Executive summary

On 17 December 2015, the Court of Justice of the European Union (CJEU) rendered its decision in the *Timac Agro Deutschland* case (C-388/14) regarding final losses of a foreign permanent establishment (PE). The Court held that where Member States apply the exemption method on foreign PE income, taxpayers with a loss-making foreign PE are not in a situation which is comparable with the situation of a taxpayer with only a domestic business. However, where Member States recognize losses of a foreign PE, a comparable situation exists which in principle allows taxpayers to argue that losses cannot be utilized anymore and therefore a recapture of such losses is not in line with the freedom of establishment.

Detailed discussion

Facts

This preliminary ruling involves a German corporation with an Austrian PE in a loss position, which was sold in 2005 to another group entity. Losses incurred in the years 1997 and 1998 were recognized in Germany under a rule allowing for the deduction of foreign PE losses even though the exemption method applied. In addition, German law provides for the recapture of such losses in
the case of a sale of the PE. For subsequent fiscal years the loss recognition rule was abolished (the recapture provision remained in place for losses recognized under the abolished rule). The claimant argued that as a result of the sale in 2005, the Austrian losses became final and hence the recapture of the losses incurred in 1997 and 1998 as well as the non-recognition of the subsequent losses was not in line with the freedom of establishment. The taxpayer relied on the Freedom of Establishment principle of the Treaty on the Functioning of the European Union (TFEU) and specifically on the Lidl Belgium decision of 15 May 2008 (C-414/06) where the CJEU held that in that specific case, Germany was not obliged to take losses of a foreign PE into account as the losses were still available in subsequent fiscal years (Germany applied the exemption method on PE income under the applicable Double Tax Treaty).

The Court now held that taxpayers with a foreign PE are not in a situation which is comparable to the situation of a domestic taxpayer operating through a domestic business. Such comparability is inevitable to establish a restriction of the freedom of establishment. Hence, according to the CJEU, Timac Agro could not rely on the Freedom of Establishment with respect to its losses suffered as of fiscal year 1999. In this respect the Court referred to its reasoning in the Nordea-decision of 17 July 2014 addressing final PE losses under the credit method. In that decision the Court stated that comparability is given only if the state of the head office taxes foreign PE income.

With respect to the losses incurred in prior years, the CJEU held that a comparable situation actually existed and final losses are in principle to be taken into account. In this context the Court noted that a loss cannot be regarded as final if the Member State in which the PE is situated does not allow for loss-carryforward. Only if the PE no longer has any income in the Member State in which it is situated may losses be classified as final. The Court referred to the statement of Austria in the Court proceedings indicating that there were still possibilities to make use of these losses and left it up to the referring Court to finally establish whether the losses at hand were actually final. However, it is important to note that the Court referenced its decision in Marks & Spencer (C-446/03) with regard to the principles relating to final losses.

Impact

This decision will have far-reaching impact on the tax practices of EU Member States that apply the exemption method on foreign PE income. By handing down the present judgment, the Court reversed its position with regard to case law on final losses, specifically the Lidl Belgium decision, without explicitly addressing this decision. At least until 2014, national courts and the overwhelming majority in tax literature interpreted the Lidl Belgium decision as holding that under the Freedom of Establishment, where Member States applied the exemption method on a foreign permanent establishment's income, final losses, incurred through an EU/European Economic Area permanent establishment, were to be taken into account. On this basis the German Federal Tax Court (BFH) has decided several cases without referring them to the CJEU based on the acte-claire-doctrine allowing Member States' courts to abstain from referring a specific question to the CJEU if it perceives the answer to be clear. Thus, in essence, the decision gives rise to questions with respect to the application and reach of the Court's acte-claire-doctrine formed by its case law. As a result, the BFH will now have to change its jurisprudence in respect of the recognition of final PE losses. Although, by referencing the decision in Marks & Spencer and other relevant case law, the Court seems to confirm the respective principles on final losses in group taxation situations involving a foreign subsidiary. However, it still appears to be not entirely clear from the reasoning of the Timac Agro decision in which situations the CJEU will qualify a loss to be final.
For additional information with respect to this alert, please contact the following:

**Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Munich**
- Dr. Klaus von Brocke  +49 89 14331 12287  klaus.von.brocke@de.ey.com
- Stefan Müller  +49 89 14331 16635  stefan.m.mueller@de.ey.com
- Andreas Wohlhöfler  +49 89 14331 11284  andreas.wohlhoefler@de.ey.com

**Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Eschborn/Frankfurt**
- Tim Hackemann  +49 6196 996 21718  tim.hackemann@de.ey.com

**Ernst & Young Belastingadviseurs LLP, Amsterdam**
- Dr. Daniel Smit  +31 88 407 84 99  daniel.smit@nl.ey.com
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients.

For more information about our organization, please visit ey.com.

EU Tax Services

© 2015 EYGM Limited.
All Rights Reserved.
EYG no. CM6092
1508-1600216 NY
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com