MARKS AND SPENCER: THE END OF AN ERA?

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Tags
C.J.E.U.
Freedom of Establishment
Group Relief
Marks and Spencer

The creation of the European Union dates back to the aftermath of World War II. Its objective was mainly to prevent the return of war between neighboring European countries. Over time, the now-called "E.U." evolved, and today its 28 Member States share one single internal market. Unlike the United States, the E.U. is not a federal country but is composed of 28 independent Member States, much like the Confederation that existed immediately after the end of the Revolutionary War. In order to create its internal market, the Member States of the E.U. handed over to the E.U. certain aspects of their sovereignty. This process resulted in the establishment of four fundamental freedoms that underpin the internal market and are supervised by the E.U. institutions. The fundamental freedoms are:

- The freedom of capital,
- The freedom of goods,
- The freedom of people, and
- The freedom of services and establishment.

These freedoms allow capital, goods, people, services, subsidiaries, and branches to freely move and be located throughout the E.U. It is with regard to the freedom of establishment that the Court of Justice of the European Union ("C.J.E.U.") handed down its landmark 2005 *Marks and Spencer* decision.[47] In a nutshell, and as explained in detail below, that case provided that losses of an out-of-country subsidiary of an entity resident in an E.U. member state should be eligible for group relief if and to the extent group relief was available to a group of wholly domestic companies. Certain conditions were imposed under the case, but in general, the freedom of establishment meant that member states could not discriminate against a foreign E.U. based subsidiary in establishing certain tax rules allowing for the utilization of losses incurred by domestic subsidiaries and disallowing the same use for foreign E.U. based subsidiaries. In a recent opinion, the C.J.E.U.'s Advocate

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[47] Case C-446/03, Marks & Spencer plc v. David Hasley (Her Majesty's Inspector of Taxes), 12/13/2005.

General, Juliane Kokott, suggested that the terms used in the *Marks and Spencer* decision should now be abandoned.[48]

I. MARKS AND SPENCER: GROUP RELIEF AND FREEDOM OF ESTABLISHMENT

Marks and Spencer involved U.K. group relief legislation that, among other things, allowed a U.K. group parent company to offset the losses of its U.K. subsidiaries against the parent's profits. In this case, the U.K. parent company, Marks & Spencer plc ("M&S"), had loss-generating subsidiaries in France, Germany, and Belgium. M&S claimed these losses against its U.K. profits, and the claims were rejected on the grounds that profits of the group parent could only be offset by losses recorded in the U.K.

The key issue in *Marks and Spencer* was whether the above-mentioned legislation constituted a restriction on freedom of establishment. Freedom of establishment prohibits a Member State from treating foreign nationals and foreign companies differently from its own nationals and companies established in its jurisdiction. It also prohibits a Member State from preventing its nationals or companies established in its jurisdiction from seeking establishment in another Member State.

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In *Marks and Spencer*, the C.J.E.U. concluded that the U.K. legislation placed a restriction on the freedom of establishment principle. It did so because a U.K. company that had only U.K. subsidiaries had a cash advantage in being able to immediately offset the subsidiaries' losses against its profits. A U.K. parent company was deprived of that cash advantage when its loss-generating subsidiaries were located in other E.U. member states. The C.J.E.U. advised that this type of restriction may be permitted only where:

- It is enacted pursuant to a legitimate objective compatible with the Treaty Establishing the European Community,
- It is justified by an imperative objective in the public interest, and
- Its application is appropriate to ensure the attainment of the pursued objective and does not extend beyond what is necessary for the attainment of that objective.

After analysis of these various factors, the C.J.E.U. concluded that because less restrictive measures existed, the U.K. group relief legislation at issue was contrary to the freedom of establishment principle.

The C.J.E.U. decided that freedom of establishment does not inherently prohibit domestic legislation which provides for a domestic parent to offset losses suffered by a domestic subsidiary but not those suffered by a foreign subsidiary organized in

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[48] Opinion of Advocate General Kokott, delivered on 23 October 2014 in Case C-172/13, European Commission v. United Kingdom of Great Britain and Northern Ireland

a member state of the E.U. However, such legislation will be viewed to violate this principle where a nonresident foreign subsidiary is precluded from using its losses in the past, present, or future, in its country of residence or in the group's country of residence. This is especially the case where less restrictive measures could be followed. In other words,the restriction must be proportional to the attainment of the freedom of establishment.

II. ADVOCATE GENERAL KOKOTT'S OPINION IN CASE C-172/13

Ultimately, the European Commission (the "Commission") doubted the compatibility of post-*Marks and Spencer* U.K. legislation with the *Marks and Spencer* decision, and requested that the U.K. modify its domestic implementation. The Commission argued that subsequent U.K. legislation made it virtually impossible to obtain cross-border group relief because it provided for very limited time in which to determine the existence of potential future relief. Absent any change in U.K. law, the Commission then referred the issue to the C.J.E.U.

In her opinion in Case C-172/13, Advocate General Juliane Kokott argued that the *Marks and Spencer* decision should be reconsidered and that it conflicts with other European case law relating to tax matters. She underscored that the circumstances of *Marks and Spencer* are far from clear and that the decision resulted in costly disputes between relevant tax administrations and the taxpayers.

Furthermore, the U.K. group relief legislation at issue did and does not violate the proportionality principle according to Kokott. Materially, a non-U.K. subsidiary is not in the same position as a U.K. subsidiary, and the U.K. legislation does allow for losses of a foreign subsidiary to be taken into account in limited circumstances. Hence, Kokott held that it does not restrict freedom of establishment.

While some speculate on the far-reaching implications of this argument, it is unlikely that the C.J.E.U. will follow Kokott's non-binding opinion. Two reasons exist for this view. First, were the opinion to be followed by the C.J.E.U., it would result in the imposition of the high costs on European groups because their tax planning arrangements would be invalidated. Second, this is not the first time that Kokott has argued in favor of abandoning the *Marks and Spencer* decision,[49] and it would not be the first time the C.J.E.U. looks the other way.

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[49] See, for instance, her opinion in Case C-123/11, A Oy, 11/19/2012.