JUDGMENT OF THE COURT (Grand Chamber)

13 December 2005 *

In Case C-446/03,

REFERENCE for a preliminary ruling under Article 234 EC from the High Court of Justice of England and Wales, Chancery Division (United Kingdom), made by decision of 16 July 2003, received at the Court on 22 October 2003, in the proceedings

Marks & Spencer plc

v

David Halsey (Her Majesty's Inspector of Taxes),

THE COURT (Grand Chamber),

composed of V. Skouris, President, P. Jann, C.W.A. Timmermans and A. Rosas, Presidents of Chambers, C. Gulmann (Rapporteur), A. La Pergola, J.-P. Puissochet, R. Schintgen, N. Colneric, J. Klučka, U. Lõhmus, E. Levits and A. Ó Caoimh, Judges,

* Language of the case: English.

Advocate General: M. Poiares Maduro,
Registrar: K. Sztranc, Administrator,

having regard to the written procedure and further to the hearing on 1 February 2005,

after considering the observations submitted on behalf of:

— Marks & Spencer plc, by G. Aaronson QC and P. Farmer, Barrister,

— the United Kingdom Government, by M. Bethell, acting as Agent, with R. Plender QC and D. Ewart, Barrister,

— the German Government, by W.-D. Plessing and A. Tiemann, acting as Agents,

— the Greek Government, by K. Boskovits and V. Kyriazopoulos, and also by I. Pouli and S. Trekli, acting as Agents,

— the French Government, by G. de Bergues and C. Jurgensen-Mercier, acting as Agents,

— Ireland, by D.J. O'Hagan, acting as Agent, with E. Fitzsimons SC and G. Clohessy, BL,

— the Netherlands Government, by H.G. Sevenster, S. Terstal and J. van Bakel, acting as Agents,

— the Finnish Government, by A. Guimaraes-Purokoski, acting as Agent,

— the Swedish Government, by A. Kruse, acting as Agent,

— the Commission of the European Communities, by R. Lyal, acting as Agent,

after hearing the Opinion of the Advocate General at the sitting on 7 April 2005,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Articles 43 EC and 48 EC.

2 The request was submitted in proceedings between Marks & Spencer plc ('Marks & Spencer') and the United Kingdom tax authority concerning the latter's rejection of a claim for tax relief by Marks & Spencer, which sought to deduct from its taxable profits in the United Kingdom losses incurred by its subsidiaries established in Belgium, Germany and France.

National legal context

3 The provisions of national law applicable in the main proceedings are to be found in the Income and Corporation Taxes Act 1988 ('the ICTA'). They are set out below on the basis of the information provided in the decision for reference.

Liability to corporation tax

4 Under sections 6(1) and 11(1) of the ICTA, corporation tax is charged on the profits of companies which are resident in the United Kingdom or which conduct trading activities in the United Kingdom through a branch or agency.

5 Under section 8(1) of the ICTA, resident companies are charged to corporation tax in respect of their worldwide profits. Under section 11(1), non-resident companies are charged to corporation tax only in respect of the profits attributable to their United Kingdom branches or agencies.

6 Under taxation conventions between the United Kingdom and, in particular, Belgium, Germany and France, the foreign subsidiaries of resident companies, as non-resident companies, fall within the scope of United Kingdom corporation tax in respect of their trading activities only if those activities are conducted in the United Kingdom through a permanent establishment within the meaning of those Conventions.

7 A tax credit system of relieving double taxation is provided for in the United Kingdom.

8 That system has, in particular, the following two aspects.

9 First, a company established in the United Kingdom which conducts trading activities in another Member State through a branch in that State is taxed in the United Kingdom on the profits of that subsidiary and deducts from the tax payable the tax paid in the other Member State, or is allowed to deduct that tax when calculating branch profits or losses in the United Kingdom. The branch trading profits are calculated on United Kingdom tax principles. If a trading loss arose that loss could be set against the profits of the company established in the United Kingdom. Any unrelieved loss may be carried forward to subsequent periods. The fact that the loss may also be relieved in the other Member State against the branch's future profits does not affect the relief against United Kingdom profits.

10 Second, a company established in the United Kingdom which conducts trading activities in another Member State through a subsidiary established in that State is taxed in the United Kingdom on the dividends paid by that subsidiary and credit is

given for the tax paid in the other Member State on the profits out of which the dividend is paid and for any withholding tax. Where controlled foreign company legislation is not applicable, the parent company is not taxed on its non-resident subsidiary's profits and it cannot set the subsidiary's losses against its own profits.

11 Under section 208 of the ICTA, dividends received by a parent company established in the United Kingdom from a subsidiary also established in that Member State are not taxed, unlike those paid by a subsidiary established in another Member State.

Group relief for losses

12 In the United Kingdom, group relief allows the resident companies in a group to offset their profits and losses among themselves.

13 Section 402 of the ICTA provides:

'(1) Subject to and in accordance with this Chapter and section 492(8), relief for trading losses and other amounts eligible for relief from corporation tax may, in the cases set out in subsections (2) and (3) below, be surrendered by a surrendering company ("the surrendering company") and, on the making of a claim by another company ("the claimant company") may be allowed to the claimant company by way of relief from corporation tax called group relief.

(2) Group relief shall be available in a case where the surrendering company and the claimant company are both members of the same group ...”

14 Section 403 of the ICTA provides that:

‘(1) If in an accounting period (“the surrender period”) the surrendering company has —

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

15 As regards the accounting periods ending before 1 April 2000, section 413(5) of the ICTA states:

‘References in this Chapter to a company apply only to bodies corporate resident in the United Kingdom ...’

16 Following a change in the law consequent upon the judgment of the Court of 16 July 1998 in Case C-264/96 *ICI* [1998] ECR I-4695, group relief has since 2000 been applicable to profits and losses within the scope of United Kingdom tax law.

17 As a consequence of that change in the law:

— losses made by a United Kingdom branch of a non-resident company may be surrendered to another group company for offset against its United Kingdom taxable profits;

— losses made by a group company established in the United Kingdom may be surrendered to the branch for offset against its profits in the United Kingdom.

Main proceedings and questions referred for a preliminary ruling

18 Marks & Spencer is a company incorporated and registered in England and Wales. It is the parent company of a number of companies established in the United Kingdom and in other States. It is one of the leading United Kingdom retailers of clothing, food, homeware and financial services.

19 From 1975 Marks & Spencer began to move into other States, with the opening of a store in France. By the end of the 1990s it had sales outlets in more than 36 countries, with a network of subsidiaries and a system of franchises.

20 A trend towards increasing losses became evident in the mid-1990s.

21 In March 2001 Marks & Spencer announced its intention to divest itself of its Continental European activity. By 31 December 2001 the French subsidiary had been sold to third parties, while the other subsidiaries, including those established in Belgium and Germany, had ceased trading.

22 In the United Kingdom, Marks & Spencer claimed group tax relief pursuant to paragraph 6 of Schedule 17A to the ICTA in respect of losses incurred by its subsidiaries in Belgium, Germany and France for the four accounting periods ended 31 March 1998, 31 March 1999, 31 March 2000 and 31 March 2001. It is clear from the file before the Court that both parties to the main proceedings agree that the losses must be computed on a United Kingdom tax basis. At the tax authority's request, Marks & Spencer therefore recomputed the losses on that basis.

23 Each of the subsidiaries had operated in the Member State in which it had its registered office. The subsidiaries had no permanent establishment in the United Kingdom and had never traded there.

24 The claims for relief were rejected on the ground that group relief could only be granted for losses recorded in the United Kingdom.

25 Marks & Spencer appealed against that refusal before the Special Commissioners of Income Tax, which dismissed the appeal.

26 Marks & Spencer appealed against that decision before the High Court of Justice of England and Wales, Chancery Division, which decided to stay proceedings and to refer the following questions to the Court for a preliminary ruling:

'(1) In circumstances where:

— Provisions of a Member State, such as the United Kingdom provisions on group relief, prevent a parent company which is resident for tax purposes in that State from reducing its taxable profits in that State by setting off losses incurred in other Member States by subsidiary companies which are resident for tax purposes in those States, where such set off would be possible if the losses were incurred by subsidiary companies resident in the State of the parent company;

— The Member State of the parent company:

  — subjects a company resident within its territory to corporation tax on its total profits, including the profits of branches in other Member States, with arrangements for the availability of double taxation relief for those taxes incurred in another Member State and under which branch losses are taken account of in those taxable profits;

  — does not subject the undistributed profits of subsidiaries resident in other Member States to corporation tax;

— subjects the parent company to corporation tax on any distributions to it by way of dividend by the subsidiaries resident in other Member States while not subjecting the parent company to corporation tax on distributions by way of dividend by subsidiary companies resident in the State of the parent;

— grants double taxation relief to the parent company by way of a credit in respect of withholding tax on dividends and foreign taxes paid on the profits in respect of which dividends are paid by subsidiary companies resident in other Member States;

is there a restriction under Article 43 EC, in conjunction with Article 48 EC? If so, is it justified under Community law?

(2) (a) What difference, if any, does it make to the answer to Question 1 that, depending on the law of the Member State of the subsidiary, it is or may be possible in certain circumstances to obtain relief for some or all of the losses incurred by the subsidiary against taxable profits in the State of the subsidiary?

(b) If it does make a difference, what significance, if any, is to be attached to the fact that:

— a subsidiary resident in another Member State has now ceased trading and, although there is provision for loss relief subject to certain conditions in that State, there is no evidence that in the circumstances such relief was obtained;

— a subsidiary resident in another Member State has been sold to a third party and, although there is provision under the law of that State for the losses to be used under certain conditions by a third party purchaser, it is uncertain whether they were so used in the circumstances of the case;

— the arrangements under which the Member State of the parent company takes account of the losses of UK resident companies apply regardless of whether the losses are also relieved in another Member State?

(c) Would it make any difference if there were evidence that relief had been obtained for the losses in the Member State in which the subsidiary was resident and, if so, would it matter that the relief was obtained subsequently by an unrelated group of companies to which the subsidiary was sold?'

Question 1

27 By its first question, the High Court seeks essentially to ascertain whether Articles 43 EC and 48 EC preclude provisions of a Member State which prevent a resident parent company from deducting from its taxable profits losses incurred in another Member State by a subsidiary established in that Member State although they allow it to deduct losses incurred by a resident subsidiary.

28 In other words, the question is whether such provisions constitute a restriction on freedom of establishment, contrary to Articles 43 EC and 48 EC.

29 In that regard, it must be borne in mind that, according to settled case-law, although direct taxation falls within their competence, Member States must none the less exercise that competence consistently with Community law (see, in particular, Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, paragraph 37 and the case-law cited).

30 Freedom of establishment, which Article 43 EC grants to Community nationals and which includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected, entails, in accordance with Article 48 EC, for companies or firms 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 Community, the right to exercise their activity in the Member State concerned through a subsidiary, a branch or an agency (see, in particular, Case C-307/97 *Saint Gobain ZN* [1999] ECR I-6161, paragraph 35).

31 Even though, according to their wording, the provisions concerning freedom of establishment are directed to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation (see, in particular, *ICI*, cited above, paragraph 21).

32 Group relief such as that at issue in the main proceedings constitutes a tax advantage for the companies concerned. By speeding up the relief of the losses of the loss-making companies by allowing them to be set off immediately against the profits of other group companies, such relief confers a cash advantage on the group.

33 The exclusion of such an advantage in respect of the losses incurred by a subsidiary established in another Member State which does not conduct any trading activities in the parent company's Member State is of such a kind as to hinder the exercise by that parent company of its freedom of establishment by deterring it from setting up subsidiaries in other Member States.

34 It thus constitutes a restriction on freedom of establishment within the meaning of Articles 43 EC and 48 EC, in that it applies different treatment for tax purposes to losses incurred by a resident subsidiary and losses incurred by a non-resident subsidiary.

35 Such a restriction is permissible only if it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interest. It is further necessary, in such a case, that its application be appropriate to ensuring the attainment of the objective thus pursued and not go beyond what is necessary to attain it (see, to that effect, Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, paragraph 26, and Case C-9/02 *De Lasteyrie du Saillant* [2004] ECR I-2409, paragraph 49).

36 The United Kingdom and the other Member States which submitted observations in the present proceedings claim that, from the aspect of a group relief system such as that at issue in the main proceedings, resident subsidiaries and non-resident subsidiaries are not in comparable tax situations. In accordance with the principle of territoriality applicable both in international law and in Community law, the Member State in which the parent company is established has no tax jurisdiction over non-resident subsidiaries. As regards the latter, tax competence belongs in principle, in accordance with the usual allocation of competence in such matters, to the States on whose territory they are established and carry out commercial activities.

37 In that regard, it must be noted that, in tax law, the taxpayers' residence may constitute a factor that might justify national rules involving different treatment for resident and non-resident taxpayers. However, residence is not always a proper factor for distinction. In effect, acceptance of the proposition that the Member State in which a company seeks to establish itself may freely apply to it a different treatment solely by reason of the fact that its registered office is situated in another Member State would deprive Article 43 EC of all meaning (see Case 270/83 *Commission* v *France* [1986] ECR 273, paragraph 18).

38 In each specific situation, it is necessary to consider whether the fact that a tax advantage is available solely to resident taxpayers is based on relevant objective elements apt to justify the difference in treatment.

39 In a situation such as that in the proceedings before the national court, it must be accepted that by taxing resident companies on their worldwide profits and non-resident companies solely on the profits from their activities in that State, the parent company's Member State is acting in accordance with the principle of territoriality enshrined in international tax law and recognised by Community law (see, in particular, *Futura Participations and Singer*, paragraph 22).

40 However, the fact that it does not tax the profits of the non-resident subsidiaries of a parent company established on its territory does not in itself justify restricting group relief to losses incurred by resident companies.

41 In order to ascertain whether such a restriction is justified, it is necessary to consider what the consequences would be if an advantage such as that at issue in the main proceedings were to be extended unconditionally.

42 On that point, the United Kingdom and the other Member States which submitted observations put forward three factors to justify the restriction.

43 First, in tax matters profits and losses are two sides of the same coin and must be treated symmetrically in the same tax system in order to protect a balanced allocation of the power to impose taxes between the different Member States concerned. Second, if the losses were taken into consideration in the parent company's Member State they might well be taken into account twice. Third, and last, if the losses were not taken into account in the Member State in which the subsidiary is established there would be a risk of tax avoidance.

44 As regards the first justification, it must be borne in mind that the reduction in tax revenue cannot be regarded as an overriding reason in the public interest which may be relied on to justify a measure which is in principle contrary to a fundamental freedom (see, in particular, Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 49 and the case-law cited).

45 None the less, as the United Kingdom rightly observes, the preservation of the allocation of the power to impose taxes between Member States might make it necessary to apply to the economic activities of companies established in one of those States only the tax rules of that State in respect of both profits and losses.

46 In effect, to give companies the option to have their losses taken into account in the Member State in which they are established or in another Member State would significantly jeopardise a balanced allocation of the power to impose taxes between

Member States, as the taxable basis would be increased in the first State and reduced in the second to the extent of the losses transferred.

47 As regards the second justification, relating to the danger that losses would be used twice, it must be accepted that Member States must be able to prevent that from occurring.

48 Such a danger does in fact exist if group relief is extended to the losses of non-resident subsidiaries. It is avoided by a rule which precludes relief in respect of those losses.

49 As regards, last, the third justification, relating to the risk of tax avoidance, it must be accepted that the possibility of transferring the losses incurred by a non-resident company to a resident company entails the risk that within a group of companies losses will be transferred to companies established in the Member States which apply the highest rates of taxation and in which the tax value of the losses is therefore the highest.

50 To exclude group relief for losses incurred by non-resident subsidiaries prevents such practices, which may be inspired by the realisation that the rates of taxation applied in the various Member States vary significantly.

51 In the light of those three justifications, taken together, it must be observed that restrictive provisions such as those at issue in the main proceedings pursue legitimate objectives which are compatible with the Treaty and constitute overriding

reasons in the public interest and that they are apt to ensure the attainment of those objectives.

52 That analysis is not affected by the indications, set out in the second part of the first question, relating to the arrangements applicable in the United Kingdom:

— to the profits and losses of a foreign subsidiary of a company established in that Member State;

— to the dividends distributed to a company established in that State by a subsidiary established in another Member State.

53 None the less, the Court must ascertain whether the restrictive measure goes beyond what is necessary to attain the objectives pursued.

54 Marks & Spencer and the Commission contended that measures less restrictive than a general exclusion from group relief might be envisaged. By way of example, they referred to the possibility of making relief conditional upon the foreign subsidiary's having taken full advantage of the possibilities available in its Member State of residence of having the losses taken into account. They also referred to the possibility that group relief might be made conditional on the subsequent profits of the non-resident subsidiary being incorporated in the taxable profits of the company which benefited from group relief up to an amount equal to the losses previously set off.

55 In that regard, the Court considers that the restrictive measure at issue in the main proceedings goes beyond what is necessary to attain the essential part of the objectives pursued where:

— the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods, if necessary by transferring those losses to a third party or by offsetting the losses against the profits made by the subsidiary in previous periods, and

— there is no possibility for the foreign subsidiary's losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.

56 Where, in one Member State, the resident parent company demonstrates to the tax authorities that those conditions are fulfilled, it is contrary to Articles 43 EC and 48 EC to preclude the possibility for the parent company to deduct from its taxable profits in that Member State the losses incurred by its non-resident subsidiary.

57 It is also important, in that context, to make clear that Member States are free to adopt or to maintain in force rules having the specific purpose of precluding from a tax benefit wholly artificial arrangements whose purpose is to circumvent or escape national tax law (see, to that effect, *ICI*, paragraph 26, and *De Lasteyrie du Saillant*, paragraph 50).

58 Furthermore, in so far as it may be possible to identify other, less restrictive measures, such measures in any event require harmonisation rules adopted by the Community legislature.

59 Accordingly, the answer to the first question must be that, as Community law now stands, Articles 43 EC and 48 EC do not preclude provisions of a Member State which generally prevent a resident parent company from deducting from its taxable profits losses incurred in another Member State by a subsidiary established in that Member State although they allow it to deduct losses incurred by a resident subsidiary. However, it is contrary to Articles 43 EC and 48 EC to prevent the resident parent company from doing so where the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods and where there are no possibilities for those losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.

Question 2

60 In the light of the answer to the first question, there is no need to answer the second question.

Costs

61 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Grand Chamber) hereby rules:

As Community law now stands, Articles 43 EC and 48 EC do not preclude provisions of a Member State which generally prevent a resident parent company from deducting from its taxable profits losses incurred in another Member State by a subsidiary established in that Member State although they allow it to deduct losses incurred by a resident subsidiary. However, it is contrary to Articles 43 EC and 48 EC to prevent the resident parent company from doing so where the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods and where there are no possibilities for those losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.

[Signatures]