Case C-105/03 *Pupino* [2005] ECR I-5309 at [41] to [43]) and to disapply any national provision that is contrary to EU law (see Case C-213/89 *R v Secretary of State for Transport ex parte Factortame Limited and Others* [1990] ECR I-2433 at [19] and [20]). However, a conforming interpretation must "go with the grain of the legislation" concerned (see *Ghaidan v Godin-Mendoza* [2004] 2 AC 557 at [33]).

78. As Arden LJ (as she then was) observed in *HMRC v IDT Card Services Ireland Limited* [2006] STC 1252, at [82]:

> "Normally when construing domestic legislation, the English courts must find the meaning of the words which Parliament has used. In the context, however, of legislation which requires to be construed in a way which is compatible with European Union law or with the rights conferred by the European Convention on Human Rights, the English courts can adopt a construction which is not the natural one. The process, however, remains one of interpretation: the obligation imposed by the Court of Justice is only to interpret national law in conformity with a directive "so far as possible". That raises the question when a process ceases to be that of legitimate interpretation and trespasses into the field of lawmaking that is the task of Parliament and not the courts."

Having referred to the decision of the House of Lords in *Ghaidan v Godin-Mendoza,* she continued:

> "87. Lord Steyn stressed that the application of section 3 [of the Human Rights Act 1998] did not depend on the linguistic features of the legislation and that section 3 represented the prime remedy where legislation was not compatible with the ECHR. He declined to formulate precise rules as to

> when section 3 could be used. Lord Rodger also considered the boundaries of section 3 and gave helpful guidance. He held that in deciding how to interpret the legislation the courts should not produce a meaning which departed substantially from a fundamental feature or cardinal principle of the legislation. Likewise the courts should be less ready to interpret legislation so as to be compatible with Convention rights where there would be important practical repercussions which the courts are not equipped to evaluate.
>
> 88. The decision in the *Ghaidan* case is a powerful statement of the court's preparedness to interpret legislation so that it is compatible with human rights. The speeches, all of which repay careful study, contain extremely valuable guidelines. The House of Lords has recognized the force of the mandatory obligation in section 3. However, section 3 permits only interpretation, not the rewriting of legislation which goes beyond mere interpretation. I would add that in section 3 the words "in a way which is compatible with the Convention rights" make it clear that the courts have a choice as to precisely how to interpret the legislation to achieve the objective in section 3, namely that, where possible, the legislation should be compatible with human rights

79. In *Vodafone 2 v HMRC* [2009] STC 1480, which concerned the compatibility of the United Kingdom CFC rules with the freedom of establishment, the Court of Appeal considered the relationship between "conforming interpretation" and "disapplication". Sir Andrew Morritt C said:

> "25. It follows, and was not disputed, that the consequence of the decision in *Cadbury Schweppes* is that there is a conflict between the freedom of establishment conferred on V2 by art 43 EC and the prima facie entitlement of HMRC under the CFC legislation to tax V2 on the profits of VIL. That conflict must be resolved in accordance with the provisions of s 2 of the European Communities Act 1972. It is not disputed that the freedom of establishment conferred on V2 by art 43 EC is an enforceable Community right within sub-s (1) of s 2 of the 1972 Act to be given legal effect without further enactment. Likewise it is not disputed that in accordance with sub-s (4) the CFC legislation 'shall be construed and have effect subject to' that right.
>
> 26. Accordingly the first issue relates to such 'construction' and the second to such 'effect'. I shall refer to the principles applicable to such construction in relation to the first issue. If such a construction is impossible the process by which effect is given to the enforceable Community right is described as 'disapplication'. Disapplication involves treating the relevant provision in the CFC legislation as if it were expressed to be 'without prejudice to' V2's freedom of establishment, see *Factortame Ltd v Secretary of State for Transport* [1989] 2 All ER 692 at 700–701, [1990] 2 AC 85 at 140 and *Fleming (t/a Bodycraft) v Revenue and Customs Comrs*; *Condé Nast Publications Ltd v Revenue and Customs Comrs* [2008] UKHL 2 at [24], [2008] STC 324 at [24], [2008] 1 WLR 195."

80. At [34] the Chancellor emphasised that it was for the national court to determine whether a conforming interpretation should be applied saying:

> "… The jurisdiction of the ECJ to give preliminary rulings relates to the interpretation of the EC Treaty and the other matters referred to in art 234 EC. They do not include the interpretation of the legislation of a member state, see *Pfeiffer v Deutsches Rotes Kreuz, Kreisverband Waldshut eV* (Joined cases C-397/01 to C-403/01) [2004] ECR I-8835, [2005] ICR 1307,

> para 115 of the judgment and *Criminal Proceedings against Pupino* (Case C-105/03) [2006] QB 83, [2005] ECR I-5285, para 47 of the judgment. Further, as those citations show, the obligation of the national court is to examine the whole of the national law to consider how far it may be applied so as to conform to enforceable Community rights."

81. The Chancellor, who at [37] referred to the parties' submissions and authorities on the principles to be observed in looking for a conforming interpretation in either the European Community or Human Rights contexts, observed that:

> "The principles which those cases established or illustrated were helpfully summarised by counsel for HMRC in terms from which counsel for V2 did not dissent. Such principles are that:
>
> > 'In summary, the obligation on the English courts to construe domestic legislation consistently with Community law obligations is both broad and far-reaching. In particular:
> >
> > (a) It is not constrained by conventional rules of construction (see *Pickstone* [1988] 2 All ER 803 at 817, [1989] AC 66 at 126 per Lord Oliver);
> >
> > (b) It does not require ambiguity in the legislative language (*Pickstone* [1988] 2 All ER 803 at 817, [1989] AC 66 at 126 per Lord Oliver; *Ghaidan* [2004] 3 All ER 411 at [32], [2004] 2 AC 557 at [32] per Lord Nicholls);
> >
> > (c) It is not an exercise in semantics or linguistics (see *Ghaidan* [2004] 3 All ER 411 at [31] and [35], [2004] 2 AC 557 at [31] and [35] per Lord Nicholls; per Lord Steyn at [48]–[49]; and Lord Rodger at [110]–[115]);
> >
> > (d) It permits departure from the strict and literal application of the words which the legislature has elected to use (*Litster* [1989] 1 All ER 1134 at 1138, [1990] 1 AC 546 at 577 per Lord Oliver; Ghaidan [2004] 3 All ER 411 at [31], [2004] 2 AC 557 at [31] per Lord Nicholls);
> >
> > (e) It permits the implication of words necessary to comply with Community law obligations (see *Pickstone* [1988] 2 All ER 803 at 814–815, [1989] AC 66 at 120–121 per Lord Templeman; *Litster* [1990] 1 AC 546 at 577, [1989] 1 All ER 1134 at 1138 per Lord Oliver); and
> >
> > (f) The precise form of the words to be implied does not matter (*Pickstone* [1988] 2 All ER 803 at 807, [1989] AC 66 at 112 per Lord Keith; *Ghaidan* [2004] 3 All ER 411 at [122], [2004] 2 AC 557 at [122] per Lord Rodger; and *IDT Card Services Ireland Ltd* [2006] STC 1252 at [114] per Arden LJ).'"

He continued, at [38]:

> "Counsel for HMRC went on to point out, again without dissent from counsel for V2, that:
>
> > 'The only constraints on the broad and far-reaching nature of the interpretative obligation are that:
> >
> > (a) The meaning should "go with the grain of the legislation" and be "compatible with the underlying thrust of the legislation being construed." (*Ghaidan* [2004] 3 All ER 411 at [33], [2004] 2 AC 557 at [33] per Lord Nicholls; Dyson LJ in *EB Central*

> *Services* [2006] STC 1252 at [114]). An interpretation should not be adopted which is inconsistent with a fundamental or cardinal feature of the legislation since this would cross the boundary between interpretation and amendment; (See *Ghaidan* at [33] and [110]–[113] per Lord Nicholls and Lord Rodger respectively; Arden LJ in *IDT Card Services* at [82] and [113]) and
>
> (b) The exercise of the interpretative obligation cannot require the courts to make decisions for which they are not equipped or give rise to important practical repercussions which the court is not equipped to evaluate. (See *Ghaidan* per Lord Nicholls at [33]; Lord Rodger at [115]; Arden LJ in *IDT Card Services* at [113].)'"

82. In addition to these principles, as is clear from the decision of the CJEU in *Pupino,* at [43], the process of conforming interpretation is also constrained by Community law principles and in particular those of "legal certainty and non-retroactivity."

83. In the present case Mr Fell contends that, in the light of the statements of principle enunciated in these authorities, it is necessary to adopt a staged or step approach and first consider whether a conforming interpretation, which does not conflict with EU law, is possible. Only if, he says, such a construction is impossible should disapplication be considered. Taking such an approach, Mr Fell submits that if it is possible to apply a conforming interpretation the national legislation would not be contrary to EU law and therefore ought not be disapplied.

84. However, I agree with Ms Shaw that disapplication and conforming interpretations of provisions are alternative remedies for a breach and should be considered as such.

85. Section 403D(1)(c) ICTA, the statutory provision with which these are appeals are concerned was expressly considered by the CJEU in *Philips Electronics*. In that case both the Advocate General, at [90(3)], and the CJEU, at [40], concluded that the appropriate remedy was not that the national court should adopt a conforming interpretation but that it should disapply the provision of national legislation as being contrary to EU law.

86. Having concluded that s 403D(1)(c) ICTA is, in the circumstances of the present case, incompatible with EU law it follows that, as in *Philips Electronics*, the only appropriate remedy is that the provision must be disapplied.

**DECISION**

87. For the reasons above I agree with the appellants that the law is *acte clair* in their favour with the result that s 403D(1)(c) ICTA must be disapplied without the need for a reference to the CJEU.

88. The appeals are therefore allowed.

**RIGHT TO APPLY FOR PERMISSION TO APPEAL**

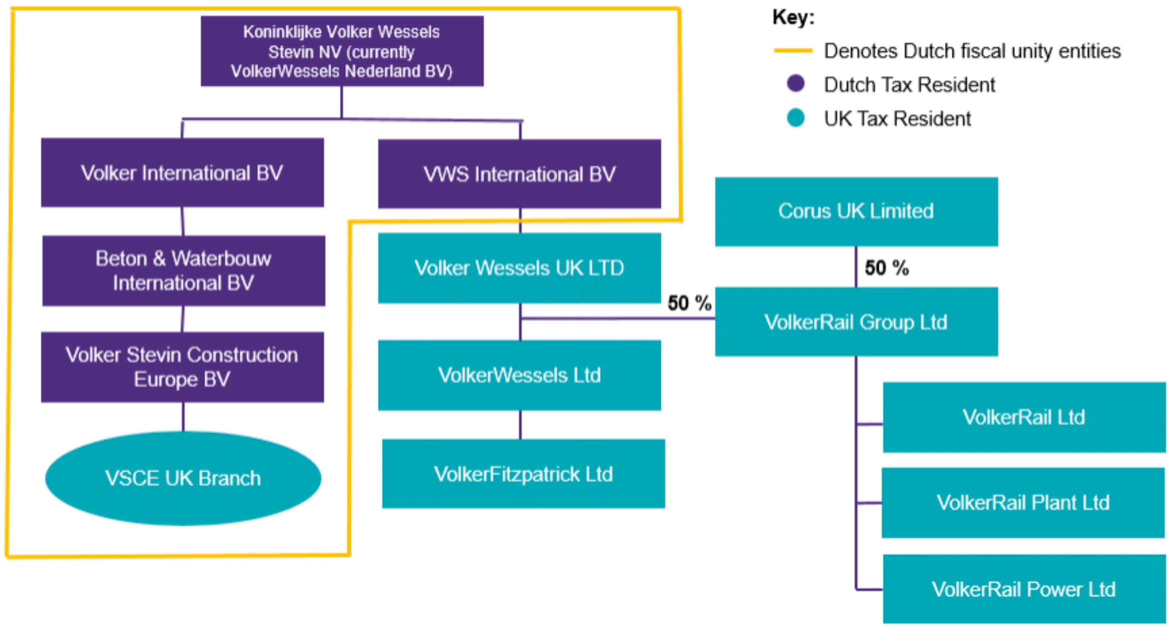
89. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

**JOHN BROOKS**
**TRIBUNAL JUDGE**

**Release date: 16 November 2020**

**APPENDIX**

## Extract from the VW Group Structure pre November 2008




## Extract from the VW Group Structure post November 2008