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Case No: CA-2022-001053
CA-2022-001054

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
MR JUSTICE ROTH AND JUDGE JONATHAN RICHARDS
[2022] UKUT 78 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 01/03/2023

Before:

LADY JUSTICE ELISABETH LAING
LADY JUSTICE FALK
and
SIR LAUNCELOT HENDERSON

- -

Between:

(1) VOLKERRAIL PLANT LIMITED **(2) VOLKERRAIL POWER LIMITED** **(3) VOLKERFITZPATRICK LIMITED** **(4) VOLKER RAIL LIMITED**	**Appellants**
- and -	
THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE & CUSTOMS	**Respondents**

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- -

Nicola Shaw KC and **Kelly Stricklin-Coutinho** (instructed by **Ernst & Young LLP**) for the **Appellants**
David Ewart KC, **Mark Fell KC** and **Harry Winter** (instructed by **the Solicitor and General Counsel to the Commissioners for HMRC**) for the **Respondents**

Hearing date: 7 & 8 February 2023

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Approved Judgment

This judgment was handed down remotely at 10.45am on 1 March 2023 by circulation to the parties or their representatives by e-mail and by release to the National Archives.

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Lady Justice Falk:

INTRODUCTION

1. The issue in this appeal is whether a provision in the group relief rules in force in the periods in question, s.403D(1)(c) of the Income and Corporation Taxes Act 1988 ("ICTA"), is compatible with the principle of freedom of establishment now set out in Articles 49 and 54 of the Treaty on the Functioning of the European Union ("TFEU"), and if not, whether s.403D(1)(c) can be read with a conforming interpretation, or must be disapplied.

2. This question might be thought to have been answered by Case C-18/11 *HMRC v Philips Electronics UK Limited* [2013] 1 CMLR 6; [2013] STC 41 ("*Philips*"), in which s.403D(1)(c) was held to impose a restriction on freedom of establishment which could not be justified, with the result that the national court was required to disapply it. The decision in *Philips* was reflected in a change in UK legislation with effect from 1 April 2013 which substantially modified the restriction as it applied within the EEA, a change which was only reversed in 2021 following the UK's departure from the EU.

3. However, HMRC now take the position that s.403D(1)(c) is compatible with the right of freedom of establishment, on the basis that the Court of Justice ("CJEU" or the "Court") must be taken to have departed from *Philips* in a case decided in 2018, Case C-28/17 *NN A/S v Skatteministeriet* ("*NN*") EU:C:2018:526. HMRC's view is challenged by the taxpayers in this case, a challenge that succeeded before the First-tier Tribunal ("FTT") in a decision of Judge Brooks released on 16 November 2020 (the "FTT decision") but largely failed before the Upper Tribunal ("UT") (Roth J and Judge Jonathan Richards) in a decision reported at [2022] UKUT 78 (TCC); [2022] STC 735 (the "UT decision"). The UT decided that, in the light of *NN*, s.403D(1)(c) should not be disapplied but could be "read down" in a manner that complied with EU law.

4. Both parties have appealed the UT decision. In outline the taxpayers, who were the substantial losers in financial terms, appeal principally against the UT's conclusions that, while s.403D(1)(c) did restrict freedom of establishment, it could be: a) justified; and b) subject to a conforming interpretation. HMRC appeal against the conclusions that s.403D(1)(c): a) did amount to a restriction on freedom of establishment; b) was disproportionate; or alternatively c) could be subject to the conforming interpretation adopted by the UT, as opposed to an alternative interpretation put forward by HMRC. HMRC contend in the alternative that this court should exercise its powers under s.6 of the European Union (Withdrawal) Act 2018 ("EUWA") and the European Union (Withdrawal) Act 2018 (Relevant Court) (Retained EU Case Law) Regulations 2020 (the "EUWA Regulations") to depart from EU law.

5. I will start with a relatively brief explanation of the relevant tax rules and some general comments about the CJEU's approach, before summarising the facts and the relevant case law.

THE LEGAL BACKGROUND

Group relief and s.403D(1)(c) of ICTA

6. In outline, the UK corporation tax system permits trading losses and certain other amounts eligible for relief from corporation tax to be "surrendered" to another member of the same group and set off against the taxable profits of that other company (the "claimant"). For these purposes a group is defined by reference to direct or indirect ownership of at least 75% of ordinary share capital by a common parent, subject to detailed rules intended to ensure that the share ownership corresponds to economic ownership and control. Relief is also available as between certain companies owned by a consortium (essentially, joint-venture companies) and consortium members or their respective groups, in which case relief is available on a proportional basis, corresponding to the percentage shareholding and economic interest owned in the consortium by the relevant shareholder. For convenience I will refer to both types of relief as "group relief".

7. At the relevant time the group relief legislation was contained in Chapter IV of Part X of ICTA. Following changes made by s.97 of and Schedule 27 to the Finance Act 2000 in the light of *ICI v Colmer* (Case C-264/96 and [1998] STC 874; [1999] STC 1089 (HL)), relief was made available not only to companies resident for tax purposes in the UK ("UK tax resident" companies) but to the UK branches of non-resident companies (in tax terminology, UK "permanent establishments"), which were permitted to surrender and claim group relief with effect from 1 April 2000. The changes made by the Finance Act 2000 also permitted group relationships to be established through non-UK resident companies, which had not previously been possible under the domestic rules.

8. Section 403D is the principal provision that was inserted into ICTA to regulate surrenders by and to UK branches of non-resident companies. In the version in force during the relevant periods, and so far as material, it provided:

> "**403D.— Relief for or in respect of UK losses of non-resident companies**
> (1) In determining for the purposes of this Chapter the amounts for any accounting period of the losses and other amounts available for surrender by way of group relief by a non-resident company carrying on a trade in the United Kingdom through a permanent establishment, no loss or other amount shall be treated as so available … except in so far as—
> (a) it is attributable to activities of that company the income and gains from which for that period are, or (were there any) would be, brought into account in computing the company's chargeable profits for that period for corporation tax purposes;
> (b) it is not attributable to activities of the company which are made exempt from corporation tax for that period by any double taxation arrangements; and
> (c) no part of—
> (i) the loss or other amount, or
> (ii) any amount brought into account in computing it,

> corresponds to, or is represented in, any amount which, for the purposes of any foreign tax, is (in any period) deductible from or otherwise allowable against non-UK profits of the company or any other person.
>
> (2) In determining for the purposes of sections 403A and 403C the total profits for an accounting period of a non-resident company, there shall be disregarded—
>
> (a) amounts not falling to be comprised for corporation tax purposes in the chargeable profits of the company for that accounting period, and
>
> (b) so far as not falling within paragraph (a) above, any amounts arising from activities which are made exempt from corporation tax for that period by any double taxation arrangements.
>
> (3) In this section 'non-UK profits', in relation to any person, means amounts which—
>
> (a) are taken for the purposes of any foreign tax to be the amount of the profits, income or gains on which (after allowing for deductions) that person is charged with that tax, and
>
> (b) are not amounts corresponding to, and are not represented in, the total profits (of that or any other person) for any accounting period,
>
> or amounts taken into account in computing such amounts.
>
> (4) Subsection (2) above applies for the purposes of subsection (3)(b) above as it applies for the purposes of sections 403A and 403C.
>
> …
>
> (7) For the purposes of this section activities of a company are made exempt from corporation tax for any period by double taxation arrangements if the effect of any such arrangements is that the income and gains (if any) arising for that period from those activities is to be disregarded in computing the company's chargeable profits.
>
> (8) In this section 'double taxation arrangements' means any arrangements having effect by virtue of section 788.
>
> (9) In this section 'foreign tax' means any tax chargeable under the law of any territory outside the United Kingdom which—
>
> (a) is charged on income and corresponds to United Kingdom income tax; or
>
> (b) is charged on income or chargeable gains or both and corresponds to United Kingdom corporation tax,
>
> but for the purposes of this section a tax shall not be treated as failing to correspond to income tax or corporation tax by reason only that it is chargeable under the law of a province, state or other part of a country, or is levied by or on behalf of a municipality or other local body.
>
> …"

9. As can be seen, s.403D(1) imposed three restrictions on the surrender of losses made by UK permanent establishments. The first two are uncontroversial and relate, broadly, to whether profits of the relevant activity would have been subject to corporation tax. The third, which is in issue in this case, denied group relief where the relevant loss, or an amount brought into account in computing it, was "deductible from or otherwise allowable against" non-UK profits of any person, as defined in s.403D(3).

10. Section 403D(2) was relevant where a non-resident company with a UK permanent establishment wished to claim group relief, rather than to surrender it as in this case. As can be seen it contained provisions broadly corresponding to s.403D(1)(a) and (b).

11. There was no equivalent to s.403D(1)(c) that operated to restrict the surrender of losses made in the UK by a UK tax resident company where those losses were deductible elsewhere. Section 403E of ICTA did contain a restriction on the surrender of foreign branch losses of UK resident companies where they were deductible against non-UK profits of another person in the overseas territory, but that obviously did not apply to profits with a UK source. Section 404 prohibited group relief entirely for losses of certain dual-resident companies, but that did not apply to trading companies. Further, no restriction was imposed on the ability of a non-resident company with a UK permanent establishment to carry trading losses forward and offset them against future UK branch profits of the same trade, or indeed to offset them against other taxable profits of the branch in the same period or carry them back to the previous period. However, s.411 of ICTA contained a general restriction on giving relief more than once under the UK rules.

UK/Netherlands DTC

12. The UK/Netherlands Double Taxation Convention ("DTC") is also relevant. Under Article 7 of the 2008 version of the DTC (SI 2009/227) the UK has the right to tax profits of a Dutch enterprise carried on through a permanent establishment in the UK. Article 21 deals with double taxation. It permits the Netherlands to tax its residents on a basis which includes income that the UK is permitted to tax under the terms of the DTC, but where Article 7 applies the Netherlands must exempt the income by allowing a reduction of tax. The 1980 version of the DTC contained similar provisions. (Reciprocal provisions apply to Dutch permanent establishments of UK entities, save that double tax is addressed via a credit rather than an exemption mechanism.)

CJEU case law and departures from earlier authority

13. The starting point is that the CJEU is not subject to the doctrine of precedent (*stare decisis*): Case C-262/96 *Sema Sürül v Bundesanstalt für Arbeit* [1999] EU:C:1999:228 ("*Sürül*") at AG36. As Advocate General La Pergola pointed out in that case, this means that the distinction between a *ratio decidendi* and an *obiter dictum* does not have the significance that it has in common law systems. Rather, "everything that is said in the text of the judgment expresses the will of the Court".

14. However, the Court's general practice is to follow its previous decisions for obvious reasons of consistency and legal certainty: Case C-267/95 *Merck v Primecrown* [1997] 1 CMLR 83 ("*Merck*") at AG142. In *Merck* Advocate General Fennelly noted that principles of Community law are to a large extent judge-made and thus not amenable to legislative change, and that the Court's main function in providing preliminary rulings is to ensure the uniform application of Community law. He also referred to the principle that issues need not be referred to the CJEU where the relevant point of law has already been addressed. He said that the practice of following earlier case law would apply unless there were "strong reasons" not to do so. In *Sürül* the Advocate General referred to the potential for a different answer to be given to a preliminary question dealt with on a previous occasion "if such a result is justified by new matters brought to [the Court's] attention in the later proceedings".

15. There are few examples of cases where the CJEU has expressly departed from a previous decision. Further, HMRC identified only one decision, Joined cases C-115/81 and 116/81 *Adoui and Cornaille v Belgium* [1982] 3 CMLR 631, where the CJEU declined to follow an earlier decision (Case C-41/74 *Van Duyn v Home Office* [1975] Ch 358) without expressly saying so. *Adoui* concerned a refusal by the Belgian authorities to issue certificates of residence to two French nationals on the grounds that they worked in a bar "which was suspect from the point of view of morals". The Court ruled that access could not be refused on the basis of activity that would not have attracted sanction if it had been carried out by a Belgian national. In doing so it implicitly departed from *Van Duyn*, in which the UK had been held to be entitled to prevent entry to the UK by a person planning to work for the Church of Scientology.

16. A further general point, touched on by the Advocate General in *Merck*, relates to the CJEU's function in providing rulings on references by national courts. Its function is not to decide the case which is the subject of the reference to it, nor to determine points of national law. Its role is to interpret EU law and provide authoritative (and indeed binding) guidance on it not only to the national court in question but to other national courts. Consistently with the Court's role of ensuring the uniform application of EU law, it routinely reframes questions and expresses its answers to them in ways that are not specific to the particular national legislation or legal issue that has been raised in the reference.

THE FACTS

17. The facts are relatively straightforward and were undisputed:

    a) The four appellant taxpayers, to which I shall refer collectively as "VolkerRail", are all UK incorporated and tax resident members of a group of companies whose ultimate parent is Koninklijke VolkerWessels NV ("KVW"), a company incorporated and tax resident in the Netherlands. The KVW group primarily undertakes building and construction projects in various sectors. Although now wholly owned by KVW, until 2008 three of the four VolkerRail companies were part of a 50:50 joint venture with another entity, Corus. The fourth, VolkerFitzpatrick Ltd, was at all material times wholly owned by KVW.

    b) Another member of the KVW group is Volker Stevin Construction Europe BV ("VSCE"), a company incorporated and tax resident in the Netherlands. At all material times VSCE had a UK branch ("VSCE UK").

    c) During the accounting periods ended 31 December 2004 to 31 December 2008 VSCE UK incurred losses of €45,966,000 in the course of its commercial operations.

    d) As a Dutch tax resident company, VSCE was within the charge to Dutch corporate income tax on its worldwide profits, including the results of VSCE UK. Until 1 January 2010 VSCE was also a member of a "fiscal unity" for corporate income tax purposes, under which it and other Dutch tax resident members of its group were treated as a single taxpayer, with tax being assessed on the parent entity. This meant that VSCE UK's losses were included in the corporate income tax return of the Dutch fiscal unity and set off against its taxable profits. The losses were set off in full against profits of the fiscal unity in the accounting

periods ending 31 December 2004 to 31 December 2009. (In fact there were two different fiscal unities over the period in question, but that is immaterial.)

e) However, the Dutch tax system also recognises that profits made by a foreign permanent establishment will typically be taxed in that location. The Netherlands accordingly grants relief from double taxation of profits, as it is required to do by the UK/Netherlands DTC. It does so by adjusting the overall tax due in a way that has the effect of exempting foreign source profits.

f) Losses from a foreign source are not similarly exempted, which was why VSCE UK's losses could be offset against profits of the fiscal unity in the way that they were. Instead, the Netherlands operates a recapture mechanism in the event that foreign profits are subsequently generated in the same jurisdiction as the foreign losses. The way in which the mechanism works is by disallowing double taxation relief against those foreign profits (that is, switching off the exemption) until the foreign losses have been effectively set off. The recapture mechanism operated in the year ended 31 December 2009, when VSCE UK reported a profit of €1,709,000.

g) VSCE left the fiscal unity with effect from 1 January 2010. It was undisputed that its departure was intended to limit the impact of the recapture mechanism. The effect was that VSCE became subject to Dutch corporate income tax as a single entity, and the recapture mechanism was restricted to its own subsequent UK profits rather than including UK profits of other entities within the fiscal unity. This resulted in a further recapture in respect of a profit of €173,000 in the year to 31 December 2010. The effect was that, of the total UK losses of €45,966,000, €1,882,000 had been recaptured by the end of 2010, leaving €44,084,000 subject to future recapture. However, by that stage VSCE had ceased trading, such that further recapture is unlikely.

h) The most relevant accounting periods for UK corporation tax purposes are those for the years ended 31 December 2007 to 31 December 2009, when VSCE UK incurred trading losses totalling around £38m. It sought to surrender the great majority of these losses by way of group relief to VolkerRail. For claimant companies other than VolkerFitzpatrick Ltd the surrender was by way of consortium relief up to the point they became wholly owned by KVW, so to that extent the claim was restricted to 50% of the losses. However, the bulk of the losses were surrendered to VolkerFitzpatrick Ltd.

i) Tax refunds were received but HMRC subsequently opened enquiries into all three periods. Enquiries were suspended pending the outcome of *Philips*, but closure notices were issued disallowing the claims in February 2019, relying on s.403D(1)(c) of ICTA.

18. It was common ground that the effect of the UT decision was that the original appeals by VolkerRail fell to be dismissed, save in relation to the €1,882,000 of losses that had been recaptured. If VolkerRail's appeal succeeds then the losses would be allowable in full, whereas if HMRC's appeal succeeds they would be wholly denied.

THE RELEVANT CJEU CASE LAW

Philips

19. The facts of *Philips* have strong similarities to the facts of this case. *Philips* concerned a claim by Philips Electronics UK Ltd ("PEUK") for consortium relief in respect of losses made by the UK branch of a Netherlands incorporated and tax resident company, LG Philips Displays Netherlands BV ("LGPD"), in the periods 2001 to 2004. LGPD was the subject of insolvency proceedings in 2006.

20. Relief was denied by HMRC, relying on s.403D(1)(c) of ICTA. PEUK challenged this on the basis that that provision was contrary to freedom of establishment. The UT made a reference to the CJEU in which it asked, in summary:

    a) whether the denial of a surrender by a UK permanent establishment of amounts that were deductible or allowable against non-UK profits (such that a surrender was only possible where it was clear that there could never be a deduction in another Member State) amounted to a restriction on freedom of establishment, in circumstances where there was no equivalent condition applicable to the surrender of UK losses of a UK resident company;

    b) if so, whether that restriction was capable of being justified on the basis of the need to prevent the double use of losses, to preserve the balanced allocation of taxing powers between Member States or a combination of both;

    c) if so, whether the restriction was proportionate to the justification(s); and

    d) if not, or the restriction was not justified, whether the UK was required to provide a remedy.

21. The CJEU concluded that provisions of the kind described, where a resident company was not subject to an equivalent condition in respect of losses it incurred in that State, did constitute a restriction on freedom of establishment which could not be justified based on the objective of preventing the double use of losses and/or preserving a balanced allocation of taxing power, and that the national court was required to disapply any such provision.

22. The CJEU recorded at [12]-[14] that the right to freedom of establishment (then contained in articles 43 and 48 of the Treaty Establishing the European Community) incorporated the right to exercise activities through a subsidiary, branch or agency, and expressly left it open to traders to choose the appropriate legal form. Companies were therefore allowed to choose a branch structure, subject to the same conditions as applied to subsidiaries. The Court then explained at [15] that the legislation in issue imposed conditions on the possibility of transferring losses of a permanent establishment in a Member State, while the transfer of losses sustained in that Member State by a resident company was not subject to any equivalent condition, and said at [16]:

> "Such a difference in treatment makes it less attractive for companies having their seat in other Member States to exercise the right to freedom of establishment through a branch. It follows that national legislation such as that at issue in the main proceedings restricts the freedom to choose the

> appropriate legal form in which to pursue activities in another Member State."

23. The CJEU went on to observe at [17] that for such a difference in treatment to be compatible with freedom of establishment it must relate to situations which are not objectively comparable or must be justified by an overriding reason in the public interest. It added:

> "The comparability of a Community situation with an internal situation must be examined having regard to the aim pursued by the national provisions at issue."

24. The CJEU then rejected an argument by the UK that the situation of a non-resident company with a permanent establishment in the UK, which is taxable only on the profits attributable to the permanent establishment, is not comparable to that of a resident company, taxable on all its income, saying at [19]:

> "The situation of a non-resident company with only a permanent establishment in the national territory and that of a resident company are, having regard to the objective of a tax regime such as that at issue in the main proceedings, objectively comparable in so far as concerns the possibility of transferring by means of group relief losses sustained in the United Kingdom to another company in that group."

25. The CJEU answered the first question referred to it by concluding at [20] that a condition of the kind in issue imposed on the transfer of losses by a permanent establishment, where a resident company was not subject to an equivalent condition, constituted a restriction on the freedom of a non-resident company to establish itself in another Member State.

26. The CJEU then moved on to the second question, which concerned justification. It framed the question as being whether a restriction of the kind in question could be "justified by overriding reasons in the public interest relating to the objective of preventing the double use of losses or the objective of preserving a balanced allocation of the power to impose taxes between Member States, or a combination of those two grounds".

27. The Court discussed the objective of preserving a balanced allocation of taxing power at [23] to [27]. It explained that the objective is "designed, inter alia, to safeguard the symmetry between the right to tax profits and the right to deduct losses". It observed that the taxing power of the Member State where the permanent establishment was situated (the "host" Member State) was not affected by the possibility of group relieving losses made by the permanent establishment. This was to be contrasted with the use of losses sustained in another Member State (where that other Member State would have the power to impose taxes), where the symmetry between the right to tax profits and the right to deduct losses would not be safeguarded. Accordingly, the host Member State could not use the objective of preserving the allocation of the power to impose taxes as a justification for imposing a condition on group relief for losses sustained by a permanent establishment of a non-resident company in circumstances where the transfer of losses sustained in that Member State by a resident company was not subject to any equivalent condition.

28. The Court's consideration of the other potential justification, double use of losses, is worth setting out in full:

> "28. As regards, secondly, the objective of preventing the double use of losses, it must be observed that even if such a ground, considered independently, could be relied on, it cannot in any event be relied on in circumstances such as those in the main proceedings to justify the national legislation of the host Member State.
> 29. The dispute in the main proceedings concerns the question whether the host Member State may impose certain conditions on the possibility of transferring, through group relief and to a resident company, losses sustained by the permanent establishment situated in that Member State of a non-resident company, while the transfer of losses sustained in that Member State by a resident company is not subject to any equivalent condition.
> 30. In such circumstances, the risk that those losses may be used both in the host Member State where the permanent establishment is situated and also in the Member State where the non-resident company has its seat has no effect on the power of the Member State where the permanent establishment is situated to impose taxes.
> 31. As observed by the A.G. in point AG49 et seq. of her Opinion, the losses transferred by the permanent establishment in the United Kingdom of LG.PD Netherlands to Philips Electronics UK, which is a resident company established in the United Kingdom, can be linked, in any event, to the United Kingdom's power to impose taxes. That power is not at all impaired by the fact that the losses transferred might also, in appropriate circumstances, be used in the Netherlands.
> 32. Consequently, in circumstances such as those of the main proceedings, the objective of preventing the risk of double use of losses cannot, as such, allow the Member State in which the permanent establishment is situated to exclude the use of losses on the ground that those losses may also be used in the Member State in which the non-resident company has its seat.
> 33. The host Member State, in whose territory the permanent establishment is situated, therefore cannot, in order to justify its legislation in a situation such as that in the main proceedings and in any event, plead as an independent justification the risk of the double use of losses.
> 34. The same is true, for the grounds set out in [23]-[33] of this judgment, with regard to a combination of the objective of preserving a balanced allocation of the power to impose taxes between the Member States and that of preventing the double use of losses.
> 35. It follows from the foregoing that the answer to the second question is that a restriction on the freedom of a non-resident company to establish itself in another Member State, such as that at issue in the main proceedings, cannot be justified by overriding reasons in the public interest based on the objective of preventing the double use of losses or the objective of preserving a balanced allocation of the power to impose taxes between Member States or by a combination of those two grounds."

29. In the light of its conclusion on this issue the CJEU did not consider the third question, proportionality, and answered the fourth question by confirming that the national court should disapply a provision contrary to article 43.

Bevola

30. Before turning to *NN* it is helpful to refer to another CJEU case, the decision of the Grand Chamber in Case C-650/16 *A/S Bevola & Jens W Trock ApS v Skatteministeriet* [2018] STC 1415 ("*Bevola*"). That case concerned a Danish incorporated and tax resident company, Bevola, that was part of a larger Danish owned group. Bevola had incurred losses in a permanent establishment in Finland. The Finnish branch had closed in 2009 and Bevola sought to deduct the losses for Danish corporation tax purposes in that year. The Danish tax authorities rejected the claim on the grounds that income from a foreign permanent establishment would not have been taxable absent a specific election for the group to be taxed on an international basis (which had not been made). Bevola challenged the rejection, arguing that it would have been permitted to deduct the losses had the permanent establishment in question been established in Denmark and pointing out that the losses could not be deducted in Finland following the closure.

31. The Court found that there was a difference in treatment and (in the context of a permanent establishment that had ceased activity such that losses could not be used in the location of the permanent establishment), objective comparability. However, it accepted the arguments of the Danish government that the restriction was justified by the maintenance of a balanced allocation of taxing powers and – given the direct link between the tax advantage conferred on a Danish permanent establishment and the inclusion of any profits of such an establishment in the Danish company's taxable results – by the need to ensure the coherence of the tax system. However, it went on to add:

> "52. Furthermore, the prevention of the risk of the double use of losses, while not expressly relied on by the Danish government, is also capable of justifying a restriction of freedom of establishment such as that at issue in the present case (see, to that effect, judgment of 3 February 2015, *European Commission v UK* (Case C-172/13) EU:C:2015:50, [2015] STC 1055, [2015] Ch 394, para 24).
>
> 53. The legislation at issue in the main proceedings can therefore be justified by overriding reasons in the public interest relating to the balanced allocation of powers of taxation between the member states, the coherence of the Danish tax system, and the need to prevent the risk of double deduction of losses."

32. The Court concluded that legislation such as that in issue was nevertheless disproportionate insofar as it prevented the deduction of "definitive" losses (as to which see further below).

NN

33. *NN* concerned a group with a Danish parent company, NN. NN owned two subsidiaries incorporated and tax resident in Sweden, Sverige 1 and Sverige 2. Each of those companies had a Danish permanent establishment. In 2006 the two branches merged by a transfer from Sverige 2 to create a single branch of Sverige 1. The group opted for the transfer to be treated as a tax-free restructuring in Sweden. In Denmark the transfer was treated as taxable, the effect of which was to allow the single branch to write off the acquisition cost of goodwill for Danish tax purposes. That produced a loss which under

the relevant "group taxation" rules could in principle be offset against profits of Danish resident companies (and other Danish branches) within the NN group.

34. However, the Danish corporation tax code included a provision, paragraph 31(2)(2) of the Selskabsskattelov (Law on corporation tax), which on the facts permitted relief to be obtained for the loss made by the combined branch only if Swedish tax law precluded relief against profits taxable in Sweden. The Danish tax authorities relied on that provision to deny NN's claim to offset losses, even though the effect of the election was that no relief would in fact be obtained in Sweden.

35. In contrast to the facts of *Philips*, another provision of the Danish law imposed a similar restriction on Danish resident companies, in that such a company could not claim a deduction for expenditure which under foreign tax rules could be deducted from income not subject to tax in Denmark.

36. The questions referred by the national court were clearly framed with *Philips* in mind. They were, in summary:

    a) what factors needed to be taken into account to determine whether resident companies were subject to an "equivalent condition" as referred to in *Philips* at [20];

    b) whether, if it was presumed that the Danish tax rules did not contain a difference in treatment of the kind described in *Philips*, a prohibition of the kind described "in a case in which the loss in the non-resident company's permanent establishment is also subject to the host country's power of taxation" itself constituted a restriction which had to be justified;

    c) if so, whether the restriction could be justified by the interest in preventing the double use of losses, the objective of ensuring a balanced distribution of powers of taxation between Member States or a combination of both; and

    d) if so, whether such a restriction was proportionate.

37. The CJEU reframed the questions put as follows:

> "16. By its questions, the referring court is asking, in essence, whether Article 49 TFEU must be interpreted as precluding national legislation concerning group taxation, pursuant to which resident companies in a group are permitted to deduct, from their overall profits, the losses of a resident permanent establishment of a non-resident subsidiary of the group only in the case where the rules applicable in the Member State in which the subsidiary has its registered office do not permit those losses to be deducted from the subsidiary's taxable profits."

38. The CJEU first considered whether there was a difference in treatment. At [22] to [26] it recorded the Danish Government's submission that, unlike the position in *Philips*, the Danish legislation contained an equivalent condition for resident companies, such that there was no difference in treatment. In the course of that discussion it referred to *Philips* in the following way at [24]:

> "In that judgment, the Court ruled that such a condition was contrary to the freedom of establishment, since the transfer of losses sustained by a resident company to another resident company in the same group was not subject to any equivalent condition."

39. However, the Court went on to accept NN's submission that paragraph 31(2)(2) established a difference in treatment of another nature, namely that if the Danish permanent establishment had been owned by one of the group's Danish subsidiaries then the losses could have been set off against the group's profits. It concluded at [29] that a difference in treatment was established because:

> "The tax treatment of a Danish group which owns a permanent establishment in Denmark through a non-resident subsidiary is, under Paragraph 31(2)(2) of the Law on corporation tax, less favourable than that of a group in which all of the companies have their registered offices in Denmark."

It went on to explain at [30]:

> "That difference in treatment is liable to render less attractive the exercise of freedom of establishment through the creation of subsidiaries in other Member States. It is, however, incompatible with the provisions of the Treaty only if it concerns situations which are objectively comparable."

40. Turning to comparability, the CJEU referred at [31] to case law that established that "comparability of a cross-border situation with an internal situation must be examined having regard to the objective pursued by the national provisions at issue". It went on as follows:

> "32. In the present case, it is apparent both from the terms of Paragraph 31(2)(2) of the Law on corporation tax and from the explanations provided by the Danish Government relating to that provision that the objective of the provision is to prevent the double deduction of losses.
>
> 33. The Court has held that, with regard to measures laid down by a Member State in order to prevent or mitigate the double taxation of a resident company's profits, companies which have a permanent establishment in another Member State are not, in principle, in a situation comparable to that of companies which have a resident permanent establishment (judgment of 12 June 2018, *Bevola and Jens W. Trock*, C-650/16, EU:C:2018:424, paragraph 37).
>
> 34. By analogy, the view must therefore be taken, as regards the measures intended to prevent the double deduction of losses, that a group whose non-resident subsidiary has a resident establishment is also not in a situation comparable to that of a group whose subsidiary, and the latter's permanent establishment, are also resident.
>
> 35. It is nevertheless important to make an exception for the situation in which there is no other possibility of deducting the losses of the non-resident subsidiary attributable to the permanent establishment which is

> resident in the Member State in which the subsidiary is established. In that situation, the group whose subsidiary is situated in another Member State is not in a different situation to that of the purely national group, in the light of the objective of preventing the double deduction of its losses. The tax-paying capacity of the two groups is then affected in the same way by the losses of their resident permanent establishment (see, to that effect, judgment of 12 June 2018, *Bevola and Jens W. Trock*, C-650/16, EU:C:2018:424, paragraph 38).
>
> 36. Admittedly, Paragraph 31(2)(2) of the Law on corporation tax removes the difference in treatment 'if the rules in the foreign State … in which the company is resident provide that a loss cannot be set off', by accepting, in that case, that the losses of the resident permanent establishment of the non-resident subsidiary may be set off against the group's income.
>
> 37. However, it cannot be excluded that such a deduction, even when permitted by the legislation of the foreign State, may not be possible in practice, particularly in the case where the non-resident subsidiary has definitively ceased all activity.
>
> 38. Thus the difference in treatment mentioned in paragraph 29 of the present judgment may, at least in that case, concern objectively comparable situations."

Although not easy to follow at first sight, at least without reference to *Bevola*, references in this passage to a "resident" permanent establishment must mean a business conducted in the Member State in question (Denmark on the facts of *NN*). Thus, applying the first sentence of [35] to the facts of *NN*, an exception is required where there is no other possibility of deducting losses of the Swedish subsidiary attributable to its permanent establishment in Denmark (that establishment being "resident" in Denmark, and the subsidiary also being "established" in Denmark through that permanent establishment).

41. The Court then considered justification. It rejected the balanced distribution of taxing powers as a justification on the basis that a double deduction would favour neither Member State to the detriment of the other. In relation to the second justification, preventing the double deduction of losses (which was obviously the focus of the Danish Government's submissions), the CJEU said this:

> "42. In that respect, the Court has already ruled that Member States must be able to prevent the risk of losses being taken into account twice (judgments of 13 December 2005, *Marks & Spencer*, C-446/03, EU:C:2005:763, paragraph 47, and of 15 May 2008, *Lidl Belgium*, C-414/06, EU:C:2008:278, paragraph 35).
>
> 43. It is true that, in a situation in which a permanent establishment's income is taxed by two Member States, it appears justified that the charges borne by that establishment should be capable of being deducted from that income in one and the other tax systems, in accordance with national rules.

> 44. However, the existence of such a situation cannot simply be inferred from the fact that two Member States concurrently exercise their power of taxation over the profits of the same permanent establishment, as is the case, in the dispute in the main proceedings, with regard to the Kingdom of Denmark and the Kingdom of Sweden.
>
> 45. The tax agreements between Member States specifically designed to prevent double taxation cannot be disregarded. In that regard, as is apparent from the European Commission's written observations and the answers given by NN's representative during the hearing, relations between the Kingdom of Denmark and the Kingdom of Sweden are regulated by the Nordic Convention.
>
> 46. Under Article 25 of that convention, if a person residing in Sweden receives income that is taxable in another contracting State, the Kingdom of Sweden allows the deduction from income tax of a sum corresponding to the income tax paid in the other State.
>
> 47. In the light of that mechanism, the parallel exercise of the powers of taxation of the Kingdom of Denmark and the Kingdom of Sweden does not entail an obligation for the Swedish company which has a permanent establishment in Denmark to pay income tax twice. In those circumstances, the ability, claimed by the Danish group to which the Swedish company belongs, to deduct the losses of such an establishment twice, that is to say, in one and the other national tax systems, does not appear to be justified.
>
> 48. Paragraph 31(2)(2) of the Law on corporation tax is specifically intended to prevent the group concerned from exploiting the same loss twice. In the absence of such a provision, as noted by the Advocate General in point 75 of his Opinion, cross-border situations would confer an unjustified advantage over comparable national situations, in which a double deduction is not possible. The difference in treatment established by national legislation thus appears to be justified."

Paragraph 75 of Advocate General Campos Sánchez-Bordona's opinion refers to the possibility of a loss made in a permanent establishment in Denmark being deducted either in Denmark or in Sweden as the company's state of residence, and states that a provision like paragraph 31(2)(2) seeks to prevent the company from using the same expenditure or loss twice, since otherwise cross-border situations would be treated more favourably than national situations, where no double deduction would be permitted.

42. The Court considered proportionality at [49] to [57]. It held at [50] that the restriction would go beyond what is necessary to prevent a double deduction if it deprived a group of "any possibility" of a deduction in a cross-border situation. It noted that in this case the losses could not in practice be set off in Sweden due to a choice made by the group and indicated that provisions that deprived the group of "any effective possibility" of deducting the losses would fail to have regard to the principle of proportionality. However:

> "55. That principle would, by contrast, be respected if the setting off, against the Danish group's profits, of the loss sustained by the resident permanent establishment of its non-resident subsidiary were accepted, by derogation from the rule laid down in Paragraph 31(2)(2) of the Law on corporation tax, [provided that] the group would have demonstrated that the setting off of the abovementioned losses against the subsidiary's profits is actually impossible in the other Member State.
>
> 56. It is for the referring court to determine whether that is the case in the dispute in the main proceedings, with regard to the Danish branch of NN's Swedish subsidiary."

The words in square brackets in [55] are translated as "since" in the English version of the judgment, but based on other language versions and the sense of the passage it was not disputed that the text should be read in the conditional manner shown.

43. The Court's ruling (*dispositif*) on the questions referred reads as follows:

> "Article 49 TFEU must be interpreted as not precluding, in principle, national legislation, such as that at issue in the main proceedings, pursuant to which the resident companies in a group are permitted to deduct, from their group profits, the losses sustained by a resident permanent establishment of a non-resident subsidiary of that group only in the case where the rules applicable in the Member State in which that subsidiary has its registered office do not permit those losses to be deducted from the latter's profits, when the application of that legislation is combined with that of a convention preventing double taxation allowing, in the latter Member State, the deduction from the income tax payable by the subsidiary of a sum corresponding to the income tax paid, in the Member State on the territory of which that permanent establishment is situated, in respect of the latter's activity. However, Article 49 TFEU must be interpreted as precluding such legislation in the case where the effect of its application is to deprive that group of any effective possibility of deducting those losses from the group's overall profits, where it is not possible to set off those losses against that subsidiary's profits in the Member State on the territory of which that subsidiary is established, these being matters for the referring court to verify."

Marks & Spencer and related cases

44. I also need to refer to other European case law on which Mr Ewart, for HMRC, placed reliance, particularly on the issue of justification but also on proportionality, starting with Case C-446/03 *Marks & Spencer plc v Halsey* [2006] Ch 184; [2006] STC 237 ("*M&S*").

45. *M&S* concerned an attempt by Marks & Spencer plc, a UK tax resident, to obtain group relief for losses incurred by subsidiaries in Belgium, France and Germany, a claim which was rejected on the basis that the losses had not been incurred in the UK. The Grand Chamber of the Court considered three factors put forward to justify the restriction, namely the need to treat profits and losses symmetrically to protect a

balanced allocation of taxing power, the risk of a double deduction of losses and the risk of tax avoidance. It said this about the double deduction of losses at [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."

The Court went on to comment at [48] that such a danger existed if group relief was extended to the losses of non-resident subsidiaries, and was avoided by a rule which precluded relief.

46. The Court concluded at [51] that, in the light of the three justifications taken together, the restriction in question pursued legitimate objectives and constituted overriding reasons in the public interest. However, it determined at [55] that the restriction went beyond what was necessary where the non-resident subsidiary has "exhausted the possibilities available" in its State of residence of having the losses taken into account for the period concerned or for previous periods, and there is "no possibility" for the losses to be taken into account in the State of residence for future periods, including by third parties. By way of shorthand, losses that meet this criterion have been described in later case law as "definitive" losses.

47. Case C-231/05 *Oy AA* [2008] STC 991 was another decision of the Grand Chamber. It concerned Finnish legislation that allowed a tax deduction for a "financial transfer" by a subsidiary in favour of a parent company, the effect being to create taxable income in the parent company. The legislation required both companies to be established in Finland. In this case the parent company was a UK company without a permanent establishment in Finland, and the claim was rejected on that basis. The rejection was challenged as being incompatible with freedom of establishment. The Court considered the three justifications that had been put forward in *M&S* and concluded that two were made out, being the need to safeguard the balanced allocation of taxing power and the need to prevent tax avoidance. Having regard to the combination of those two factors, the Court found at [60] that a system such as that in issue was justified. In relation to the risk of losses being used twice (which Finland and other Member States, including the UK, had sought to rely on by analogy), it simply said at [57] that "the Finnish system of intra-group financial transfers does not concern the deductibility of losses".

48. Case C-414/06 *Lidl Belgium GmbH & Co KG v Finanzamt Heilbronn* [2008] STC 3229 related to a German entity which was denied a deduction for a loss made by its permanent establishment in Luxembourg in calculating its profits for German tax purposes, whereas a loss from activities in Germany would have been allowable. Under the terms of the Luxembourg/Germany DTC profits of the Luxembourg permanent establishment were exempt in Germany. The CJEU held that there was a restriction on freedom of establishment but then considered Member States' submissions that the restriction could be justified by the need to preserve the allocation of taxing power and by the need to prevent the danger of losses being taken into account twice. It accepted that the objective of preserving the allocation of taxing power, reflected in the provisions of the DTC, was capable of justifying the tax regime in issue because it safeguarded symmetry. The Court then went on to say this:

> "35. As regards the second justification put forward in the observations submitted to the Court, which is based on the danger that losses might be

> taken into account twice, the Court has accepted that the Member States must be able to prevent such a danger (see *Marks & Spencer* at [47]; and *Rewe Zentralfinanz eG v Finanzamt Koln-Mitte* (C-347/04) [2007] 2 C.M.L.R. 42 at [47]).
> 36. In this connection, it must be pointed out that, in circumstances such as those which underlie the main proceedings, there is clearly a danger that the same losses will be used twice (see *Marks & Spencer* at [48]). It is possible that a company might deduct, in the Member State in which its seat is situated, losses incurred by a permanent establishment belonging to it and situated in another Member State and that, despite such offsetting, the same losses might be taken into account subsequently in the Member State in which the permanent establishment is situated, when that establishment generates profits, thereby preventing the Member State in which the principal company has its seat from taxing that profit.
> 37. Consequently, the two justifications put forward must each be considered as being capable of justifying a restriction on the freedom of establishment arising from the tax treatment by the Member State in which the seat of a company is located of losses incurred by a permanent establishment belonging to that company and situated in another Member State."

49. It will be observed that there is a clear statement at [37] that the two justifications relied on were independently valid (in that they must "each" be capable of justifying a restriction), although as Ms Shaw, for VolkerRail, submitted, that point is made by reference to a restriction arising from the tax treatment in the Member State of residence rather than in the location of the permanent establishment.

50. The Court went on to address a specific question raised by the referring court as to whether the three justifications relied on in *M&S* were cumulative or whether the existence of one was sufficient. It said at [40] that:

> "… bearing in mind the wide variety of situations in which a Member State may put forward such reasons, it cannot be necessary for all the justifications referred to at [51] of the *Marks & Spencer* judgment to be present in order for national tax rules which restrict the freedom of establishment laid down in Art.43 EC to be capable, in principle, of being justified."

The CJEU went on to give *Oy AA* as an example where two of the three were relied on (a combination of the balanced allocation of taxing power and the need to prevent tax avoidance) and to refer to its reliance on two factors in the present case.

51. Case C-322/11 *Re K* [2013] All ER (D) 123 related to an individual resident in Finland who was refused a tax deduction by the Finnish tax authorities for a loss incurred on the sale of a French property. The France/Finland DTC gave France the right to tax any gain made on the property and exempted it in Finland, although it could be taken into account in determining the applicable tax rate on other income. K relied on the fact that a loss on a Finnish property could be taken into account, and argued that the loss was also "definitive" since he had no other income or assets in France.

52. The CJEU held that there was a restriction on freedom of establishment which could not be justified by reference to the location of the property, but went on to consider the three justifications relied on in *M&S*, concluding that the first (balanced allocation of taxing power) was made out but that the second and third were not. It also concluded that the legislation was justified by the need to ensure cohesion of the tax system. In reaching its conclusions the Court made the following observations on the double deduction justification:

> "56. As regards, in the second place, the justification relating to the need to prevent losses being taken into account twice, which is put forward by the German and Swedish Governments, the Court has accepted that the Member States must be able to prevent that danger (see *Marks & Spencer*, paragraph 47; *Rewe Zentralfinanz*, paragraph 47; and *Lidl Belgium*, paragraph 35).
>
> 57. However, in circumstances such as those underlying the dispute in the main proceedings, there appears to be no danger of a taxpayer deducting the same loss twice.
>
> 58. As the Advocate General has noted in point 32 of his Opinion, losses incurred in France on an immovable property situated there cannot be deducted either from overall income or from a gain realised on the sale of another asset."

53. Turning to proportionality at [72] to [82], the Court concluded that K could not be regarded as having exhausted the possibilities available for deducting the loss in France, because "such a possibility has never existed". This was because the French legislation made no provision for losses on immovable property to be deductible (see the Advocate General's opinion at paragraph 32). In those circumstances, requiring the Member State of residence to allow the loss would effectively oblige it to bear the adverse consequences arising from the application of legislation of the other Member State. There was no requirement to adjust tax legislation to remove all disparities arising from national tax rules.

54. In Case C-123/11 *Re A Oy* [2013] STC 1960 a Finnish parent company proposed that its loss-making Swedish subsidiary should merge with it following a cessation of trading, with the effect that the parent would take over certain long-term lease commitments. Its request for advance confirmation that the subsidiary's losses would be allowable in Finland, on the grounds that they would have been had the subsidiary been Finnish, was refused.

55. The CJEU dealt with justification at [40] to [46] of its judgment, finding that all three factors relied on in *M&S* were made out and, taken together, meant that a provision of the kind in question could be justified. As regards the risk of losses being used twice, it commented that such a risk did exist in connection with a merger of the kind in question and was averted by a rule which excluded the possibility, referring to *M&S* at [47] and [48].

56. On the question of proportionality, the Court again applied the test in *M&S* at [55], noting that even though the parent would no longer have a subsidiary or permanent establishment in Sweden, those circumstances were not by themselves capable of

establishing that there was no possibility of the losses being taken into account (paragraph [52]). It was for the national court to determine whether the non-resident subsidiary had exhausted all the possibilities of taking the losses into account.

57. The Advocate General who provided the opinion in *Philips*, Advocate General Kokott, also provided the opinion in *Re A Oy*. A couple of aspects of it are worth noting. First, at AG49 she commented that the case law on justification had continued to develop since *M&S* and stated, with reference to her opinion in *Philips*, that:

> "… the crucial factor for the justification is that the national legislation pursues the objective of preserving the allocation of the power to tax. The objective of preventing the double use of losses is not an autonomous justification."

This point was not endorsed by the Court in *Re A Oy* and, as is clear from its decisions, it has not accepted it.

58. Secondly, the opportunity cannot be missed to set out the first paragraph of Advocate General Kokott's opinion, which appears to encapsulate her view of the impact of the "no possibility" test introduced by *M&S*:

> "The name Marks & Spencer is actually that of a chain of department stores. In the Court's case law on tax law, however, it stands for an express recognition that the allocation of taxation powers among the Member States may justify restrictions of the freedom of establishment. In the Member States' case law and in the works of commentators, on the other hand, the name Marks & Spencer appears also to be synonymous with chaos and despair."

59. Case C-172/13 *European Commission v UK* [2015] Ch 394; [2015] STC 1055 was a decision of the Grand Chamber in infraction proceedings against the UK in respect of the modified group relief rules introduced following *M&S*, which in broad terms required the question of whether possibilities for future use of the losses had been exhausted to be determined as at the end of the period in question rather than at any later time. After referring at [24] to the three factors relied on in *M&S* as providing justification for the restriction, the Court considered the Commission's argument that the revised rules made it virtually impossible in practice for cross-border group relief to be obtained, limiting it to only two situations, namely where the legislation of the State of residence made no provision for the carry forward losses, or where the subsidiary was put into liquidation before the end of the accounting period in which the loss was sustained. The Court rejected the first of these as being irrelevant, saying with reference to *Re K* that it was settled law that losses of a non-resident subsidiary could not be characterised as definitive by reference to a rule in the other State which precluded the possibility of carry forward. The second was rejected on the basis that the Commission had not proved that the legislation required the non-resident subsidiary to be put into liquidation. The Court also observed that the receipt of even minimal income provided a possibility that losses could be offset.

60. Finally, Case C-405/18 *AURES Holdings a.s. v Odvolací Finanční Ředitelství* [2020] STC 1695 ("*AURES*") concerned a company that was incorporated and tax resident in the Netherlands which set up a permanent establishment in, and subsequently

transferred its tax residence and all its activities to, the Czech Republic. It sought to deduct losses it had incurred in the Netherlands from its corporation tax base in the Czech Republic. The case was dealt with on the basis that companies transferring their tax residence to a Member State after incurring losses are not in a comparable position to resident companies which incur losses in that Member State, in the light of the objectives of preserving the allocation of the power to impose taxes between Member States and preventing the double deduction of losses. The situation in *Bevola* was distinguished on the basis that *AURES* concerned a situation where the losses were incurred at a time when there was no establishment at all in the Czech Republic and therefore no taxing rights on its part, and extending *Bevola* would be inconsistent with the Court's decisions on "exit" taxation.

DISCUSSION

The requirements for establishing an infringement and the issues on the appeal

61. It is undisputed that, in order for VolkerRail to succeed in demonstrating an infringement of freedom of establishment for which a remedy must be provided, the following must be established:

    a) Section 403D(1)(c) of ICTA results in the difference in treatment identified in *Philips* between: (i) non-resident companies which exercise their freedom of establishment through a UK permanent establishment; and (ii) non-resident companies which exercise their freedom of establishment through a UK resident subsidiary. The UT's conclusion that there was such a difference is not under appeal.

    b) The difference in treatment must involve objectively comparable situations, again as found in *Philips*. The UT's conclusion to that effect is challenged by HMRC.

    c) The restriction on freedom of establishment found to exist by virtue of a) and b) above is not justified by the aim of preventing the double use of losses (neither of the two other justifying factors in *M&S* being in point). VolkerRail challenge the UT's conclusion that there was justification.

    d) If there is justification, whether s.403D(1)(c) is disproportionate. The UT found that it is disproportionate in two respects, namely: (i) the feature that none of the losses could be surrendered if any part of them was deductible or allowable against non-UK profits; and (ii) the fact that the provision prevented a UK permanent establishment of a non-resident company transferring losses even where there was no possibility of them being deducted or allowed against non-UK profits. HMRC challenge the UT's determination that s.403D(1)(c) is disproportionate in any respect and say that it can and should be read as referring to actual possibilities. VolkerRail maintain that, in addition to the two respects in which the UT found s.403D(1)(c) to be disproportionate, it is also disproportionate in failing to differentiate between the permanent deduction of losses and a temporary deduction such as was in issue here, given the recapture mechanism.

62. If s.403D(1)(c) is found to be incompatible with EU law to any extent, a further question arises as to whether it must be disapplied entirely (which was the effect of

Philips) or can be subject to a conforming interpretation. Both parties appeal against the UT's conclusion that s.403D(1)(c) should be read as referring to "deducted from or otherwise allowed against" as opposed to "deductible from or otherwise allowable against" (even though it appears to have been HMRC that suggested that interpretation to the UT). VolkerRail say that the legislation should, if not disapplied in accordance with *Philips*, be read as applying only where there was a permanent deduction of losses and not where they were subject to recapture. Further, it maintains that the UT's interpretation impermissibly goes against the grain of the legislation. HMRC maintain that "deductible" and "allowable" can and should be read (whether conventionally or using conforming interpretation) as referring to possibilities, in accordance with the approach taken in *NN* at [50] and [55].

Whether a restriction exists: objective comparability

63. As the UT observed, the CJEU's conclusion in *Philips* at [19] that there was objective comparability between a non-resident company with a permanent establishment in the Member State in question and a company resident in that State is not accompanied by additional reasoning. Mr Ewart submitted that *Bevola* and *NN* showed that the case law had moved on, especially as regards the objective of the tax regime to which regard must be had. Correctly identified, the objective in this case was to prevent the double deduction of losses, just like the objective of paragraph 31(2)(2) of the Danish Law as identified in *NN*. Mr Ewart criticised the reasoning that led to the UT's conclusion that objective comparability was made out.

64. In my view this point can be dealt with shortly. There is no appeal against the conclusion that s.403D(1)(c) gives rise to a difference in treatment between a permanent establishment of a non-resident company and a UK resident subsidiary of a non-resident company. The test of objective comparability self-evidently requires a comparison between those two situations: in other words, are they in fact objectively comparable? Whilst it is necessary to have regard to the objective of the tax regime in answering the question, that can only go so far. It cannot prevent the comparison being required to be made between the two situations identified as giving rise to the difference.

65. In *NN* the difference identified was one between the situation in that case and the position where only Danish companies were involved. The analysis of objective comparability proceeded on that basis: see the passage cited at [40.] above. In contrast the difference identified in *Philips* is the same as the one identified here. Even if the CJEU did incorrectly identify the relevant objective in *Philips*, *NN* cannot be regarded as amounting to a departure from *Philips* on this issue.

66. The UT's reasoning was somewhat different. Although I agree with the conclusion, I should clarify that I am not persuaded by its comment that the question of comparability should not need to be determined by reference to the facts of each case, such that s.403D(1)(c) is either compatible or not, irrespective of the factual position. By definition, the comparison must be by reference to the particular difference identified, and what that difference is will depend on the facts.

Justification: double deduction of losses

67. Where a restriction on freedom of establishment exists, it is permissible only if it is justified by overriding (or "imperative") reasons in the public interest (see for example *M&S* at [35] and *NN* at [18]).

68. On its face, the conclusion in *Philips* at [35] applies to the facts of this case. As in that case, what is in issue is a restriction on the freedom of a non-resident company to establish itself in another Member State, which *Philips* determines cannot be justified by the objective of preventing the double use of losses and/or the objective of preserving a balanced allocation of taxing power.

69. However, the reframed questions and the *dispositif* in *NN*, set out at [37.] and [43.] above, can equally be applied to the facts of this case. The only distinction that I can identify in the latter, which is on any basis an immaterial one, is that under the UK/Netherlands DTC the Netherlands gives relief by an exemption rather than a tax credit.

70. Obviously the analysis does not end there, and the Court's reasoning must be carefully considered, but it is a notable starting point.

71. It is clear from the judgment in *Philips* that the Court rejected the prevention of the double use of losses as a permissible justifying objective on the basis that allowing losses in the Member State where the non-resident company was resident had no effect on the taxing rights of the Member State in which the permanent establishment was situated: see in particular at [30] and [31] (set out at [28.] above). It also did so without expressly determining whether such an objective could be relied on independently: see at [28].

72. Although the Court appears to have been considering the double use of losses as a potential independent justification at this stage of the judgment, it is striking that its reasoning essentially goes no further than its earlier reasoning rejecting the objective of preserving a balanced allocation of taxing power. That too is based on the fact that the taxing power of the Member State where the permanent establishment is situated is unaffected by losses also being available elsewhere.

73. *NN* not only removes any doubt that the objective of preventing a double deduction of losses can be relied on independently, but the Court's reasoning (set out at [41.] above) is very different.

74. The starting point of the reasoning in *NN* is the statement in *M&S*, repeated in subsequent cases, that Member States "must be able to prevent the risk of losses being taken into account twice". The Court then goes on to take a nuanced approach which recognises that two Member States may have taxing rights over a permanent establishment, such that in principle deductions should be available under both systems, but that the position is affected by tax agreements between Member States (in that case the Nordic Convention). The effect was that the Swedish company was not required to pay tax twice, and in those circumstances the ability to deduct losses in both tax systems "does not appear to be justified". In the absence of paragraph 31(2)(2) cross-border situations would confer an unjustified advantage over comparable national situations, such that the difference in treatment appeared to be justified.

75. Ms Shaw submitted that *NN*, *M&S* and the other cases relied on by Mr Ewart should be distinguished from *Philips* on the following basis. *Philips* was a "host state" case, meaning that it concerned the freedom of a non-resident entity to establish itself in another Member State. The difference in treatment complained of related to the taxation system of the Member State in which the permanent establishment was situated (the host). That State has the primary taxing right over the establishment in question, and as the Court found in *Philips* those taxing rights are wholly unaffected by any losses being available for use in another Member State. There are numerous references in *Philips* to the fact that the losses were incurred in the host Member State, and the reference to "such" circumstances in [30] and equivalent references in other parts of that section of the judgment (see [28.] above) clearly refer to that situation.

76. Ms Shaw submitted that, in contrast, *NN* and other cases starting with *M&S* where restrictions on double deductions were found to be justified are all "home state" cases, meaning cases where the freedom said to be infringed is the freedom of a resident entity to establish itself in another Member State. (In *NN* this was the freedom of a Danish company to establish a subsidiary in another Member State which would in turn carry on business in Denmark.) That justified a different approach, bearing in mind the subordinate or non-existent taxing rights of the home state over profits of a foreign establishment (for example, the fact that the UK would not have been able to tax the profits of Marks & Spencer's non-UK subsidiaries). Mr Ewart's description of *Philips* as an outlier that was inconsistent with the other cases was wrong: it was simply the only case that addressed host state discrimination. The reasoning in *NN* was tied to a comparison with a wholly domestic situation, and the difference in treatment was justified by reference to that.

77. Ms Shaw's arguments were attractively put but in my view they cannot succeed. They put forward a rationalisation that is not properly discernible from the reasoning of the Court. The reasoning in *NN* at [42] to [48] can be applied directly to s.403D(1)(c) and the facts of this case. As in that case, double taxation of profits is precluded by an agreement between the Member States in question. Section 403D(1)(c) does indeed prevent a double deduction which would not be possible under UK law by virtue of s.411 of ICTA. Further, the point at the foundation of the reasoning in *Philips*, namely that the taxing power of the Member State where the permanent establishment was situated was unaffected, also applied in *NN*. Denmark's power to tax was not affected by any possibility that the losses might also be relieved in Sweden.

78. *NN* makes clear, if there were previously any doubt, that the objective of preventing the double deduction of losses can provide an independent justification. That justification can be made out whether the particular difference identified on the facts of the case is between a non-resident establishing itself in the Member State in question, or a resident of that State establishing itself in another Member State. It cannot sensibly have validity only in the latter case.

79. This is illustrated by the arbitrary results to which VolkerRail's approach would lead. If on the facts of *NN* the parent company had been Swedish rather than Danish, and the group had sought to use the losses against the profits of a Danish sister company, then the facts would have been essentially identical to those in *Philips*: in Ms Shaw's terminology it would now be a host state case: indeed, even without a change in the facts it could be regarded as a host state case from the perspective of the Swedish company with the permanent establishment in which the deduction arose (Sverige 1).

Sverige 1 and/or any Swedish parent of Sverige 1 would not have been able to complain about the particular difference in treatment identified in *Philips* (because of the rule that imposes a similar restriction on Danish companies) but the group would still be being treated differently to a wholly domestic Danish group. This is because freedom of establishment for nationals of a Member State within the territory of another Member State includes the right to "set up and manage undertakings under the conditions laid down for its own nationals by the law of the country where such establishment is effected" (Joined cases C-397/98 and C-410/98 *Metallgesellschaft Ltd v Inland Revenue Commissioners* [2001] STC 452 at [41]).

80. On those facts, with a Swedish parent, the analysis of how a provision such as paragraph 31(2)(2) could be justified could proceed in the same way. The objective of the rule would remain the prevention of any double deduction of losses.

81. Similarly, the objective of s.403D(1)(c) is the prevention of any double deduction of losses. That is so irrespective of the fact that there is no equivalent rule applying to group relief surrenders by UK resident companies. Further, if such a rule had existed then Philips could, like NN, still have identified that it was being treated differently to a wholly domestic group. The objective of s.403D(1)(c) would be unchanged. Whether a similar rule does or does not apply in a case where a company rather than a branch is established does not alter the objective of s.403D(1)(c). Similarly, if the Danish tax rules had not contained an equivalent restriction on Danish companies then paragraph 31(2)(2) would still have had the objective of preventing a double deduction.

82. The absence of an equivalent rule to s.403D(1)(c) that applies to group relief surrenders by UK resident companies is straightforwardly explained by the fact that, as HMRC pointed out with reference to evidence before the FTT, it is far more common for losses of permanent establishments to be at risk of a double deduction than for losses of resident companies. This is because in the former case the results of the permanent establishment are commonly taken into account in the State of residence as well as in the location of the permanent establishment, whereas in the latter case that is much rarer. Indeed, one conventional reason for establishing a branch rather than a subsidiary in a new location is to facilitate the use of losses in the State of residence, being losses that would not be available if they were incurred by a non-resident company. It is somewhat illogical for a discrimination claim to be based on a restriction which, in reality, would have no application in the comparator case because the losses would not actually be at risk of a double deduction.

83. Conversely, if losses had been at risk of a double deduction in the comparator case then imposing a restriction on group relief in that situation would simply impose an additional burden or restriction on non-residents seeking to establish in the UK as compared to resident entities, a difference which would itself require justification.

84. I agree with Ms Shaw that the CJEU has expressed the defence of justification by reference to the difference in treatment identified, in other words asking itself whether that difference can be justified. Indeed, it did so in a preliminary observation in *NN* at [18], with reference to Case C-337/08 *X Holding BV v Staatssecretaris van Financien* (C-337/08) [2010] STC 941 at [20]. However, if the objective of preventing a double deduction is a valid one then whether it is or is not pursued in different factual circumstances goes more to whether the Member State is acting consistently and systematically, an issue considered further below, and whether the measure in question

is proportionate. If the prevention of double deductions is in principle a valid objective, and the UK legitimately took the view that action to secure that objective was only required in respect of permanent establishments and not UK resident companies, then the difference in treatment between the two situations *is* explained by that justification.

85. The principle that Member States "must be able to prevent" the risk of losses being taken into account twice must now be regarded as part of the settled case law of the EU. It has been endorsed either explicitly or in substance in a number of cases, including four decisions of the Grand Chamber (*M&S*, *Oy AA*, *European Commission v UK* and *Bevola*). *NN* makes it clear that it can provide an independent justification. *NN* is also in line with the earlier case law relied on by HMRC and a logical evolution of it. Indeed, the validity of preventing double deductions as a justification is reinforced by the "no possibilities" test first formulated in *M&S*. Where that test is satisfied there is of course no risk of a double deduction. In contrast to *NN*, *Philips* does not recognise the prevention of double deductions as an objective that can be divorced from questions of taxing power. Mr Ewart is correct to describe *Philips* as an outlier.

86. It is true that the language of "host state" is used in the Court's judgment in *Philips*. Further, the reference to "such circumstances" at [30] and similar references are to the position of a "host state". Moreover, Advocate General Kokott's opinion in *Philips* not only contains plenty of references to the "host state", but at AG55 to AG57 specifically draws a distinction between the taxing rights of the "host state" and the state of origin (the home state). However, that is in the context of the allocation of taxing rights, not double deduction. The Court's endorsement of "AG49 et seq" at [31] of its judgment, while made in the course of a discussion of double deduction of losses, does no more than endorse the point made in that paragraph, namely that the UK's power to tax is not impaired by the losses being available in the Netherlands.

87. Advocate General Kokott's opinion in *Philips* goes on to consider the double use of losses at AG58 to AG67. Ms Shaw submitted that these paragraphs form part of the "AG49 et seq" endorsed by the Court. I disagree. They go well beyond the point made by the Court at [31]. In particular, those later paragraphs contain a broader discussion of aspects of what Advocate General Kokott refers to as the "current international delimitation of taxation rights" and the UK tax system. In particular, she explained that the double use of losses may be required where double taxation is countered through a credit mechanism rather than an exemption. She stated that, against that background, the prevention of the double use of losses "cannot be an end in itself" and that the use of losses of a UK permanent establishment the profits of which are taxed in the UK should not be regarded as "double" in any event. She then referred to the potential under the UK tax system for losses to be carried backwards or forwards and, at AG66 and AG67, expressed the view that this meant that even if the prevention of the double use of losses were an autonomous justification it could not be relied on by the UK in that case because that objective was not pursued in a consistent and systematic manner, there being no restriction on carrying losses forward and back by reference to their availability for use elsewhere.

88. Although an Advocate General's opinion can be of great assistance in understanding the reasoning of the Court, it does not have the status of a judgment of the Court except and to the extent that the reasoning in it is adopted or incorporated into the Court's judgment. Further, and importantly, it is worth reiterating that the Court's role is not to determine points of national law but to interpret EU law and provide guidance on it (see

[16.] above). Insofar as Advocate General Kokott was commenting on the way in which the UK tax system works, that is an expression of a view which should of course be accorded respect, but which (even without the benefit of *NN*) would not determine how this court should act.

89. A further important observation to make is that the distinction Ms Shaw draws between home and host state taxation is not based on underlying principles of EU law, a point that also applies to Advocate General Kokott's comments about the international delineation of taxing rights. The principle that the Member State that acts as host to a permanent establishment of a non-resident entity enjoys primary taxing rights, with the State of residence having subordinate taxing rights, is an approach that many countries adopt and which is reflected in numerous DTCs. Indeed, it reflects the "model" DTC approach adopted by the OECD. However, the principle is not set in stone and is frequently departed from in some respects, a typical example being the treatment of shipping and air transport (Article 8 of the UK/Netherlands treaty). Further and importantly, the approach of conferring primary taxing rights on the host state is not a function of EU law. This reflects the fact that, in general, direct taxation has not been harmonised, so Member States retain sovereignty in that area. As such, it would be surprising if a principle that is generally (but not universally) implemented only by DTCs and national legislation was the basis of a fundamental distinction under EU law.

90. I would also observe that Ms Shaw's submission that *Philips* alone is a host state case and that all the other cases relied on by HMRC are home state cases is not without difficulty. *NN* is only a home state case from the perspective of the Danish parent. If in *Philips* the group had had a UK parent then it might alternatively have been described as a home state case, because the UK parent could have maintained that by establishing a Dutch subsidiary which conducted business in the UK it was being treated differently to a wholly domestic group. In *AURES* the Court referred to the Czech Republic as the "host state", although on Ms Shaw's approach it should be regarded as the home state. The fact that the Court used that terminology in rather a loose way suggests that it is not drawing a fundamental distinction of the kind relied on by VolkerRail.

91. As already explained, the CJEU's general approach is to follow its previous decisions, it is rare for it not to do so in fact and it is even more unusual for it to do so without being explicit. Further, *Philips* was obviously before the Court in *NN*. Indeed, the questions referred to it were framed with *Philips* in mind, and NN (and the Commission) argued that *Philips* resolved the question while the Danish government maintained that it could be distinguished. The Advocate General in *NN*, Advocate General Campos Sánchez-Bordona, made a number of references to *Philips*. He suggested at AG3 that its facts were "so similar to those in [*NN*] that, at first sight, it would be possible simply to transpose the solutions in that judgment to this case". He commented at AG63 that based on *Philips* it was difficult to classify the prevention of the double deduction of losses as an overriding reason in the public interest, but suggested at AG64 that:

> "… perhaps the time has arrived to moderate those assertions made in the judgment in *Philips Electronics*, in view of the fact that the EU legislature has paid special attention to the fight against double deduction since that judgment was delivered."

92. The reference by the Advocate General in *NN* to the fight against double deduction is a reference to the OECD's work on Base Erosion and Profit Shifting (BEPS), the final reports on which were published in October 2015, and subsequent EU action in that regard including Directives 2016/1164 and 2017/952. One of the aims was to target "hybrid mismatches" designed to achieve double deductions, including in permanent establishment situations.

93. Advocate General Campos Sánchez-Bordona noted at AG70 that, while it post-dated the facts of *NN*, he believed that:

> "… Directive 2016/1164 reflects a widespread concern, the strength of which was probably not evident – and, of course, was not expressly reflected in legislation – when the judgment in *Philips Electronics* was given."

He went on to refer to guidance provided by the Court about the link between the prevention of double deductions and the fight against tax evasion, and then to explain with reference to *M&S* that losses might be used twice in the absence of any fraudulent intent and (at AG73) to observe that:

> "… [using losses twice] remains conduct which, in line with the school of thought favoured by the OECD, must also be rejected under EU law. That is why, as I pointed out above, the aim of preventing such conduct may perhaps be categorised as an (independent) overriding reason in the public interest, without necessarily having to be linked to the fight against tax evasion."

94. The Advocate General's comments in *NN* about the concerns reflected in the BEPS project have force. There is no indication of an appreciation of them in either Advocate General Kokott's opinion in *Philips* or in the decision of the Court in that case.

95. The Court in *NN* did not expressly refer to or accept the Advocate General's invitation to "moderate" the assertions in *Philips*. The only reference to the Advocate General's opinion is to paragraph 75 (see [41.] above). The facts of *Philips* are considered only in the context of the Court's conclusion that *NN* concerned a difference in treatment of another kind. In that sense, it might be said that the Court proceeded on the basis that *Philips* concerned a different situation. However, for the reasons given I have concluded that the reasoning and conclusion on the issue of justification in *NN* conflicts with that in *Philips* on that issue, and can only be rationalised on the basis that it departs from *Philips* in a critical respect.

96. As already explained, the Court will depart from earlier case law if there are strong reasons to do so, including where it is justified by new matters brought to its attention (see [14.] above). The developments referred to by the Advocate General might fall into the category, but it is also worth emphasising the importance of consistency. *NN* was a development of a line of cases starting with *M&S*. It is *Philips* that stands out as taking a different approach.

97. One of the points made by Advocate General Kokott in *Philips* was that the UK could not in any event rely on the double use of losses as a justification because it was not pursued in a consistent and systematic manner, there being no restriction on carrying

losses forward and back. However, there is a rationalisation which she appears not to have considered, as follows.

98. If losses of a permanent establishment are group relieved in the UK, then by definition they will not be available for the permanent establishment to use by way of carry forward or back. That means that profits made by the permanent establishment which could otherwise be offset by the losses will be fully taxed. If the Member State of residence gives double tax relief via a credit then, to that extent, there will be less tax to pay in that State. However (absent s.403D(1)(c)) the benefit of a double use losses will not be unwound: they will not only have been group relieved in the UK but also used in the State of residence.

99. In contrast, if losses are carried forward (or back) then their effect will be to reduce UK tax on profits of the permanent establishment, thereby also reducing the tax credit available in the State of residence. As illustrated by simplified examples provided by HMRC, the net effect is to produce an overall tax result corresponding to tax on the group's economic profits.

100. Ms Shaw sought to challenge the examples, but the focus of her challenge was the effect of the recapture mechanism in the Netherlands. The existence of that mechanism does not detract from the general principle, and is an issue best considered in the context of proportionality.

101. The UK's failure to apply a similar restriction to s.403D(1)(c) to surrenders by UK resident companies might also be argued to be evidence of an inconsistent or unsystematic approach. However, the response to this is the one provided at [82.] above, namely the materially lower risk of losses being at risk of a double deduction in that case.

Proportionality and conforming interpretation

102. As already mentioned, the UT found s.403D(1)(c) to be disproportionate in two respects, first that it prevented a surrender unless "no part" of the loss was deductible for foreign tax purposes, and secondly by reference to the test being whether losses are deductible or allowable. It applied a conforming interpretation, in which "deductible from or otherwise allowable against" was read as "deducted from or otherwise allowed against".

103. The first of the UT's reasons for finding s.403D(1)(c) to be disproportionate does not arise on the facts of this case and it is not necessary to decide it. It could be relevant in a case where only a specific part of the losses was deductible under foreign law, such as the example given by the UT of losses of £1 million, £10,000 of which were deductible elsewhere. However, the words "except in so far as" at the end of the first paragraph of s.403D(1) provide a basis for a conventional interpretation of s.403D(1)(c) that would avoid that result (a point also made at [85] of the UT decision). Indeed, the slightly different drafting approach taken in the current version of the rules in s.107 of the Corporation Tax Act 2010 appears to be consistent with this interpretation.

104. I note Mr Ewart's submission that the reasoning in *Re K* referred to at [53.] above and applied in *European Commission v UK* means that there would be no need for a conforming interpretation in any event in relation to this aspect of s.403D(1)(c),

because the UK is not required to adjust its rules by reference to restrictions imposed under the tax laws of other Member States. For the reasons given below, I am not persuaded by that point, but in any event I doubt that it is necessary to do anything other than address the matter through conventional interpretation.

105. The issue that does arise in this case is whether the terms deductible and allowable satisfy the requirement of proportionality. HMRC maintain that they do and that they should be read consistently with the "no possibilities" approach taken in *M&S* and later cases. That test was clearly satisfied: all the losses were deductible, and had been deducted in fact. This conclusion was also consistent with *NN*. VolkerRail maintains that this is the wrong approach. Rather, s.403D(1)(c) was disproportionate because it made no allowance for the recapture mechanism.

106. I consider VolkerRail's submissions to have been substantively addressed by the Court in *NN*. Its reasoning on proportionality was in terms of possibilities: see [42.] above. It left it to the national court to determine whether use in Sweden was "actually impossible". In this case use by the KVW group was not only possible but occurred in fact.

107. I accept that, to the extent that the recapture mechanism operated, then (cash flow issues apart) double use of the losses would be addressed. However, that does not mean that s.403D(1)(c) must be regarded as disproportionate. Quite apart from the fact that no nuance of that nature is hinted at in the case law, there are three reasons why this is so.

108. First, it must be borne in mind that a UK permanent establishment would remain free to carry back and carry forward losses. Relief is not precluded entirely.

109. Secondly, as *NN* shows, group relief could still be available if a "no possibility" test was met. As to that, I am not persuaded that the reasoning in *Re K* and *European Commission v UK*, cases that concerned (or also concerned) the allocation of taxing power, would apply in the manner that Mr Ewart suggests. If an amount is not in fact allowable under foreign law then s.403D(1)(c) can have no application. Conversely, if a loss is allowable under foreign law then s.403D(1)(c) applies. There is a caveat to this if it is in fact not possible to use the losses (see *NN*) but that caveat has no application on the facts of this case.

110. Thirdly, Member States must have a margin of discretion in framing national legislation which pursues a justified objective in the context of taxation. Although there appears to be no decision of the CJEU that addresses this point in terms, in Case C-151/17 *Swedish Match AB v Secretary of State for Health* ("*Swedish Match*") the Court made comments along those lines in the context of the exercise of powers by EU institutions, stating at [35] and [36] that while the principle of proportionality requires that acts of EU institutions should not go beyond what is necessary in order to achieve a legitimate objective, the Court had accepted that the EU legislature "must be allowed a broad discretion in areas … in which its action involves political, economic and social choices and in which it is called upon to undertake complex assessments and evaluations". Accordingly, only if the measure is "manifestly inappropriate having regard to the objective which the competent institutions are seeking to pursue" would the Court intervene. The criterion is not whether the measure adopted is the only or the best possible one.

111. In her opinion in Case C-75/18 *Vodafone Magyarország Mobil Távközlési ZRT v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága* [2020] 3 CMLR 16 ("*Vodafone*"), Advocate General Kokott referred at AG116 to the need for national legislation genuinely to reflect a concern to achieve an objective in a consistent and systematic manner, and went on at AG117 to make similar points to those made in *Swedish Match* about the discretion enjoyed by Member States, including applying a "manifestly inappropriate" test. These comments were made in the context of a tax dispute, the Advocate General noting that in the absence of EU harmonisation national legislatures have an element of discretion in the field of tax law.

112. Advocate General Hogan's opinion in another tax case, Joined cases C-478/19 and C-479/19 *UBS Real Estate Kapitalanlagegesellschaft mbH v Agenzia delle Entrate*, takes a similar approach at AG99 to AG116.

113. The application of these principles to national law also derives some support from the approach taken in Joined cases C-46/93 and C48/93 *Brasserie du Pêcheur SA v Federal Republic of Germany* and *R v Secretary of State for Transport ex p Factortame (No 4)* [1996] QB 404 ("*Brasserie du Pêcheur*"), a decision relied on by Advocate General Kokott in *Vodafone*. In *Brasserie du Pêcheur*, which as is well known established liability of Member States for damages for breach of Community law in certain circumstances, the Court stated at [42] that the conditions under which a Member State could incur liability for damages should not, absent a particular justification, differ from those governing the liability of the Community in similar circumstances, and at [47]:

> "… where a Member State acts in a field where it has a wide discretion, comparable to that of the Community institutions in implementing Community policies, the conditions under which it may incur liability must, in principle, be the same as those under which the Community institutions incur liability in a comparable situation."

114. A legislative choice to prevent group relief for losses of a permanent establishment where those losses are deductible elsewhere, without making further (potentially complex) provision to cover the possibility that relief is made available but is later clawed back – and indeed without making equivalent provision for the more unusual case where losses of a UK resident company are at risk of a double deduction – is to my mind a legislative choice that was within the margin of discretion. VolkerRail's preferred approach that the legislation would be proportionate only if it allowed group relief unless there was no possibility of relief being clawed back (effectively a reversal of the *M&S* approach), while of course being another possible legislative choice, would in contrast appear to fall well short of achieving the objective of preventing a double deduction.

115. In these circumstances there is no need to adopt a conforming interpretation of s.403D(1)(c). I should record however that I would not have been readily attracted by the UT's approach, in part because it is not clear to me that it does "go with the grain of the legislation" rather than being inconsistent with a fundamental feature of it (*Ghaidan v Godin-Mendoza* [2004] 2 AC 557 at [33]), but also because at least as applied by parties in this case it appears to lead to its own lack of clarity. For example, it was not clear to me that the effect of the UT's decision was the one agreed by the parties, namely that VolkerRail's claim to group relief was to be allowed to the extent that

losses had been recaptured, rather than denied altogether. An obvious question is the point in time at which the existence and extent of any recapture should be tested.

Departure from EU law

116. Given the conclusions reached it is not necessary to consider HMRC's alternative argument that this court should exercise its powers under s.6 EUWA and the EUWA Regulations to depart from EU law.

CONCLUSION

117. In conclusion, I would dismiss VolkerRail's appeal and allow HMRC's appeal on the issue of proportionality, with the result that VolkerRail's appeals against the closure notices denying group relief for losses surrendered by VSCE UK are dismissed in their entirety.

Sir Launcelot Henderson:

118. I agree.

Lady Justice Elisabeth Laing:

119. I also agree.