Procedure file

Basic information

INI - Own-initiative procedure	2007/2144(INI)	Procedure completed
Tax treatment of losses in cross-border situations Subject 3.45.04 Company taxation		

Key players

European Parliament	Committee responsible	Rapporteur	Appointed
	ECON Economic and Monetary Affairs		13/02/2007
		PPE-DE KAUPPI Piia-Noora	
	Committee for opinion	Rapporteur for opinion	Appointed
	IMCO Internal Market and Consumer Protection	The committee decided not to give an opinion.	
	JURI Legal Affairs		10/09/2007
		PPE-DE GARGANI Giuseppe	
European Commission	Commission DG	Commissioner	
	Internal Market, Industry, Entrepreneurship and SMEs	KOVÁCS László	

Key events

19/12/2006	Non-legislative basic document published	COM(2006)0824	Summary
21/06/2007	Committee referral announced in Parliament		
21/11/2007	Vote in committee		Summary
30/11/2007	Committee report tabled for plenary	A6-0481/2007	
14/01/2008	Debate in Parliament		
15/01/2008	Results of vote in Parliament		
15/01/2008	Decision by Parliament	T6-0008/2008	Summary
15/01/2008	End of procedure in Parliament		

Technical information

Procedure reference	2007/2144(INI)
Procedure type	INI - Own-initiative procedure

Procedure subtype	Initiative
Legal basis	Rules of Procedure EP 54
Stage reached in procedure	Procedure completed
Committee dossier	ECON/6/49695

Documentation gateway

Non-legislative basic document		COM(2006)0824	19/12/2006	EC	Summary
Committee draft report		PE393.905	05/09/2007	EP	
Amendments tabled in committee		PE394.172	03/10/2007	EP	
Committee opinion	JURI	PE396.466	20/11/2007	EP	
Committee report tabled for plenary, single reading		A6-0481/2007	30/11/2007	EP	
Text adopted by Parliament, single reading		T6-0008/2008	15/01/2008	EP	Summary
Commission response to text adopted in plenary		SP(2008)1176	27/02/2008	EC	
Commission response to text adopted in plenary		SP(2008)1340	18/03/2008	EC	

Tax treatment of losses in cross-border situations

PURPOSE: to report on the tax treatment of losses in cross-border situations.

CONTENT: the Commission has prepared this report within the context of coordinating Member States? direct tax system in the Internal Market. The specific purpose of this report is to explain the basic principles and problems regarding cross-border loss relief and to suggest ways in which the Member Stats can consider allowing cross-border relief of losses.

The issue of tax losses in cross-border situations: Virtually all tax systems within the EU treat profits and losses asymmetrically. Profits are taxed for the tax year in which they are earned but the tax value of a loss is not refunded when the loss is incurred. In order not to become ?over-taxed? companies will therefore typically set losses off against another positive tax base within the company or within a group of companies. In this way they avoid cash-flow disadvantages that result from the time lag for setting off the loss. A company with several domestic branch operations will, in principle, be automatically taxed on the net result. In most other situations, relief for losses is possible only when authorised by a specific provision adopted by the respective Member States.

The internal market and the impact on business decisions: Varying national rules on cross-border losses by the Member States impact on the functioning of the internal market. The lack of cross-border loss relief creates a barrier to entering other markets, which in turn perpetuates the artificial segmentation of the internal market along national lines. Due to economies of scale, companies in large Member States have an advantage over potential competitors from smaller Member States ? even where the latter are more innovative and efficient. Thus, the lack (or limited) availability of cross-border loss relief, favours domestic investments and acts as a disincentive to investments in other Member States; favours cross-border investment in larger Member States; favours large companies to the disadvantage of SME?s; and influences the choice between a permanent establishment and a subsidiary as a form of establishment.

Losses within one company ? the issue of losses incurred by permanent establishments: When it comes to the issue of losses incurred by permanent establishments, the report notes that this could, potentially, hinder companies from establishing themselves outside of the country in which they are established. For example, where losses incurred by permanent establishments may not be set off against profits of a head office (vertical upward set-off), there will be a difference in treatment when compared to a purely domestic situation. This makes it less attractive to exercise freedom of establishment and a company may refrain from setting up a permanent establishment in another Member States. Indeed, the ECJ explicitly states, in the AMID case, that a company with a permanent establishment abroad is in a comparable situation to that of a company who is not.

Losses within a group of companies ? the issue of losses incurred by foreign subsidiaries: Groups of companies do not have legal personality under corporate law, nor is such a group recognised as a single taxable entity in its own right. With a group of companies, therefore, losses are not taken into account automatically in the way there are within a single company. However, a number of Member States have introduced a domestic system for group taxation in order to treat a group as a single economic unit, though only a limited, albeit increasing number of Member States, have loss relief systems that also apply to cross-border situations. This lack of a domestic group taxation scheme can also distort investment decisions regarding the legal form of the investment and favour the establishment of a branch rather than a subsidiary.

Alternatives for cross-border loss relief: In theory there are three possible alternatives which provide for such a minimum level of loss compensation. These alternatives do not differ when losses are taken into account but do differ with regard to their treatment of future profits of subsidiary at the level of the parent company. The three alternatives are:

I. definitive loss transfer (inter-group loss transfer): This scheme would lead to a definitive transfer of losses or profits without recapture, unless counterbalancing measures have been introduced. One way of neutralising the effect on the revenue of the

Member States, in which a loss-absorbing company is resident, would be to introduce a clearing system so that the Member State of the company surrendering the loss would compensate the Member State of the company absorbing the loss. The system would need to take account of any significant differences between applicable tax rates and tax accounting rules. Special attention would also have to be given to tax planning issues.

II. temporary loss transfer (deduction /reintegration method): Under this scheme a loss incurred by a subsidiary situated in another Member State and which was deducted from the results of the parent company, is subsequently recaptures once the subsidiary returns to profitability. This results in temporary transfer of losses. This was the approach chosen in the 1990 proposal for a Directive. The advantage of this method is that it is relatively easy to operate.

III. current taxation of subsidiary?s results (system of consolidated profits): Under this system, the profits and losses for a given tax year of selected, or all group members, are taken into account over a certain time period at the level of the parent company. Consolidated subsidiaries would be treated in the same manner as permanent establishments. The credit method would be applied to eliminate double taxation. Tax paid by a subsidiary in its State of residence would be credited against the tax payable in the Member State of the parent company in respect of income from the subsidiary. Profit distribution between the group members would not be taken into account. The application of such a scheme is not linked or limited to the existence of losses. Therefore, once a subsidiary has been elected to participate in such a scheme, it will normally be applied for a certain period for time. A system of consolidated profits could consist of either a selective scheme or a comprehensive scheme.

Conclusion: In its conclusion, the Commission stresses the need for an effective cross-border loss relief scheme within the EU. The limited availability of cross-border loss relief is one of the most significant obstacles to cross-border business activity. Those who will most benefit from such a scheme are SME?s?, who currently suffer from the lack of such relief.

Thus, where Member States do not allow losses incurred by permanent establishment in other Member States to be taken into account, the Commission strongly encourages these Member States to review their tax systems in order to promote the freedom of establishment provided by the EU Treaty. The Commission also strongly encourages Member States to introduce and maintain domestic tax systems for loss relief within a group of companies that offer treatment equivalent to that provided for loss relief within a single company. This would eliminate distortions and enhance the attractiveness of the country in question as an investment location. Finally, the Commission stresses the need to make cross-border loss relief within a group of companies more widely available, for the development of businesses across the single market and world wide.

Three possible approaches are being offered for cross-border loss relief. The response should be co-ordinated in order to maximise the benefits for the internal market and in order to reduce any unnecessary duplication of effort within the 27 EU Member States. The Commission, therefore, invites the Council, European Parliament to examine the proposals set out in this Communication with a view to urging the Member States to:

- review existing national systems to provide relief for losses within a company in cross-border situations;
- rapidly implement one or more of the possible solutions presented in this Communication for the treatment of losses incurred within groups of companies; and
- consider how the suggestions set out in this Communication can be applied to both domestic and cross-border situations by improving existing loss relief schemes and by introducing new ones.

Tax treatment of losses in cross-border situations

The Committee on Economic and Monetary Affairs adopted the own-initiative report by Piia-Noora KAUPPI (EPP-ED, FI) in response to the Commission communication on tax treatment and losses in cross-border situations.

MEPs express concern over the negative impact that the different treatment of cross-border losses by Member States has on the functioning of the internal market. They consider that differing company tax regimes create obstacles to entering different national markets and the proper functioning of the internal market, distort competition, and prevent the maintenance of a level playing field for undertakings at EU level.

The report underlines that any targeted measure to introduce cross-border loss relief should be defined and implemented on the basis of a multilateral, common approach and coordinated action by the Member States. It recalls that such targeted measures represent an intermediate solution pending the adoption of the Common Consolidated Corporate Tax Base (CCCTB) which constitutes a comprehensive long term solution for tax obstacles linked to the cross-border offsetting of losses and profits.

MEPs consider that action in favour of groups of companies that do business in several Member States should be a priority, as it is precisely those groups that suffer from different treatment with regard to cross-border losses, compared to groups of companies that do business in one Member State only.

Acknowledging that simply extending domestic regimes to cross-border situations is difficult as the tax bases are different, the report urges that the relevance of cross-border loss relief be acknowledged whilst underlining that further in-depth elaboration is necessary as regards the cross-border loss relief scheme.

The committee believes that corporate groups present in several Member States should be treated as far as possible in the same way as groups present in a single Member State. In situations involving cross-border losses by foreign subsidiaries, double-taxation of the parent company must be avoided, fiscal competence must be fairly distributed between Member States, losses may not be offset twice and tax avoidance must be prevented.

The report reiterates the importance of defining the concept of 'corporate group' in order to prevent firms from opportunistically distributing profits and losses among Member States. It also notes that a further thorough analysis is of great importance with respect to assessing the extent to which the proposed cross-border loss relief scheme could promote the cross-border activity of SMEs.

Tax treatment of losses in cross-border situations

The European Parliament adopted a resolution based on the own-initiative report drafted by Piia-Noora KAUPPI (EPP-ED, FI) in response to the Commission communication on tax treatment and losses in cross-border situations. The resolution was adopted by 491 votes for, 109 against, and 90 abstentions. Parliament stated that the existence of 27 different tax systems in the EU constituted an impediment to the smooth functioning of the internal market, caused significant additional costs for cross-border trade in terms of administration and compliance, hindered corporate restructuring, and lead to cases of double taxation.

MEPs expressed concern over the negative impact that the different treatment of cross-border losses by Member States has on the functioning of the internal market. They noted that any measure which impeded the freedom of establishment was contrary to Article 43 of the EC Treaty and that its removal ought thus to be the focus of targeted action. Differing company tax regimes created obstacles to entering different national markets and the proper functioning of the internal market, distort competition, and prevent the maintenance of a level playing field for undertakings at EU level and thus merited attention of this kind. Targeted action at EU level in respect of tax deductions of cross-border losses could be of greater benefit to the functioning of the internal market.

Parliament stressed that any targeted measure to introduce cross-border loss relief should be defined and implemented on the basis of a multilateral, common approach and coordinated action by the Member States in order to guarantee the coherent development of the internal market. Such targeted measures represented an intermediate solution pending the adoption of the Common Consolidated Corporate Tax Base (CCCTB), which constituted a comprehensive long-term solution for tax obstacles linked to the cross-border offsetting of losses and profits, as well as for transfer pricing and cross-border merger and acquisition and restructuring operations.

Parliament considered that action in favour of groups of companies that did business in several Member States should be a priority, as it was precisely those groups that suffered from different treatment with regard to cross-border losses, compared to groups of companies that did business in one Member State only. The distortions arising from the difference in national systems penalised SMEs in particular in comparison with their potential competitors and the Commission should adopt specific measures in that area.

Acknowledging that simply extending domestic regimes to cross-border situations was difficult as the tax bases were different, Parliament urged that the relevance of cross-border loss relief be acknowledged whilst underlining that further in-depth elaboration was necessary as regards the cross-border loss relief scheme. A decision should be taken as to whether cross-border loss relief should be limited to subsidiaries as regards their parent company or vice versa and a thorough assessment should therefore be made of the budgetary effects of the scheme whereby the subsidiaries' profits are allowed to set off the parent company's losses. Parliament discussed the judgment of the Court of Justice in the Marks & Spencer case and in the Oy AA case. It believed that corporate groups present in several Member States should be treated as far as possible in the same way as groups present in a single Member State. In situations involving cross-border losses by foreign subsidiaries, double-taxation of the parent company must be avoided, fiscal competence must be fairly distributed between Member States, losses may not be offset twice and tax avoidance must be prevented.

Parliament welcomed the three options proposed in the Commission communication on Tax Treatment of Losses in Cross-Border Situations. It signalled its support for targeted measures which would enable the effective and immediate deduction of losses by foreign subsidiaries (on an annual and not simply terminal basis, as in the Marks and Spencer case) which would be recaptured once the subsidiary returns to profit through a corresponding additional tax on the parent company. It recommended, in order that those proposals could be implemented in such a way as to prevent tax evasion, considering whether it would be appropriate to establish an automatic information exchange system, similar to the VIES for VAT, so that the Member States could check the existence of negative tax bases declared by subsidiary companies in other Member States. Nonetheless, Parliament urged the Commission to investigate further the possibilities of providing companies with a consolidated corporate tax base for their EU-wide activities.