

**Euro Tax Flash**

**Issue 231 - July 18, 2014**

## **Euro Tax Flash from KPMG's EU Tax Centre**



### **CJEU Decision in the Nordea case**

Freedom of establishment – recapture of foreign losses – balanced allocation of taxing rights

On July 17, 2014, the CJEU rendered its decision in the Nordea Bank case ([C-48/13](#)) concerning Denmark's recapture rule of tax losses incurred by a foreign permanent establishment. The Court held that the Danish provision constituted a restriction of the freedom of establishment, which could be deemed a justifiable restriction but was found not proportional to the objectives pursued.

#### **Background**

Nordea Bank was a Danish company engaged in retail banking activities in Finland, Sweden and Norway through permanent establishments. Under Danish tax law, resident companies took into account the profits and losses incurred by permanent establishments located abroad when determining their taxable income. In the event of a partial or complete transfer of the activities of a foreign permanent establishment to an affiliated company, Danish tax law provided for any gain made upon the transfer to be incorporated in the taxable income of the company carrying out the transfer, and any losses from the permanent establishment that were previously deducted but had not been matched by subsequent

profits to be recaptured.

In the course of a restructuring, Nordea's permanent establishments were closed and transferred to local affiliated companies. This triggered not only a tax on the realized gains but also a recapture of the tax losses that the Danish head office had previously deducted from its taxable income.

### **The CJEU's decision**

The Court held that the Danish provisions constituted a restriction on the freedom of establishment, as Danish companies having a foreign permanent establishment were treated less favorably than if they had a comparable domestic establishment. This was because of the recapture mechanism for losses deducted in respect of foreign permanent establishments, which did not apply if establishments in Denmark are transferred in identical circumstances.

According to settled case law, a restriction on the freedom of establishment is permissible only when it relates to situations which are not objectively comparable or when justified by overriding reasons in the public interest, to the extent the restriction is appropriate to attain its objective and does not go beyond what is necessary to do so.

In its judgment, the Court noted that Denmark had equated foreign permanent establishments to resident establishments by also taxing the profits of foreign permanent establishments and that they were therefore comparable. This was so regardless of the fact that Denmark applied a credit method to neutralize the risk of any double taxation. The Danish Government argued that the restriction on the freedom of establishment could be justified by the need to ensure a balanced allocation of taxing rights in connection with the prevention of tax avoidance. Denmark argued that the purpose of the recapture rule was to prevent groups from offsetting losses of a permanent establishment in Denmark and escaping Danish taxation by selling, just before the permanent establishment becomes profitable, to an affiliated company abroad, making the actual reincorporation of losses impossible for Denmark. The Court noted that an artificial arrangement of this kind would erode the Danish company's tax base and, thus, affect the allocation of the power to impose taxes. The Court accepted that this could justify the restriction, but concluded that the Danish legislation went further than was necessary to achieve this objective. In this respect, the CJEU noted that the objective of the balanced allocation of the power to impose taxes is to safeguard the symmetry between the right to tax profits and deduct losses.

According to the Court, this symmetry was maintained by the fact that losses could be offset by taxing the profits made throughout the period when the permanent establishment belonged to the resident company and those made at the time of the permanent establishment's transfer. However, the recapture of losses to counterbalance the loss of taxing rights of future profits went beyond what is necessary to attain the objective.

### **EU Tax Centre Comment**

This case may be of relevance for Member States applying a credit method with similar rules on the recapture of foreign losses; they may well have to readdress the EU compatibility of their rules.

Should you require further assistance in this matter, please contact the EU Tax Centre or, as appropriate, your local KPMG tax advisor.

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