CJEU decision in the NN case on Danish rules concerning loss relief

Denmark - Freedom of Establishment – Loss Relief – Permanent Establishment – Proportionality

On July 4, 2018, the Court of Justice of the European Union (CJEU) published its decision in the NN A/S case (C-28/17) concerning the compatibility with EU law of the Danish rules on the deductibility of losses from a Danish permanent establishment (PE) whose head office is not tax resident in Denmark. The Court concluded that the Danish legislation constitutes a restriction to the freedom of establishment, but that such restriction may be justified by the prevention of double deduction of losses.

Background

NN A/S, a Danish resident company, had a subsidiary in Sweden that was the head office of a PE in Denmark. In 2008, NN A/S sought to offset the tax losses of the Danish PE against its profits. The tax authorities rejected the request arguing that losses incurred by the Danish PE of a non-resident company can only be offset against the profits of a Danish tax group to the extent that these losses cannot be used in the jurisdiction of the PE's head office. On the contrary, in a purely domestic situation, the possibility to offset the losses of a PE against the group's profits is not subject to any conditions.

NN A/S appealed the decision, considering that based on the CJEU decision in the Philips Electronics case (C-18/11) this difference in treatment constitutes a restriction to the freedom of establishment that cannot be justified. In this context, the Danish Court of Appeal requested the CJEU to clarify whether its decision in the Philips Electronics case is applicable in the case at hand and to analyze the compatibility of the Danish rules with the freedom of establishment.

The CJEU decision

Siding with the argumentation developed by the taxpayer, the CJEU first acknowledged that there is a difference in treatment between a Danish group holding a Danish PE through a non-resident subsidiary and a purely Danish group. However, this difference in treatment is constitutive of a restriction to the freedom of establishment if it concerns objectively comparable situations. Referring to the Bevola case (C-650/16), the Court concluded that Danish groups which have a non-resident subsidiary holding a Danish PE are in a comparable situation to that of groups with a Danish PE held through a Danish subsidiary, having regard to the objective of the Danish legislation to prevent the double use of losses.

The Court then turned to analyzing whether such restriction may be justified by overriding reasons in the public interest. As regards the allocation of powers to tax, the Court noted that the fact that the losses could be used both in Denmark and in Sweden does not favor either of the two states to the detriment of the other. Therefore, it does not impact a balanced allocation of taxing rights. The Court then went on to assess whether the restriction may be justified by the prevention of double deduction of losses. In this respect, consideration should be given to the provisions of the existing double tax treaty between Denmark and Sweden. As the double taxation of a PE's profits is prevented by a tax credit mechanism under this treaty, the possibility to use the corresponding PE losses twice is not justified. As a consequence, the objective to prevent the double deduction of losses should be considered as an appropriate justification. However, such restriction may not go beyond what is necessary to attain the objective pursued. In this respect, the Court considered that the Danish legislation may lead to a disproportionate situation, if it deprives the taxpayer of any possibility to offset the losses incurred by the Danish PE. On the other hand, the principle of proportionality should be respected, if the Danish legislation allows the losses of a Danish PE to be offset in Denmark, as far as the group can evidence that such loss cannot effectively be deducted in another Member State. In the case at hand, the Court left it to the referring court to assess whether the losses incurred by the Danish PE can or cannot be offset in Sweden.

The Court thus concluded that the Danish legislation is a restriction of the freedom of establishment, but that such restriction may only be justified by the prevention of double deduction of losses in cases where there is a double tax treaty between Denmark and the relevant Member State where the subsidiary is situated that effectively mitigates the risk of a PE's profits to be taxed in both countries. The Court further left it to the national court to assess whether the application of such legislation is proportionate in the case at hand.

EU Tax Centre comment

The case is very similar to the Philips Electronics case (C-18/11); however, the CJEU reaches a different conclusion than in its previous case law. In the Philips Electronics case, the Court rejected the prevention of the double use of losses as a justification, stating that the fact that the losses could be used in both the UK and the Netherlands does not affect the UK's power to tax. The potential double counting of losses could not, therefore, in itself mean that the host state of the PE can prevent the recognition of these losses. On the contrary, in the case at hand, the Court made reference to the interaction of the Swedish and Danish tax systems as well as the existence of provisions preventing double taxation of the PE's profits, in order to conclude that the prevention of the double use of losses in principle constitutes a valid and independent justification. The Court therefore seems to consider that a potential restriction may only be unjustified in cases where no mechanism is foreseen to prevent double taxation of a

PE profits. This constitutes a significant shift in the Court's previous case law on the utilization of cross-border losses, although its impact remains limited by the recalling of the "final losses" exception. However, the judgment itself provides little additional guidance as regards this exception, and it remains to be seen how this will be interpreted by the referring court in the case at hand.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

Robert van der Jagt
Chairman, KPMG's EU Tax Centre and
Partner,
Meijburg & Co

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name of your local KPMG contact.

KPMG's EU Tax Centre, Laan van Langerhuize 9, 1186 DS Amstelveen, Netherlands