

Luxembourg – Losses of EU Permanent Establishments March 2008

Luxembourg case law used to allow companies to deduct the foreign losses incurred by their permanent establishments located in treaty countries. The legislation has been amended, however, and, in most cases, new domestic provisions disallow the deduction of foreign losses. The Advocate General's (AG) opinion in the recent *Lidl Belgium* case brought before the EU Court of Justice ("ECJ") may provide taxpayers with new arguments to claim cross-border relief and ask for the deduction of tax losses generated by their EU permanent establishments at head office level.

The AG's Opinion in the *Lidl Belgium* Case ([C-414/06](#))

This case refers to the German tax treatment of losses incurred by the Luxembourg permanent establishment ("Lux PE") of a German resident company ("GermanCo"). GermanCo asked to offset the losses of the Lux PE against its German taxable profits. The German tax authorities considered that the losses incurred by the Luxembourg PE could not be deducted in Germany, as profits recorded by the Luxembourg PE were tax exempt under the Luxembourg - Germany double tax treaty (principle of symmetry). The German Federal Finance Court had expressed doubts on the compatibility of this national measure with EC law principles and referred the case to the ECJ..

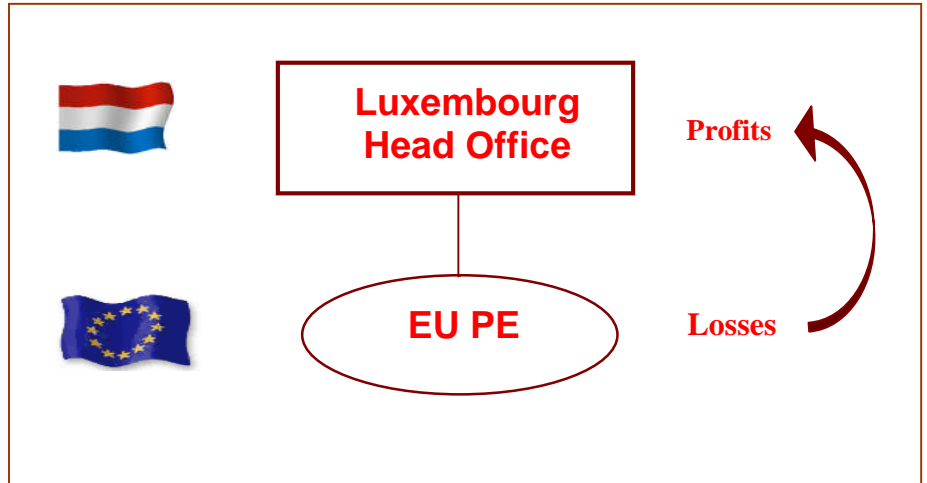
The AG considers that the German tax measure at issue is in breach of the freedom of establishment principle, since a German company with a Luxembourg PE is not allowed to take into account its Luxembourg losses and is thus treated less favourably than a German company with losses from a domestic PE.

According to the AG, the non-recognition of foreign PE losses could however be justified by some grounds of justification accepted by the Court, namely the balanced allocation of the power to impose taxes between Member States and the danger that losses might be used twice.

Nevertheless, the AG considered that the German tax measure at issue is disproportionate with regard to the objectives of preserving the balanced allocation of the power to impose taxes and keeping losses from being used twice. According to the AG, a less restrictive approach would be to allow the immediate deduction of losses in Germany and provide for the recapture of the loss in future profitable periods. Such a measure would avoid the cash flow disadvantage of the measure at issue.

Consequences for Luxembourg Taxpayers

Should the ECJ follow the AG's opinion, Luxembourg taxpayers would be able to immediately deduct losses incurred by their EU PEs, even in a double tax treaty situation. For the time being, we believe that Luxembourg taxpayers can use the AG's opinion as a basis to claim the deduction of losses incurred by their EU PEs. While taxpayers wait for the ECJ to rule on the *Lidl Belgium* case, they could use already apply for the deduction in the tax returns they are preparing. They could also file an amendment to the returns they already filed but which have not been assessed yet.



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