Cross Border group relief

The European Commission has announced that it is referring the UK to the European Court of Justice (ECJ) for incorrectly implementing the ECJ’s judgment in Marks and Spencer plc on cross border group relief. So where we are now on cross border group relief, what should other companies be doing and what is this recent case on consortium relief?

The M&S saga

Marks & Spencer plc (M&S) sold its loss making subsidiary in France and shut down its Belgian and German loss making subsidiaries, which were subsequently liquidated. M&S claimed to be able to set the losses of its European subsidiaries off against its UK profits under the UK’s group relief rules. At that time the UK rules only permitted group relief surrenders between UK resident companies or group companies carrying on a trade in the UK. The case was referred to the ECJ, which decided that the UK’s group relief rules were largely consistent with EU principles but did contravene the EC treaty by not allowing relief:

- where the non-resident subsidiary had exhausted the possibilities available in its own state for having the losses relieved for the current or previous accounting periods, including by transferring losses to a third party; and
- where there was no possibility of those losses being taken into account in that state for future periods either by the subsidiary itself or by a third party.

Following the ECJ judgment the case was returned to the High Court and then appealed to the Court of Appeal, which gave some guidance on how the ECJ’s “no possibilities” test should be applied. The Court of Appeal decided (among other things) that the no possibilities test should be applied at the time the group relief claim was made (and not as HMRC had contended, at the end of the accounting period in question).

The case was then remitted to the First Tier Tribunal to apply the law to M&S’s particular facts. M&S was not able to group relieve the losses of the French company, which had been sold because relief for those losses was given to the new owner in France. It was, however, able to claim in relation to the German and Belgian subsidiaries because in addition to the initial group relief claims made shortly after the relevant accounting periods, M&S made further alternative claims while the German and Belgian companies were in liquidation and the Tribunal ruled that, although the no possibilities test was not satisfied when the original claims were made, it was satisfied when the alternative claims were made.

Since this decision the matter has again been referred to the Tribunal because HMRC and M&S could not agree the quantum of the losses and HMRC has appealed the previous Tribunal decision to the Upper Tribunal. In the Tribunal hearing on the quantum of the losses, the Tribunal decided that the quantum of losses should be decided using UK rules in the year in which the losses fall for UK computational purposes, even if there is no foreign tax loss for that year.

Change in legislation

Finance Act 2006 extended the group relief regime with effect from 1 April 2006 to allow for surrenders by a non-UK resident company acting other than through a UK permanent establishment as long as:

- the surrendering company is a 75% subsidiary of the claimant company and the claimant company is resident

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in the UK or both the surrendering company and the claimant company are 75% subsidiaries of a third company that is resident in the UK;

- the surrendering company is either resident in an EEA territory or has incurred the relevant losses in the course of carrying on a trade through a permanent establishment in an EEA territory; and

- the relevant losses meet four restrictive conditions designed to ensure that relief is only available for the sorts of losses which could be group relieved if made by a UK company and that no other company could claim relief for the losses.

One of the four conditions limits the amount of losses that may be surrendered to the lower of the foreign loss and the loss calculated on UK tax principles. Following the latest First Tier Tribunal decision in the M&S case (where it was held that the loss should be calculated on UK principles and as arising in the accounting period in which it would be treated as arising in the UK), this would appear to be contrary to the EC Treaty.

Another factor which makes the legislation very restrictive is that it sets the date for determining whether the no possibilities test is satisfied as the end of the accounting period in which the loss arises – rather than the time the group relief claim is made (as the Court of Appeal held in M&S). If the overseas jurisdiction permits the carry forward of loss relief indefinitely or until the company is dissolved, it is extremely difficult to meet the ECJ’s no possibilities test by the end of the accounting period in question.

**The European Commission**

The European Commission has announced that it is referring the UK to the ECJ over its implementation of the M&S decision. It considers that the UK imposes conditions on cross border group relief which make it impossible or virtually impossible for the taxpayer to benefit from tax relief because:

- there is an unnecessarily restrictive interpretation of the condition that there should be no possibility of use of the loss in the state of the subsidiary;

- the date for determining whether the condition that there should be no possibility of use of the loss in the state of the subsidiary is met is set immediately after the end of the accounting period in which the loss arises;

- the time limit to claim for group relief for losses made by subsidiaries established in other Member States is set at twelve months (extended in case of enquiries by HMRC) after the filing date for the company tax return of the claimant company; and

- the legislation only applies to losses incurred after 1 April 2006.

The Commission believes that these conditions make the new legislation incompatible with the freedom of establishment, guaranteed by the EC Treaty and the EEA Agreement. Arguably there are other conditions in the legislation which make it contrary to the EC Treaty, such as the relationship that must exist between the companies which prevents an EEA parent surrendering losses to a UK subsidiary.

Clearly we will need to wait until the ECJ decision to see definitely whether the UK will be forced to change the group relief rules again (although it does seem likely). However in the meantime, companies which have been prevented from claiming group relief for overseas losses because of the UK’s restrictive rules should be considering their position and, in particular, whether there is any scope for making group relief claims.

**Consortium relief**

A recent First Tier Tribunal case involving Philips Electronics UK Limited has considered whether the UK’s rules on consortium relief comply with EU law. This is unrelated to the M&S group relief litigation as it concerns consortium relief and UK losses, rather than cross border losses but it involves the application of some of the principles considered in M&S.

UK legislation currently provides that where a company is a member of a consortium and a group, such as where a company with 100% subsidiaries is also party to a joint venture, consortium relief is only available to members of its group if the company in question (the link company) is UK resident or is carrying on a trade in the UK through a permanent establishment. In the Philips Electronics case the link company was Dutch resident and the issue was whether losses of a UK branch of a Netherland subsidiary of the joint venture could be surrendered by way of consortium relief to a UK subsidiary in the 100% group. The UK rules also prevent the use of any losses incurred by a UK branch if any part

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Those losses have been used elsewhere. In this case some of the losses of the UK branch had been used by another Dutch company.

The Tribunal held that both the restriction on the residence of the link company and the provision preventing surrender of losses where any part of them have been used elsewhere constituted restrictions on the freedom of establishment and cannot be justified.

The Tribunal decision is particularly interesting because:

- it shows that the First Tier Tribunal is prepared to apply ECJ law itself without referring the matter to the ECJ – which means other taxpayers do not have to go through the costly litigation that M&S have;
- the Tribunal allowed the UK subsidiary (which wanted to use the losses) to invoke the EC freedoms rather than making the joint venture company or the link company (who had been discriminated against) do so.

The decision is likely to be appealed by HMRC but companies which have been prevented from making consortium relief claims in similar circumstances should consider what claims they can and should now be making.

Should you have any questions please contact Catherine Robins (catherine.robins@pinsentmasons.com), or your usual Pinsent Masons adviser who will be able to assist you further.