[2022] UKUT 78 (TCC)

Appeal number: UT/2021/000014

CORPORATION TAX – Whether s403D(1)(c) of ICTA constitutes unlawful restriction on freedom of establishment – yes because, while justified, it operates disproportionately – conforming interpretation adopted – appeal allowed

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS — **Appellants**

-and-

(1) VOLKERRAIL PLANT LTD
(2) VOLKERRAIL POWER LTD
(3) VOLKERFITZPATRICK LTD
(4) VOLKERRAIL LTD

Respondents

TRIBUNAL: MR JUSTICE ROTH
JUDGE JONATHAN RICHARDS

Sitting in public by way of hybrid hearing at The Royal Courts of Justice, Rolls Building, Fetter Lane, London on 28 and 31 January 2022

David Ewart QC, Mark Fell and Harry Winter instructed by the General Counsel and Solicitor for Her Majesty's Revenue & Customs for the Appellant

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

DECISION

1. A non-UK resident company which has a permanent establishment (a "PE") in the UK is permitted to surrender losses associated with that PE to other members of its group by way of "group relief" so as to reduce the corporation tax liability of the recipient companies. However, by s403D of the Income and Corporation Taxes Act 1988 ("ICTA") as in force at material times, there was a restriction on the ability to surrender losses of such a PE if that loss was deductible or otherwise allowable against non-UK profits of either the surrendering company or any other person. The question raised in these proceedings is whether this restriction is compatible with the provisions of the Treaty on the Functioning of the European Union (the "TFEU") concerning freedom of establishment.

2. In a decision (the "Decision") of the First-tier Tribunal (Tax Chamber) (the "FTT") released on 16 November 2020, the FTT concluded that the relevant provisions of s403D did infringe the fundamental freedom of establishment and should be disapplied in their entirety. HMRC appeal to this Tribunal against the Decision with the permission of the FTT.

Relevant factual background

3. There is no material dispute about the facts and at [6] of the Decision the FTT set out the parties' agreed statement of facts. The relevant facts can be summarised as follows.

4. The respondent companies (the "Respondents") are all UK resident members of a group of companies whose ultimate parent is Koninklijke VolkerWessels NV ("KVW NV"), a company incorporated in the Netherlands. Until 2008, the Respondents were not wholly-owned subsidiaries of KWV NV because a third party company ("Corus") held an indirect interest in them. However, that simply means that the losses surrendered to the Respondents before 2008 were surrendered by way of "consortium relief", whereas after 2008 losses were surrendered to them by way of full "group relief". Since there is no material distinction between the consortium relief and group relief rules, we will as a convenient shorthand refer to the Respondents as being members of the Volker Wessels "group".

5. The losses at issue in these proceedings were of EUR 45,966,000 incurred by the UK PE of Volker Stevin Construction BV ("VSCE BV") in the course of its commercial operations during the accounting periods ending 31 December 2004-2008. VSCE BV was, like the Respondents, a member of the Volker Wessels group.

6. Dutch resident companies are taxed in the Netherlands on their worldwide profits, which include the results of branches or PEs outside the Netherlands. Therefore, the entire worldwide profits of VSCE BV, including profits attributable to its UK PE, were within the charge to Dutch corporate income tax.

7. VSCE BV was, until 1 January 2010, a member of a "fiscal unity" with all members of that fiscal unity treated as a single taxpayer for Dutch corporate income tax purposes.

Accordingly, VSCE BV's losses were included in the corporate income tax return of the Dutch fiscal unity and were set off against taxable profits of the fiscal unity in the accounting periods ending 31 December 2004 to 31 December 2009.

8. Netherlands tax law as applicable in periods relevant to this appeal, provided for VSCE BV to obtain a credit against its Dutch corporate income tax liability that reflected the fact that the profits of its UK PE were within the charge to UK corporation tax. That was of little significance to this appeal in periods in which VSCE BV's UK PE was loss-making (since by definition in those periods it was not paying any UK tax which could generate a tax credit in the Netherlands).

9. However, as noted above, foreign-sourced losses were included in the fiscal unity's Dutch tax base. Netherlands tax law provided for a "recapture" mechanism if the fiscal unity subsequently generated taxable profits in the same overseas jurisdiction. In that case, the Dutch tax credit would be denied until the foreign losses had effectively been set off against the foreign profits, so as to "claw back" the relief the Netherlands had given for those losses.

10. In its accounting period ended 31 December 2009, the UK PE of VSCE BV reported a profit of EUR 1,709,000 for the purposes of Dutch corporate income tax. As a result, an equivalent amount of the losses that had been set off against taxable profits in the Netherlands were "recaptured".

11. On 1 January 2010, VSCE BV left the fiscal unity and became a single tax-paying entity. As a result, the burden of the recapture mechanism was restricted to any subsequent UK profits made by VSCE BV alone, as opposed to any subsequent UK profits made by the fiscal unity as a whole.

12. In its accounting period ending 31 December 2010, VSCE BV filed a single entity tax return which included EUR 173,000 profit relating to its UK PE.

13. Of the EUR 45,966,000 of UK losses utilised against Dutch profits, EUR 1,882,000 (i.e. the EUR 1,709,000 referred to in paragraph 10 plus the EUR 173,000 referred to in paragraph 12) have been recaptured. The balance of the losses of EUR 44,084,000 remain in principle subject to recapture. However, because VSCE BV is no longer part of a fiscal unity and has ceased trading, any subsequent recapture of these losses is unlikely, unless it starts trading once more.

UK statutory provisions

14. UK statutory provisions provide various types of relief for losses that a company has suffered. We need not set out mechanics of these provisions in detail since their meaning and effect is not in dispute. In summary, the following types of relief were in principle available under UK tax law for the trading losses that the UK PE of VSCE BV suffered:

(1) Those losses could be set "sideways" against other (non-trading) profits that the PE had, or chargeable gains it had realised, in the same accounting period as that in which the loss arose.

(2) The losses could be carried back (for a limited period) so as to reduce trading profits in earlier accounting periods.

(3) The losses could be carried forward and set off against trading profits of a later accounting period.

(4) The losses could be surrendered by way of group or consortium relief.

15. It is the fourth of these options that is of significance in these proceedings. To the extent that VSCE BV surrendered losses to "claimant companies" in its group or consortium, the profits of those claimant companies would be reduced by reference to the amount of loss surrendered. However, s403D of ICTA imposes the following restriction:

> **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—
>
> …
>
> (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.

16. Therefore, to paraphrase, if a loss incurred by a UK PE of a non-UK company is deductible or otherwise allowable against "non-UK profits" of the company concerned or any other person, that operates as a restriction on the ability to surrender those profits by way of group relief. We need not set out the definition of "non-UK profits" in full since it was common ground that the profits of the Dutch fiscal unity against which VSCE BV's losses were set were "non-UK profits" for the purposes of s403D.

17. We also note the following aspects of the UK statutory regime that were common ground:

(1) At times material to these appeals, there was no analogue of s403D(1)(c) that applied to a UK resident company surrendering losses, as distinct from a UK PE of a non-resident company.

(2) A UK PE of a non-resident company would be entitled to carry forward a loss, instead of surrendering it by way of group relief, even if it were able to obtain relief for that loss against non-UK taxable profits.

The Decision of the FTT and the grounds of appeal against it

18. The compatibility or otherwise of s403D of ICTA has previously been the subject of decisions of both the FTT and Upper Tribunal in the UK and the Court of Justice of the European Union (to which we will refer, together with its predecessor body, the European Court of Justice, as the "CJEU").

19. The FTT in the present case interpreted the judgment of the CJEU in Case C-18/11 *HMRC v Philips Electronics UK Limited*, EU:C:2012:532, [2013] STC 44 ("*Philips*") as deciding that the restriction imposed by s403D(1)(c) was contrary to EU law as it infringed the freedom of establishment guaranteed by the TFEU. It concluded (see [75] of the Decision) that the CJEU's conclusion in this regard should stand unless *Philips* had been overruled or distinguished by subsequent case law.

20. HMRC argued that in its judgment in Case C-28/17 *NN A/S v Skatteministeriet* ("*NN*"), EU:C:2018:526, the CJEU had indeed departed from *Philips*. At [71] and [72] of the Decision, the FTT rejected that argument.

21. Therefore, the FTT decided that *Philips* remained authority for the proposition that the prohibition imposed by s403D infringed the principle of freedom of establishment enshrined in the TFEU. The FTT declined HMRC's invitation to give s403D a "conforming interpretation" under which it would be compatible with EU law. It decided instead that s403D should be disapplied in its entirety, concluding that this was an outcome mandated by the CJEU's decision in *Philips* (see [85] and [86] of the Decision).

22. The freedom of establishment with which these proceedings are concerned was described as follows in *NN*:

> 17. Freedom of establishment, which Article 49 TFEU grants to European Union nationals, includes, in accordance with Article 54 TFEU, for companies formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the European Union, the right to exercise their activity in other Member States through a subsidiary, branch or agency.
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> 18. In order for the law of a Member State to constitute a barrier to the freedom of establishment of companies, it must result in a difference in treatment to the detriment of the companies exercising that freedom; that difference in treatment must relate to objectively comparable situations and must not be justified by an overriding reason in the public interest or proportionate to that objective (see, to that effect, judgment of 25 February 2010, *X Holding*, C-337/08, EU:C:2010:89, paragraph 20)

23. We need not set out HMRC's grounds of appeal in full since it was common ground that they permit HMRC to challenge all aspects of the FTT's conclusions that we have

set out above. We will, therefore, approach this appeal by considering the four issues identified in *NN* and a fifth issue, concerning appropriate remedies:

> (1) Whether s403D results in a difference in treatment that operates to the detriment of companies established in the EU seeking to exercise their freedom to exercise their business activities through a subsidiary, branch or agency in the UK.
>
> (2) Whether any difference in treatment relates to objectively comparable situations.
>
> (3) Whether any difference in treatment can be justified by an overriding reason in the public interest.
>
> (4) Whether any difference in treatment is proportionate to that objective.
>
> (5) What remedies should be imposed if the provision in question is incompatible with EU law? In particular, can the provision be "read down" so as to be compatible or should it be disapplied in its entirety?

24. The parties were agreed that these conditions should be approached cumulatively. If there is no difference in treatment or any difference in treatment does not relate to objectively comparable situations, then the analysis ends with a conclusion that there is no restriction on freedom of establishment. If a potentially objectionable restriction on freedom of establishment is found which cannot be justified then the question of proportionality does not arise and it is necessary to move straight to the question of remedies. If, by contrast, the potentially objectionable restriction is justified it is then necessary to consider whether it is proportionate and, if it is not, there will still be a contravention of EU law.

Introductory remarks: *Philips*, *NN* and "host state" versus "home state" discrimination

25. Central to the Respondents' case for upholding the Decision is the proposition that *Philips* and *NN* were concerned with very different types of restriction on freedom of establishment. We therefore start by identifying the restrictions that those two cases identified since that will put in context some of the discussion that follows.

Philips

26. We have already noted that *Philips* was concerned with s403D(1)(c), the very statutory provision at issue in this case. As we have noted, the restriction in s403D(1)(c) applied only to UK PEs of non-resident companies. There was no analogous provision that denied a UK resident company the ability to surrender losses if those losses had also been set off against non-UK profits. In paragraph 15 of its judgment, the CJEU concluded that s403D(1)(c) established a restriction on freedom of establishment. A non-UK resident company with a UK PE was treated differently from a UK resident company by being subjected to a restriction on its ability to surrender losses to which a resident company was not subject. That difference in treatment would make it less attractive for a non-UK company to form a PE in the UK (as distinct from a UK subsidiary).

NN

27. *NN* concerned provisions of Danish tax law that can be summarised as follows:

> (1) Danish tax law provided, at least in the circumstances relevant in *NN*, for Danish resident companies and Danish PEs of non-Danish companies to be subjected to "group taxation" (paragraph 19 of the CJEU's judgment).
>
> (2) Therefore, in principle, losses sustained in a Danish PE of a non-Danish company could be set off against profits, subject to tax in Denmark, of Danish subsidiaries and Danish PEs of non-Danish companies.
>
> (3) However, there was an exception imposed by paragraph 31(2)(2) of the Danish law on corporation tax. As applicable in the factual situation of *NN*, a loss sustained by a Danish PE of a Swedish company could only be set off against income of the group taxable in Denmark if Swedish tax law provided that the loss could not be set off against profits taxable in Sweden (see paragraph 9 of the Advocate General's opinion).

28. A similar restriction applied to Danish companies. By paragraph 5G(1) of the Danish law on tax assessment, a Danish company could not claim a deduction for expenditure which under the tax rules of another State could be deducted from income not subject to tax in Denmark (see paragraph 10 of the Advocate General's opinion). This was a point of distinction with *Philips* since, as we have noted, the UK group relief rules imposed no restriction analogous to s403D(1)(c) of ICTA on UK resident companies. The losses at issue arose when two Swedish subsidiaries of a Danish group (NN), both of which had Danish PEs, decided to merge those PEs into one (by the transfer of one PE to the PE of the other subsidiary). For Danish tax purposes, that merger was treated as a taxable transfer of assets at market value so that the enlarged PE was entitled to a tax deduction for the amortisation of goodwill that it had acquired. For Swedish tax purposes, however, the group opted to treat the transaction as a tax-free succession, so that there was no deduction <u>actually</u> available for purchased goodwill under Swedish tax rules (paragraphs 12 to 14 of the Advocate General's opinion).

29. Therefore, in practice, on the facts of *NN*, there was no prospect of a double deduction in respect of goodwill since the deduction was not available in Sweden. However, the Danish tax authorities proceeded on the basis that the Swedish tax rules did not *preclude* the deduction of the PE's losses against the subsidiary's profits since Swedish loss relief would have been available if the group had not opted to treat the transaction as a tax-free succession. The provisions of paragraph 31(2)(2) of the Danish law on corporation tax were therefore engaged so that Danish loss relief was denied.

30. We agree with the Respondents' observations that the CJEU formulated the restriction on freedom of establishment to which the Danish tax provisions gave rise in *NN* somewhat differently from the restriction which it found in *Philips*. In paragraphs 22 to 26 of its judgment in *NN*, the CJEU recorded submissions made by the Danish government. The essence of these was that there was no "difference in treatment" because a Danish resident company was subject to the same restriction that applied to the Danish PE of a Swedish company: neither could obtain relief for losses that were

relievable against non-Danish profits. The Danish government made the specific submission that there was no difference in treatment of the kind that the CJEU had previously addressed in *Philips* (see paragraph 26 of the judgment).

31. The CJEU did not expressly accept or reject that submission. However, in paragraph 27, the CJEU recorded NN's submission that there was a "difference in treatment of another nature" which, in context, must mean a difference in treatment other than that addressed in *Philips*. That submission is summarised at paragraph 28 of the judgment:

> 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.

32. In paragraphs 29 to 30 of its judgment, the CJEU accepted that this "other" difference in treatment was present, in the following terms:

> 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.

33. The phraseology in paragraph 28 is a little unusual as it is somewhat odd to speak of a Danish PE of a Danish company given that a PE of a company is generally understood to be a business establishment of that company located in a <u>different</u> jurisdiction to the place of residence. However, when paragraphs 28 to 30 are read together, in our judgment the CJEU is concluding as follows:

> (1) Danish PEs and Danish subsidiaries were treated identically. Neither was entitled to relief in Denmark for losses that were relievable against non-Danish profits. Therefore, the "difference in treatment" set out in *Philips* was not present.
>
> (2) However, there was another "difference in treatment" in issue. An "all-Danish" group that chose to operate entirely through Danish resident companies would not need to concern itself with any restriction on its ability to surrender losses freely between group members. There would be no prospect of such an "all-Danish" group being entitled to relief in another Member State for losses against non-Danish profits. By contrast, if a group

contained Danish PEs of companies in another Member State, there was a potential restriction on the free use of Danish losses.

(3) Therefore, a Danish company contemplating establishing a business activity in Denmark would have an incentive to conduct that activity itself (or through a Danish subsidiary) rather than establishing a subsidiary in Sweden which trades through a Danish PE.

34. In her submissions, Ms Shaw QC described *Philips* as being a case of "host state" discrimination since the legal provision at issue operated as a disincentive to a non-UK resident establishing itself in the UK by forming a UK PE, as distinct from a UK subsidiary. By contrast, she described *NN* as involving case of "home state" discrimination since the provision at issue operated as a disincentive to a Danish resident company establishing itself outside Denmark by forming a Swedish subsidiary to carry on business through a Danish PE. We agree that those are convenient ways of labelling the differences between the kinds of discrimination that were present in *Philips* and *NN*.

35. In his submissions denying that *NN* could be described as a case of "home state" discrimination, Mr Ewart QC referred us to paragraph 75 of the Advocate General's opinion in *NN*, which was quoted with approval in the CJEU's judgment. In that paragraph, the Advocate General described the Danish loss at issue as being theoretically available to be deducted "from the basis of assessment for tax in the host state (Denmark)". That, Mr Ewart submitted, indicated that both the CJEU and the Advocate General were approaching *NN* as a case of "host state" discrimination, just like *Philips*. However, in our judgment that submission takes the Advocate General's statement out of context. The Advocate General was not using the words "host state" to explain any difference between the discrimination identified in *Philips* and that identified in *NN*. Moreover, in the extract from paragraph 75 on which Mr Ewart relies, the Advocate General was referring to the process by which Denmark would, in principle, afford relief for losses associated with a Danish PE of a Swedish company. If the focus is on the loss relief alone, Denmark could quite fairly be described as acting as a "host state" in giving relief for the losses. That does not undermine Ms Shaw's submission that restrictions on the availability of Danish loss relief could amount to what she described as "home state" discrimination by adversely affecting the ability of Danish companies to establish Swedish subsidiaries with Danish PEs.

36. We therefore accept Ms Shaw's broad submission that the "difference in treatment" that the CJEU identified in *NN* was somewhat different from that identified in *Philips*. We are content to adopt her expressions of "home state" and "host state" discrimination as a shorthand description. However, we would make the following observations about this classification which will be significant in our discussion of some of the later issues:

(1) Simply because one type of discrimination can be described, in shorthand, as "home state" discrimination and another as "host state" discrimination does not in itself compel the conclusion that the two types of discrimination are to be analysed differently as a matter of law.

(2) Although a convenient shorthand, the categories of "home state" and "host state" discrimination are not necessarily mutually exclusive.

Difference in treatment operating to the detriment of non-UK companies

37. In our judgment, s403D results in the restriction on freedom of establishment set out in paragraph 15 and 16 of the CJEU's judgment in *Philips*. A UK resident company can surrender losses by way of group relief even if those losses are also eligible for relief in another member state. By contrast, a UK PE of a non-resident company will have a restricted entitlement to surrender losses associated with the PE if those losses are eligible for relief in another member state. That difference of treatment makes it less attractive for a company such as VSCE BV to carry on business in the UK through a PE, as compared with forming a UK subsidiary to carry on operations on the UK. That is a prima facie restriction on the ability of VSCE BV to establish a PE in the UK.

38. However, we consider that s403D results also in the restriction on freedom of establishment identified in *NN*. An "all UK" group would have an incentive to carry on further UK operations in a UK company in its group rather than forming a Dutch subsidiary to carry on those operations in a UK PE.

Objective comparability

39. The CJEU dealt with the issue of objective comparability very briefly in *Philips*. At [18] of its judgment it recorded submissions from the UK to the effect that a UK PE of a non-resident company was not in a comparable position to a UK resident company because the former is taxable only on income generated in the UK, whereas the latter was subject to tax on all its profits, wherever generated. At [19], the CJEU simply rejected that submission. It gave no express reasons for doing so. However, paragraphs [31] to [37] of the Advocate General's opinion demonstrates that the Advocate General considered that the UK's submissions in this regard were contrary to settled case law of the CJEU.

40. Whatever its precise reasoning, the Respondents understandably place significant emphasis on paragraphs 19 and 20 of the CJEU's judgment. They submit that, in the paragraph quoted below, the CJEU has already determined the question of objective comparability in their favour in the context of the very statutory provision, s403D of ICTA, that is at issue in this appeal:

> 19 …The situation of a non-resident company with only a permanent establishment in the national territory and that of a resident company are, having regard to the objective of a tax regime such as that at issue in the main proceedings, objectively comparable in so far as concerns the possibility of transferring by means of group relief losses sustained in the United Kingdom to another company in that group.
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> 20 Consequently, the answer to the first question is that Article 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. HMRC argue, however, that in its judgment in *NN,* the CJEU departed from this ostensibly clear finding of objective comparability. There is little support for that position in the Advocate General's opinion in *NN*, because the Advocate General proceeded on the basis that *Philips* had already determined that situations with which *NN* was concerned were objectively comparable (see paragraphs 56 to 59 of his Opinion) and therefore moved quickly to an analysis of whether the restriction was justified. However, HMRC's argument is that in paragraphs 31 to 38 of its judgment in *NN*, the CJEU declined to follow the Advocate General's analysis to the effect that issues of comparability had been settled by *Philips* and indeed concluded that the relevant situations were <u>not</u> comparable.

42. In paragraphs 31 and 32 of its judgment, the CJEU concluded that the question of comparability had to be considered having regard to the objective pursued by the national provisions at issue. In *NN*, the objective pursued was to "prevent the double deduction of losses". Having established that, the CJEU said as follows:

> 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.
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> 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).
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> 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.
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> 38. Thus the difference in treatment mentioned in paragraph 29 of the present judgment may, at least in that case, concern objectively comparable situations.

43. The parties put forward radically different interpretations of these paragraphs of the CJEU's judgment in *NN*. HMRC characterised them as a wholesale departure from *Philips* that should be interpreted as follows:

> (1) In line with the earlier decision of the CJEU in Case C-650/16 A/S *Bevola and another v Skatteministeriet* [2018] STC 1415, at least as regards national measures seeking to prevent double taxation or double relief for losses, VSCE BV's UK PE should no longer be regarded as being in a comparable position to a UK company.
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> (2) Alternatively, VSCE BV's UK PE is only comparable to a UK subsidiary for the purposes of s403D if, as a matter of fact, it had no real possibility of using its losses against taxable profits in the Netherlands (the exception recognised in paragraph 35 of the judgment in *NN*). That requirement builds on jurisprudence developed both by the CJEU and the UK courts following the judgment of the CJEU in Case C-446/03 *Marks & Spencer PLC v Halsey (HM Inspector of Taxes)*. It required the facts to be tested at the end of the accounting period in which the losses were regarded as arising for UK corporation tax purposes (see the judgment of the Court of Appeal in *Marks & Spencer PLC v Halsey (HM Inspector of Taxes)* [2007] EWCA Civ 117). Judged at that point in time, there was clearly a real possibility in the present case of the losses being relieved against taxable income in the Netherlands, as demonstrated by the fact that the losses were relieved against profits of the fiscal unity. The existence of that real possibility was, therefore, fatal to any argument that VSCE BV's UK PE was in a position comparable to that of a UK company.
>
> (3) Alternatively, VSCE BV's UK PE was only comparable to a UK company for the purposes of s403D insofar as, properly construed, s403D would deny the ability to group relieve losses of that PE in circumstances where there was no real possibility of setting those losses off against profits taxable in the Netherlands. Section 403D(1)(c) can be construed purposively to prevent this outcome from arising.

44. By contrast, the Respondents invite us to approach paragraphs 33 to 38 of the judgment in *NN* as follows:

> (1) The CJEU could not be intending to depart from *Philips*. Had it wished to do so, it would have said so expressly since its general practice is to follow previous decisions so as to ensure legal certainty and consistency in the application of EU law.

(2) However, in any event, the CJEU's judgment on comparability in *NN* is not inconsistent with its judgment on the same issue in *Philips* having regard to the fact that *NN* was a case of "home state" discrimination whereas *Philips* was a case of "host state" discrimination.

(3) Therefore, *Philips* remains authority for the proposition that the difference in treatment in which s403D results between a UK PE and a UK resident company relates to situations that are objectively comparable.

45. We do not accept the totality of the Respondents' submissions summarised in paragraph 44 above. As we explain in the next section of this judgment, the CJEU does on occasions depart from previous decisions without saying so expressly. While the Respondents may be correct that, in formulating its conclusions on comparability in *NN*, the CJEU had a situation of "home state" discrimination in mind (see paragraph 50 below), we also explain in the next section why we do not consider that there is a sharp line between the principles that need to be applied in "home state" cases as compared with "host state" cases.

46. However, having found that s403D does establish a difference in treatment between VSCE BV's UK PE (which needs to overcome the restrictions imposed by s403D before it can surrender losses by way of group relief) and a hypothetical UK subsidiary (which would not be subject to any such restriction), we agree with the Respondents that the situations of the UK PE and the subsidiary are comparable.

47. It is clearly significant that, in the context of s403D itself and the kind of difference in treatment which we have set out in paragraph 46 above, the CJEU has already found in *Philips* that the two situations are comparable. We recognise that it is possible that the CJEU could have departed from this decision without saying so expressly. We feel bound to remark that it is unfortunate that the CJEU in *NN* did not address its previous judgment in *Philips* or comment on the Advocate General's view that the two are indistinguishable on this point. However, we note that *NN* was a preliminary ruling and that in the reference the Danish court had expressly asked the CJEU whether the facts of the instant case came within the reasoning of *Philips*: see the judgment in *NN* at paragraph 15. The option of asking the CJEU for clarification by way of a reference is no longer open to a UK court or tribunal. In all the circumstances, we consider that we would need to see a clearer statement from the CJEU before concluding that it has in *NN* reversed its judgment in *Philips* and held that the two situations cannot be regarded as comparable.

48. We therefore reject HMRC's argument summarised in paragraph 43(1) above. Moreover, we consider that the CJEU's judgment in *NN* cannot be read as establishing that a PE and a subsidiary are <u>incapable</u> of being comparable for the purposes of provisions that seek to deny double relief for losses. On the contrary, paragraph 35 of the CJEU's judgment at least establishes that there are circumstances in which a PE and a subsidiary are capable of being regarded as comparable in that context. If the CJEU had concluded that a PE and a subsidiary were not comparable, there would have been no objectionable difference in treatment and the CJEU would not have needed, in paragraphs 39 to 57 of its judgment to consider whether any difference in treatment could be justified or operated proportionately.

49. We also reject HMRC's argument summarised in paragraph 43(2) above. The CJEU should not be taken as concluding that the question of comparability needs to be determined on a case by case basis by reference to the facts of particular cases. That follows from the fact that the task in both *NN*, *Philips* and indeed this case is to establish whether legislative provisions of a member state infringe the fundamental freedom of establishment set out in the TFEU. That cannot be determined on an ad hoc basis by reference to the facts of particular cases. Legislation is either compatible with the TFEU or it is not. The logical consequence of HMRC's submission is that s403D(1)(c) might have to be disapplied in some cases but not others, and might need to be given a conforming construction in some cases, but not others. That would amount to depriving s403D(1)(c) of the status of legislation at all and substituting for that legislation the views of the courts and tribunals on how particular situations should be treated.

50. In our judgment, the CJEU concluded in paragraphs 33 and 34 of *NN*, with regard to provisions of Danish tax law that are designed to prevent Danish resident companies obtaining double relief from losses, that a group containing a Swedish subsidiary with a Danish PE is not generally comparable with the situation of a Danish company with a Danish permanent establishment. It may be, as the Respondents submitted, that in this formulation of its conclusion the CJEU had "home state" discrimination in mind. However, nowhere does the CJEU state expressly that its conclusions are relevant only in cases of "home state" discrimination and that the different principles set out in *Philips* are instead to be applied to "host state" discrimination.

51. Even though they were not generally comparable, the CJEU goes on to conclude in paragraph 35 of its judgment in *NN* that the two situations are comparable in certain limited cases. We respectfully find the first sentence of paragraph 35 troublesome: the reference to "losses of the non-resident subsidiary attributable to the permanent establishment which is resident in the Member State in which the subsidiary is established" is difficult to follow. However, that sentence seems to be saying that where a Swedish company has no other possibility of setting losses associated with its Danish PE against profits taxable in Sweden, then the Swedish company with its Danish PE is in a comparable situation to a Danish company by way of exception to the general rule identified by the CJEU in paragraph 34 of its judgment. Although it is not straightforward to extract that meaning from the precise words used, read in context, particularly with paragraph 38 and the *dispositif* to the CJEU's judgment, we do not consider that paragraph 35 can realistically be given any other meaning.

52. It is the presence of this exception that causes the CJEU ultimately to conclude that the two situations are objectively comparable. The Danish legislation at issue did not obviously admit of any exception to be made if there was no other possibility of using the losses in Sweden. On its face, the Danish restriction on loss relief applied because the loss in question was in principle deductible in Sweden even though it could not in practice be used in Sweden (see the analysis of the CJEU in paragraphs 37-38 and 52-53). Accordingly, the Danish loss restriction was capable of application to situations which were objectively comparable and therefore constituted a restriction on the freedom of establishment unless it could be justified. On that basis, the CJEU proceeded to consider questions of justification and proportionality.

53. As we have noted in paragraph 43(3) above, HMRC invite us to conclude that s403D(1)(c) can be construed so as to impose no restriction in circumstances where there is no possibility of VSCE BV's losses being set against profits taxable in the Netherlands. However, in our judgment, those arguments are best approached after the issues of justification and proportionality have been determined, as part of the exercise of determining, if necessary, whether s403D(1)(c) can be given a "conforming interpretation" that makes it compliant with the TFEU. It might be said that it is logically appropriate to determine the precise meaning of s403D(1)(c) as part of the process of deciding whether it addresses situations that are objectively comparable. However, the difficulty with such an approach is that the wording of s403D(1)(c) raises the clear suggestion that it applies whenever losses are <u>in principle</u> deductible or allowable against non-UK profits. Therefore, the only basis on which s403D(1)(c) could be construed differently would be by adopting a 'conforming' interpretation in order to make it compliant with EU law. It is therefore appropriate to consider the issues of justification and proportionality first, since they have a bearing on what a conforming interpretation of s403D(1)(c) requires.

54. In conclusion, we find that the difference in treatment that we have identified involves situations that are objectively comparable.

Justification

55. The next issue is whether this difference in treatment, can be justified by an overriding reason in the public interest. HMRC seek to rely on a single justification: the need to prevent multiple relief being given for the same losses. The Respondents argue that this justification is insufficient. They rely strongly on the decision in *Philips* which expressly rejected the UK's argument that the difference in treatment in s403D could be justified by the need to prevent multiple relief for losses. For their part, HMRC argue that this aspect of the CJEU's conclusion in *Philips* has been superseded by later judgments, in particular that in *NN*.

The differing conclusions in Philips and NN

56. It is clear that the CJEU in *NN* came to a different conclusion, in the case before it, as to whether the desire to avoid double loss relief amounted to a sufficiently good justification from the conclusion that the CJEU reached, on the different case before it, in *Philips*.

57. In *Philips*, two justifications for s403D were put forward. The first concerned the need for a balanced allocation of the power to impose taxes as between Member States. The CJEU rejected that as a justification in paragraphs 23 to 26 of its judgment. Since HMRC do not seek to rely on this as an independent justification, we need say little about the CJEU's reasoning in this regard. The second justification put forward in *Philips* concerned the need to prevent double use of losses. The CJEU gave the following reasons for rejecting that justification:

> 28 As regards, secondly, the objective of preventing the double use of losses, it must be observed that even if such a ground, considered

> independently, could be relied on, it cannot in any event be relied on in circumstances such as those in the main proceedings to justify the national legislation of the host Member State.
>
> 29 The dispute in the main proceedings concerns the question whether the host Member State may impose certain conditions on the possibility of transferring, through group relief and to a resident company, losses sustained by the permanent establishment situated in that Member State of a non-resident company, while the transfer of losses sustained in that Member State by a resident company is not subject to any equivalent condition.
>
> 30 In such circumstances, the risk that those losses may be used both in the host Member State where the permanent establishment is situated and also in the Member State where the non-resident company has its seat has no effect on the power of the Member State where the permanent establishment is situated to impose taxes.
>
> 31 As observed by the Advocate General in point 49 et seq. of her Opinion, the losses transferred by the permanent establishment in the United Kingdom of LG.PD Netherlands to Philips Electronics UK, which is a resident company established in the United Kingdom, can be linked, in any event, to the United Kingdom's power to impose taxes. That power is not at all impaired by the fact that the losses transferred might also, in appropriate circumstances, be used in the Netherlands.
>
> 32 Consequently, in circumstances such as those of the main proceedings, the objective of preventing the risk of double use of losses cannot, 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.
>
> 33 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.

58. There is perhaps a hint in the opening sentence of paragraph 28 that the CJEU had some doubt whether avoiding the double use of losses was even capable of amounting to a justification on its own. However, this issue did not feature prominently in its judgment.

59. Paragraph 31 of the CJEU's judgment indicates approval of the Advocate General's reasoning in "point 49 et seq" of her Opinion. Paragraph 49 of the Advocate General's Opinion is in fact concerned with the availability of a justification based on the balanced allocation of taxing powers. The Advocate General set out her opinion on the justification based on double use of losses in paragraphs 58 to 66 of her Opinion. Those paragraphs contain much interesting discussion. Paragraphs 60 to 63 suggest that the Advocate General considered that the analysis of a justification based on double use of losses would differ depending on whether the "home state" or "host state" discrimination was involved and the Respondents understandably place emphasis on this. At paragraph [64] she concluded that the prevention of double use of losses

"cannot be an end in itself". Moreover, in paragraphs 66 and 67 of her Opinion, the Advocate General indicated that UK legislation did not pursue the objective of preventing double use of losses sufficiently consistently or systematically to use that objective as a justification. She pointed out, for example, that UK legislation would not restrict the carry forward or carry back of a PE's losses even if relief for those losses had been given locally.

60. However, we do not consider that the aspects of the Advocate General's reasoning that we have summarised fall within the scope of the CJEU's approval in paragraph 31 of its judgment. Rather, in our view, the essence of the CJEU's conclusion was that, whether or not the Dutch company (LG PD Netherlands) gave relief in the Netherlands for losses of its UK PE, the UK's taxable measure of profit or loss in either case would be the same. Accordingly, there was no justification for s403D to link a UK PE's entitlement to loss relief to whether those losses had been used elsewhere.

61. The CJEU in *NN* approached this issue very differently. There is no suggestion that preventing the double use of losses was, on its own, incapable of justifying a restriction on freedom of establishment. Having noted that Article 25 of the Nordic Convention sought to prevent double taxation of profits in a case where a Swedish company had a Danish PE, by providing for Danish tax paid to be creditable against the company's Swedish tax liability, the CJEU concluded:

> 47 In the light of that mechanism [i.e. that set out in Article 25 of the Nordic Convention], 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.

62. In her oral submissions on behalf of the Respondents, Ms Shaw accepted that if in *NN* the CJEU was departing from the conclusions on justification that it had expressed in *Philips*, then HMRC's appeal would succeed on the question of justification at least. To that we would add that if the CJEU's conclusions on justification set out in *Philips* have <u>not</u> been superseded by either the decision in *NN* or the principles developed by the CJEU in reaching that decision, then this Tribunal is bound to conclude, in the light of *Philips*, that the discrimination to which s403D gives rise is not justified. Both propositions follow from the fact that the CJEU's decisions in *Philips* and *NN* and the principles set out in those judgments, are "retained EU case law" for the purposes of s6(7) of the European Union (Withdrawal) Act 2018 and our obligation, pursuant to

s6(3) of that Act, to decide this appeal in accordance with that case law together with general principles of EU law as they stood on IP completion day.

63. Therefore, the key matter we need to decide in connection with the issue of justification is whether *NN* was either departing from *Philips* or setting out different principles that were incompatible with those in *Philips*. As a shorthand, we describe the relevant question as being whether *NN* "overruled" *Philips*.

Whether NN overruled Philips

64. The Respondents advance two broad arguments in support of their proposition that *NN* did not overrule *Philips*:

> (1) The CJEU in *NN* did not expressly overrule *Philips* and there is no basis for inferring that it did.
>
> (2) *NN* and *Philips* were concerned with different situations with *NN* addressing a case of "home state" discrimination and *Philips* addressing a case of "host state" discrimination.

65. In support of their first argument summarised in paragraph 64(1), the Respondents referred to various decisions of the CJEU and opinions from Advocates General to the effect that it is rare for the CJEU to decline to follow previous decisions, and that where it does so it will say so expressly, or at least in terms make it clear that this is what it is doing.

66. However, we have already observed that it is by no means impossible for the CJEU either to decline to follow previous decisions, or to develop principles that are inconsistent with its earlier decisions, without saying so expressly. In submissions on behalf of HMRC, Mr Ewart gave an example of the CJEU doing precisely that.

67. In Case 41/74 *Van Duyn v Home Office* EU:C:1974:33, the UK imposed no sanctions under domestic law on UK citizens who were members of the Church of Scientology or who worked for that organisation. However, it purported to prevent Ms Van Duyn, a Dutch national, from entering the UK to take up employment with the Church of Scientology on the grounds that the Church of Scientology was an undesirable organisation. The CJEU held that the UK was entitled to invoke reasons of public policy, referred to in Articles 48 and 56 of the then applicable Treaty, to treat a Dutch national, such as Ms Van Duyn, differently from its own nationals.

68. A diametrically opposite conclusion was reached in joined cases C-115 and 116/81 *Adoui and Cornaille v Belgium* EU:C:1982:183. In that case, Belgian law imposed no legal sanctions on people by reason only that they chose to work as prostitutes although Belgian law did criminalise certain offences associated with prostitution such as incitement to debauchery. Ms Adoui and Ms Cornaille were French nationals residing in Belgium. The Belgian authorities refused to issue them with a certificate of residence on the ground that they worked in a bar "which was suspect from the point of view of morals". The case of *Van Duyn v Home Office* was cited extensively to the CJEU by Member States submitting observations in support of the proposition that the Belgian

state had lawfully applied the reservations applicable to public policy set out in Articles 48 and 56 of the Treaty. However, the CJEU's judgment said simply, in paragraph 9, that Belgium was not entitled to refuse Ms Adoui or Ms Cornaille access to its territory by reason of conduct which would not have attracted any sanction had it been conduct of a Belgian national. The Court's reasoning does not even refer to *Van Duyn*, still less provide any hint that the principle set out in that case was not being followed.

69. Ms Shaw submitted that *Adoui* was not a particularly good example of the proposition that Mr Ewart sought to establish because the CJEU did, in paragraph 8 of its judgment in *Adoui*, expressly modify its previous decision in Case C-30/77 *Bouchereau* EU:C:1977:172 and *Van Duyn* had been referred to in *Bouchereau*. We are not persuaded by that submission. The CJEU did in paragraph 8 of its judgment include a quote from *Bouchereau* to the effect that the public policy safeguards referred to in Articles 48 and 56 presupposed the existence of a "genuine and sufficiently serious threat affecting one of the fundamental interests of society". It then went on to articulate the principle we have already described to the effect that nationals of a different Member State should not be held to a higher standard. However, Mr Ewart's point remains valid. The CJEU's judgment on this issue does not state expressly that principles set out in previous CJEU judgments are being departed from. As Prof Barnard states in *The Substantive Law of the EU: The Four Freedoms* (6th edn, 2019) at p. 479, the subsequent case law of the CJEU has "implicitly reversed" this aspect of the *Van Duyn* ruling.

70. In our judgment, Ms Shaw was correct to accept, in answer to questions from the Tribunal, that sometimes the CJEU acknowledges expressly when it is "moving on" from reasoning in previous cases and sometimes it does not. Therefore, the real issue is whether, on proper analysis of the judgment, the CJEU in *NN* was moving on from its decision in *Philips* on justifications consisting of a desire to prevent cross-border double loss relief.

71. We cannot help but think that the need for this, and perhaps other litigation, could have been avoided if the CJEU had dealt expressly with the suggestion in paragraph 64 of the Advocate General's opinion in *NN* to the effect that perhaps the time had come to moderate the assertions in *Philips* that preventing double deduction of losses could not amount to an overriding reason in the public interest that could justify discrimination. Having considered inferences pointing in both directions, we have come to the conclusion that the CJEU's judgment in *NN* does represent a departure from the principles in *Philips*. That has led us to conclude that the discrimination to which s403D gives rise can be justified by an overriding reason in the public interest.

72. By way of preface we note that the question whether preventing double use of losses is a sufficiently good reason for the presence of tax measures that discriminate between companies established in different Member States involves a value judgment. There is no reason why the outcome of that value judgment should remain static. It is understandable that the outcome will vary as tax systems and taxpayer behaviour evolve. As the Advocate General noted in paragraphs 65 to 69 of his opinion in *NN*, since *Philips* was decided much work has been done within the EU and elsewhere in response to the OECD's reports on Base Erosion and Profit Shifting ("BEPS"). The

OECD's reports on BEPS mention the specific iniquity of taxpayers obtaining double relief for the same loss or expense. Directives 2016/1164 and 2017/952, referred to in paragraph 69 of the Advocate General's opinion, are expressly intended to regulate mismatch outcomes arising from the application of different Member States' laws to PEs that could lead to double deduction. Against that background, it is not inherently surprising that the CJEU would decide that preventing double loss relief should now constitute an acceptable justification on its own, even if it was not previously.

73. We did not understand the Respondents to disagree with this proposition. They accept that it might have been open to the CJEU to reformulate the scope of a permissible justification based on double use of losses. However, they argue that in *NN* the CJEU did not do so, at least in a "host state" case such as that in issue in these proceedings and in *Philips*. In her oral submissions, Ms Shaw argued that it would be a "leap of faith" to conclude that the principles formulated in *NN* relating to double use of losses could be read across and applied to host state discrimination.

74. We reject the Respondents' submission set out in paragraph 73 for the following reasons:

(1) On its face, the CJEU's conclusion in paragraph 47 and 48 of *NN* is stark. Since the Danish PE's profits were not taxed twice, its losses should not be relieved twice. If Denmark were required to afford relief for losses of a Danish PE of a Swedish subsidiary that had been relieved in Sweden, a Swedish resident company would obtain an unjustified advantage. No part of that conclusion is linked to a perception that NN involved a case of "home state" discrimination rather than "host state" discrimination.

(2) The categories of "host state" and "home state" discrimination are not mutually exclusive. The circumstances of *Philips* and of this case involve instances of both (see our conclusions in paragraphs 37 and 38 above).

(3) The CJEU in *NN* was well aware that the Advocate General considered that the Danish government's reliance on a separate justification based on double use of losses was inconsistent with *Philips*: see the Advocate General's Opinion at paragraphs 62-63. If the CJEU in *NN* thought that its conclusions were consistent with *Philips,* because *Philips* was concerned with either a different kind of discrimination or the mechanics of the domestic provision at issue in *Philips* were different from those in *NN*, we think that it would have said so given the importance of the doctrine of legal certainty in CJEU jurisprudence. The Advocate General in *Philips* had sought to articulate a distinction between "home state" and "host state" cases in her opinion and it would have been natural for the CJEU in *NN* to draw on that reasoning if it wished to make the same distinction.

(4) The Respondents have given no sufficiently good, principled reason why the CJEU would have thought that double use of losses was acceptable in a "host state" case, but not in a "home state" case. In her oral submissions, Ms Shaw argued that, in the circumstances of this appeal, it was for the "home state", the Netherlands, to prevent double use of losses, by enacting legislation precluding VSCE BV from obtaining tax relief in the

Netherlands for losses of its UK PE that could be surrendered by way of group relief in the UK. In failing to do so, the Netherlands had "dropped the ball" and it was not open to the UK to step in and fix the problem. However, both the OECD's work on BEPS and recital (10) to Directive 2017/952 make it clear that where PEs are involved, it is objectionable for taxpayers to be able to take advantage of mismatches occasioned by differences between the tax law applicable in the location of the PE and tax law applicable in the state of residence to obtain double relief for the same losses. Whether the difference in tax treatment arises because of one jurisdiction "dropping the ball" or not, the outcome is the same: a double use of losses. Since both the OECD and the EU evidently consider that outcome to be objectionable, we see no reason why the CJEU should have concluded in *NN* that the outcome was potentially permissible in a host state case.

(5) We acknowledge that *NN* was a case in which domestic legislation precluded both resident companies and PEs from obtaining loss relief for losses that were relievable in other jurisdictions and that s403D considered in *Philips* imposed no similar restriction applicable to resident companies. We have accepted that this was part of the reason why *NN* can be seen as a case of "home state" discrimination, whereas *Philips* also involved "host state" discrimination. However, we reject the Respondents' broader contention that the CJEU therefore considered that the discrimination in *NN* was more "justified" than that in *Philips* on the basis that Danish tax law pursued the aim of preventing double relief for losses more consistently and coherently. An evaluation of the degree of consistency or coherence of the domestic measure did not feature in the CJEU's judgment in *NN*. Nor did it feature in the judgment in *Philips* since, as we have noted in paragraph 59 above, the CJEU did not refer to comments that the Advocate General made in this respect.

(6) We do not accept the Respondents' arguments that *NN* should be regarded simply as a case about "final losses" (that is losses which are not double deductible because there is no possibility of using them elsewhere). It is true, of course, that *NN* contains some discussion of the issue of final losses which is not present in *Philips*. However, the CJEU's conclusion in *Philips*, to the effect that preventing double use of losses was simply incapable of amounting to a justification for the discriminatory UK measure, made it unnecessary for the CJEU to go on to consider how the averred justification applied to "final losses". The CJEU in *NN* only needed to consider the issue of final losses because it had moved away from the conclusion in *Philips* on the invalidity of a justification based on preventing the double use of losses.

75. Therefore, in respectful disagreement with the FTT, we consider that *NN* establishes that the aim of preventing double use of losses is an overriding reason in the public interest that justifies the discriminatory treatment present in s403D(1)(c).

Proportionality

76. It is common ground that our conclusion set out in paragraph 75 above is not the end of the matter. Even though the restriction on freedom of establishment is justified, it will not be compatible with principles of EU law if it operates disproportionately.

77. In our judgment, there are two respects in which the restriction set out in s403D(1)(c) of ICTA operates disproportionately:

> (1) On a natural reading of s403D(1)(c), a loss may not be surrendered by way of group relief if any part of it is allowable against non-UK profits. It is disproportionate to refuse to allow losses of, say £1 million to be surrendered by way of group relief if just £10,000 is deductible against non-UK profits.
>
> (2) Section 403D(1)(c) prevents losses being surrendered by way of group relief if they are merely deductible or allowable against non-UK profits. Losses might be deductible or allowable against non-UK profits in the sense that non-UK tax law might provide for a deduction or allowance to be available if certain conditions are satisfied. Therefore if, to use the wording of the CJEU in its judgment in *Marks & Spencer plc*, the non-UK company has "exhausted the possibilities available in its State of residence of having the losses taken into account", s403D(1)(c) would operate disproportionately. In such a case, there would be no possibility of the losses being used outside the UK, but UK group relief would still not be available.

78. Footnote 27 to HMRC's skeleton argument appeared to acknowledge that s403D(1)(c) might be regarded as disproportionate in the sense set out in paragraph 77(1) above, but argued that any lack of proportionality could be cured by a conforming interpretation. In his oral submissions, however, we understood Mr Ewart to be submitting that the result was not disproportionate, applying the approach to proportionality set out in paragraphs 50-56 of *NN*. He argued that the CJEU there held that it was only if there was no possibility of setting of the losses of the Danish PE in the other state (Sweden) that the Danish law precluding the deduction of the losses in Denmark was disproportionate. Therefore, since s403D(1)(c) does not preclude the surrender for group relief if there is a possibility of the loss being deducted in the other state (here, the Netherlands), it is not disproportionate. However, we think this misinterprets the ruling in *NN*. We set out the relevant paragraphs of the CJEU's judgment below:

> 50 A rule such as that laid down in Paragraph 31(2)(2) of the Law on corporation tax would go beyond what is necessary to prevent the double deduction of a loss in the case where the effect thereof would be to deprive a group of any possibility of deducting the loss of a resident subsidiary in a cross-border situation such at that at issue in the main proceedings.
>
> 51 That might be the case, according to the referring court, in the dispute in the main proceedings.
>
> 52 Since the loss sustained by the permanent establishment in Denmark of NN's Swedish subsidiary is, in principle, deductible from that

> subsidiary's profits, which are taxable in Sweden, it cannot be deducted from the taxable group profits in Denmark, pursuant to the rule laid down in Paragraph 31(2)(2) of the Law on corporation tax.
>
> 53 However, in the case in the main proceedings, the loss is the result of the merger of two Danish branches in the group and the choice made by the group — as permitted by Swedish law — that that merger be treated for tax purposes as a restructuring of activities, and, as such, not subject to tax in Sweden. Consequently, it would not be possible, in practice, to set those losses off against the Swedish subsidiary's profits.
>
> 54 In a similar case, the national provisions at issue in the main proceedings — the consequence of which, according to the referring court, is to deprive the Danish group of any effective possibility of deducting the losses of the resident permanent establishment of its non-resident subsidiary — fail to have regard for the principle of proportionality.
>
> 55 That principle would, by contrast, be respected if the setting off, against the Danish group's profits, of the loss sustained by the resident permanent establishment of its non-resident subsidiary were accepted, by derogation from the rule laid down in Paragraph 31(2)(2) of the Law on corporation tax, since the group would have demonstrated that the setting off of the abovementioned losses against the subsidiary's profits is actually impossible in the other Member State.
>
> 56 It is for the referring court to determine whether that is the case in the dispute in the main proceedings, with regard to the Danish branch of NN's Swedish subsidiary.

79. In our judgment, the CJEU is saying that if on the facts it was "impossible in practice" to set off the losses of the Danish PE of the Swedish subsidiary against the Swedish subsidiary's profits in Sweden, the effect of the Danish law would be to deprive the Danish group of "any effective possibility of deducting the losses" of that Danish PE. This would therefore go beyond what was reasonable to prevent double deduction of losses. However, if the Danish law allowed a derogation which permitted the setting off of the PE's loss in Denmark because the group showed that the setting off of those losses in Sweden is "actually impossible", then the Danish legislation would be proportionate. It was therefore for the Danish court to determine whether such a derogation is permissible.

80. We do not consider that this reasoning supports an argument that the possibility of setting off only part of the losses sustained is sufficient. In *NN*, the losses which had to be deductible in Denmark to render the legislative provision proportionate were the losses of the Danish PE, not just a part of those losses. By contrast, under s403D(1)(c), on its natural reading, once a part of the losses of the UK PE are deductible for the purposes of foreign tax on non-UK profits, none of those losses are eligible for surrender for group relief. In our judgment, such an outcome would clearly be disproportionate. We do not see that the earlier judgment of the CJEU in Case C-172/13 *Commission v UK*, EU:C:2015:50, to which Mr Ewart referred, assists HMRC in this regard.

81. HMRC accept that the effect that we have described in paragraph 77(2) would be disproportionate if the legislation operated in that way. However, they argue that, construed purposively, the legislation does not operate in the way we have described in paragraph 77(2). In our judgment, the natural reading of s403D(1)(c) is that it does have the effect outlined in paragraph 77(2). The words "deductible" and "allowable" focus attention on legal possibilities afforded by the relevant non-UK legislation. They do not obviously invite any analysis of what is achievable in practice. Advocate General Kokott expressed a similar view in paragraph 75 of her Opinion in *Philips* and we respectfully agree with her. We will consider HMRC's arguments as to a "purposive" interpretation in the section below in which we consider whether s403D can be "read down" so as to comply with principles of EU law.

Remedies

82. Therefore, we have concluded that s403D(1)(c) imposes a restriction on freedom of establishment. The restriction is justified, but operates disproportionately. It is not, therefore, compatible with EU law. It is common ground that, in those circumstances, unless we can adopt a "conforming construction" of the provisions which results in them being compliant with EU law, the relevant provisions of s403D(1)(c) must be disregarded.

83. In their skeleton argument, the Respondents argued that s403D(1)(c) should be disapplied completely to the extent that it applies to losses of a UK PE of a company resident in another member state. They pointed out that this was the conclusion reached by the CJEU in *Philips* and referred to other judgments in which the CJEU had indicated that national provisions that were incompatible with freedom of establishment should be disapplied. However, those arguments were all made in the context of the Respondents' arguments that the restriction on freedom of establishment that arises from s403D(1)(c) could not be justified. We have rejected that argument, holding that the restriction can be justified by the need to prevent double loss relief. Since the defect in s403D(1)(c) arises from a lack of proportionality, rather than a lack of justification, we consider it is appropriate to start by considering whether the provision can be construed in a manner that makes it proportionate. If such a construction can be found, then in our judgment it would be inappropriate to hold that relevant aspects of s403D(1)(c) should be disapplied altogether.

84. The parties were agreed that the judgment of the Court of Appeal in *Vodafone 2 v HMRC* [2009] EWCA Civ 446 is authority for the proposition that we have a broad and far-reaching obligation to seek to construe s403D(1)(c) so as to be compatible with EU law. However, that is subject to two provisos (see paragraph 38 of the judgment of Sir Andrew Morritt C in that case):

> (1) Any conforming interpretation must "go with the grain of the legislation". 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.

(2) The exercise of the interpretative obligation cannot require this Tribunal to make decisions for which we are not equipped or which give rise to important practical repercussions which we are not equipped to evaluate.

85. We consider that there is no real difficulty with the aspect of disproportionality that we have identified in paragraph 77(1) above. The legislation can appropriately be read as providing that group relief is denied only to the extent that amounts are deductible or allowable against non-UK profits. That may even be the outcome the legislation was intended to achieve since the operative provision in s403D(1) provides for group relief not to apply "except in so far as" the circumstance of s403D(1)(c) is present. Admittedly the impact of the implication to be derived from the words "except in so far as" is diminished by the opening or words of s403D(1)(c) which refer to "no part of" the loss in question being deductible from or allowable against non-UK profits. However, whatever conclusions are to be drawn from the somewhat tangled syntax of s403D(1)(c), the interpretation we set out above quite clearly goes with the grain of the legislation and neither party sought to argue otherwise.

86. HMRC argue that the disproportionality identified in paragraph 77(2) can be cured by a conforming interpretation of the statute under which the words "deductible from or otherwise allowable against" in s403D(1)(c) are read respectively as "deduct**ed** from or otherwise allow**ed** against". That interpretation is in material respects identical to the relevant provisions of s107 of the Corporation Tax Act 2010 ("CTA 2010"), which re-wrote s403D(1)(c) of ICTA. Section 107 of CTA 2010 was amended by s30 of the Finance Act 2013, with effect for accounting periods beginning on or after 1 April 2013, so as to replace the words "deductible" and "allowable" with "deducted" and "allowed" respectively.

87. That introduces one of the Respondents' objections to HMRC's proposed conforming interpretation set out in paragraph 86, namely that it impermissibly brings forward the effect of changes made by s30 of the Finance Act 2013. In the Respondents' submission, Parliament legislated for those amendments to have effect only for accounting periods commencing on or after 1 April 2013. The Tribunal should not, under the guise of conforming interpretation, give legislation retrospective effect.

88. We reject that submission. The process by which courts and tribunals interpret statutes inevitably results in what can loosely be termed "retrospective" effect since that process results in the true meaning of the statute being revealed only some time after it was enacted. That effect would be no more pronounced in this case simply because, as events turned out, Parliament chose to legislate in s30 of Finance Act 2013.

89. The Respondents' next objection was that the conforming interpretation proposed would lead to far-reaching practical repercussions which this Tribunal is not equipped to evaluate, thereby crossing the boundary between interpretation and amendment in the way set out in paragraph 115 of the speech of Lord Rodger of Earlsferry in *Ghaidan v Godin-Mendoza* [2004] UKHL 30. They argue that the question whether a loss is "deducted" is not straightforward in many cases. For example, the losses at issue in this appeal are subject to a "recapture" mechanism in the Netherlands. If it is known that the losses are to be recaptured in one, two or five years, are those losses "deducted" or not? By contrast, the wording of s403D(1)(c) asks a question about legal <u>possibilities</u>

which can be answered in a straightforward way by reference only to the relevant non-UK law.

90. We reject the Respondents' argument, that difficulties associated with ascertaining whether a loss has been "deducted" are so complicated as to require specific and expanded legislative provision. That there is no need for such specific and expanded legislative provision is demonstrated by the fact that, when legislating in s30 of Finance Act 2013, Parliament gave no guidance on the meaning of the word "deducted". Having had the opportunity to consider the matter, Parliament evidently concluded that the interpretation and application of this concept can appropriately be left to the courts.

91. Finally, we do not accept the Respondents' further argument that HMRC's conforming interpretation would go against the grain of the legislation. We recognise, of course, that there is a difference between a loss being "deducted" and being "deductible". If there were no difference, then HMRC's proposed interpretation would not affect the meaning of s403D(1)(c) and so would not be a "conforming" interpretation. However, the proposed interpretation retains the essential feature of s403D(1)(c), namely that UK group relief should be restricted where other relief is available for the same loss. It simply targets the denial of UK group relief more proportionately, at situations where there has been an <u>actual</u> use of the losses outside the UK as distinct from a mere theoretical possibility that they could be used in that way.

92. Accordingly, we would adopt the following conforming interpretation of s403D(1)(c):

> (1) The restriction on UK group relief is to be construed as applying only to the extent that the loss is, in any period, deducted against non-UK profits. Thus, if only £10,000 of a £1m loss can be so deducted, s403D(1)(c) restricts group relief only to the extent of £10,000 and not the full £1m.
>
> (2) The words "deductible from or otherwise allowable against" in s403D(1)(c) are to be construed as meaning "deducted from or otherwise allowed against".

93. Having adopted that conforming interpretation, we do not need to consider an alternative interpretation that HMRC put forward under which a loss would not be treated as "deductible" or "allowable" in s403D(1)(c) if it is not actually possible for the loss to be deducted.

Disposition

94. HMRC's appeal is allowed because the FTT erred in concluding that s403D(1)(c) should be disapplied. Given that error of law in the Decision, we will set the Decision aside.

95. We will set the Decision aside and replace it with a decision to the effect that s403D(1)(c) imposes a justified restriction on freedom of establishment, although that restriction operates disproportionately. Therefore, s403D(1)(c) is incompatible with EU

law but it can be "read down" so as to comply with EU law in the manner we have set out in paragraph 92 above.

96. There remains the question of how the interpretation set out in paragraph 92 should be applied to the actual facts of this case. We will invite the parties to agree the precise extent to which relevant claims for group relief are to be disallowed between themselves. If they cannot agree, either party may apply to the Upper Tribunal within 28 days of release of this decision for further directions. If such an application is made, we are likely to remit the matter of calculation back to the same FTT that heard the original appeal. If a party seeks a different direction, it should explain the alternative direction sought when making its application to the Upper Tribunal in accordance with this paragraph.

Signed on Original

MR JUSTICE ROTH
JUDGE JONATHAN RICHARDS

RELEASE DATE: 07 March 2022