Case C-28/17, *NN*

CJEU issued its judgment on the compatibility with the TFEU of Danish legislation limiting the use, within domestic fiscal units, of losses incurred by Danish PEs of EU companies

On 4 July 2018, the Court of Justice of the European Union ("Court") issued its judgment in Case C-28/17, *NN*. The case concerned a Danish parent company ("Danish Parent") which held shares in a Swedish subsidiary ("Swedish Subsidiary") with a Danish permanent establishment ("Danish PE"). The Danish Parent and the Danish PE were part of a fiscal unit in Denmark.

The Danish PE incurred in Denmark a loss resulting from the merger with the permanent establishment of another Swedish company of the Group, as that merger was not treated as tax neutral for Danish tax purposes. On the contrary, the merger was considered tax neutral in Sweden; as a consequence, no tax loss occurred for Swedish tax purposes. The Danish Parent could not use the loss of the Danish PE to reduce the taxable profits of the fiscal unit because of the limitation imposed by Danish legislation, under which the losses of domestic permanent establishments of foreign companies may be used within the fiscal unit only if the tax rules of the States in which those companies are resident provide that such losses cannot be set off in the calculation of the company's income in those States.

The Court first found that the Danish legislation established a difference in treatment, as the limitation on the use of losses applicable to Danish groups having a non-resident subsidiary with a Danish PE did not apply to purely Danish groups (para. 29).

Second, based on its recent decision in the case C-650/16, *Bevola* (see our EU Tax Alert 2018/12), it acknowledged that non-resident subsidiaries with a domestic PEs and resident subsidiaries with a domestic PE are not, in principle, in comparable situations. In reaching this conclusion, the Court assessed comparability having regard to the objective pursued by the special Danish rule limiting the use of losses in cross-border situations, rather than considering the objective pursued by the general Danish rule allowing the use of losses with Group of companies (para.34). It is worth mentioning that the use of the latter objective, as reference for assessing comparability (i.e. allowing the set-off of territorially relevant profits and losses incurred by different companies of a Group), would have led the Court to reach the opposite conclusion.

That notwithstanding, the Court recognized that those situations become comparable where the losses of the domestic PE cannot be used in in the State of residence of the company to which the PE belongs (para. 35). In that situation (which is for the referring court to ascertain), the different tax treatment of cross-border and purely domestic groups amounts to a *prima facie* restriction of the relevant EU freedom.

The Court then analysed whether that restriction could be justified by any overriding reason in the public interest. In this respect, it discharged the possibility to invoke the argument of the balanced allocation of taxing rights, as the double deduction of the loss would favour neither of the two Member States concerned to the detriment of the other (para. 40).

With regard to the justification represented by the need to prevent the double use of losses, the Court made two interesting statements. First, it found that, where the tax treaty between the State of the PE and the State of residence of the Company provides for the credit method to eliminate international juridical double taxation, the parallel exercise of the powers of taxation by those States does not entail an actual obligation for the company to pay income tax twice. In those circumstances, the possibility to deduct the losses of such an establishment twice (i.e. once in the residence State and once in the PE State) does not appear justified and would amount to an unjustified advantage for cross-border situations over purely domestic situations (paras. 47 and 48). Second, it acknowledged that a national legislation, such as the one in the main proceeding, would nonetheless 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. This would be the case, for instance, where it was actually impossible to use the loss in the State of residence of the company (paras. 53-55). One might dispute, however, whether this condition is satisfied in the case where the residence State treats a merger as neutral for tax purposes since, in that case, the non-recognition of the loss as a result of the merger is generally balanced by the possibility for the resulting company to deduct a higher value of assets and liabilities in the subsequent tax years.

The decision of the Court is at variance with ATAD II, which, in respect of intra-EU cases of double deduction, provides that it should be the State of the investor (i.e. the residence State) to deny the use of the losses. The State of the PE, on the other hand, should continue to allow the loss deduction according to its standard regime. In this respect, although the Court's decision could provide the basis for the Italian legislature to amend the current rules on tax consolidation, which do not make the use of losses incurred by domestic PEs subject to the requirement that they are not also deducted in the residence State, it seems more reasonable that Italian rules will be only amended in order to comply with the provisions of ATAD II, which shall be applied by the Member States as from 1 January 2020.

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