

CJEU rules that Germany does not infringe the freedom of establishment by not allowing the deduction of final losses incurred in a permanent establishment in the UK

On 22 September 2022, the Court of Justice of the European Union (CJEU) rendered its judgement in the case C-538/20 (W AG) finding that Germany does not infringe the freedom of establishment by not allowing the deduction of final losses which a German company had incurred in its permanent establishment (PE) situated in the UK because Germany as the state of residence has waived its power to tax the profits (and losses) of that PE under a double tax treaty.

Facts of the case

The plaintiff is a German securities bank which owned a loss-making PE in the UK from August 2004 until February 2007. Having closed the PE, the plaintiff claimed the deduction of the final losses in its German tax returns filed for the fiscal year 2007. The German tax authorities disregarded the final losses of the UK PE for the plaintiff's corporate tax and trade tax. The plaintiff made the case that the German tax authorities' construction of the UK-German tax treaty, according to which an exemption of profits from a UK PE means that losses are also exempted, violates the freedom of establishment. The Federal Fiscal Court referred the case to the CJEU.

CJEU judgment

The CJEU ruled that in the case where the state of residence refrained from exercising its power to tax the profits (and losses) of the foreign PE under a double tax treaty, the situation of a company with a PE in another Member State is not objectively comparable to the situation of a company with a domestic PE. Therefore, the freedom of establishment is not infringed by the unequal treatment of the two situations and there is no requirement under EU law to deduct final losses of the foreign PE at the level of the parent company. According to the CJEU, this ruling does not contradict the judgment in *Bevola and Trock* (C-650/16 of 12 June 2018) since in the latter decision Denmark had unilaterally (i.e. by national law) waived its power to exert its taxing rights over the profits (and losses) incurred in another Member State.

Takeaway

This judgement shows that the CJEU is tending to regard a foreign loss-making PE as not comparable to a domestic loss-making PE if a tax treaty exempts profits (and losses) of a foreign PE. Therefore, it can be assumed that final PE losses which are exempted under a tax treaty can not be deducted in the state of residence of the taxpayer.

Let's talk

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