

M&S TAKES TAX CASE TO EUROPE

The Advocate-General of the European Court of Justice (ECJ) is due to give his opinion on the case of Marks & Spencer v Halsey on 7 April 2005. M&S has claimed relief for European subsidiary company losses against UK taxable profits.

The fact that the opinion is due to be given so soon after the February oral submissions, essentially an opportunity for the judges to ask questions, underlines the importance of the case.

Normally, the opinion – which is not binding, but is more than likely to be followed by the court – is delivered months after the two sides make their representations.

Key points

The Inland Revenue wants to stop the losses of European subsidiaries being offset against UK group profits. Such a prohibition under UK law could be in breach of the European treaty.

Should M&S triumph, then the claims by other companies under Group Litigation Orders (GLOs) is estimated to cost the Exchequer billions. And add to that bill the possibility of other challenges to UK tax law on non-compliance with European obligations could amount to £20bn.

Finally, in the longer term, this case could increase the pressure for a common European Union tax system. In the meantime, companies could see Gordon Brown introduce defensive action – such as abolishing group relief altogether – in a bid to curtail ongoing tax losses.

Background

In November 2002, the Special Commissioners decided that the parent company's (Marks & Spencer's) decision to establish a subsidiary in another country was choosing to subject itself to a different tax system and non-UK losses could not be used against UK profits.

In May 2003, the High Court acknowledged that there were some real arguments to be considered under European law and referred the matter to the ECJ. Mr Justice Parks commented: "I don't know how many other companies are queuing up behind M&S. But the amounts make me shiver and I'm sure they make the Revenue shiver also."

Dirty tricks

The Revenue's reaction, according to a letter in the *Financial Times* on 8 February from Philip Martin, the former deputy head of tax at M&S – included "all manner of 'dirty tricks' by the Revenue that are being investigated by the regulatory authorities."

Dirty tricks aside, queue they did. General Litigation Orders (GLOs) have been made under which between 60 and 70 companies are submitting claims based on the outcome of the M&S case. Initially, the High Court dismissed the claims on the basis that they had to be made to the Commissioners and be subject to the normal system. The Court of Appeal subsequently ruled that a GLO should be dealt with by the High Court. Hence, so much now hangs off this one case.

The legal issues

- The European Community Treaty Article 43 establishes the right of freedom of establishment
- Current rules make it less attractive to establish a subsidiary in another member state than to establish a subsidiary in the UK
- Current rules hinder the right to choose the most appropriate form of establishment: a branch presence in another member state is more favourably treated on this tax issue than a subsidiary
- The attempt by the Revenue to mount a defence based on fiscal cohesion and the need to protect national tax revenues is likely to find little favour at the ECJ.

If M&S wins the case there are some immediate ramifications:

- M&S and other GLO companies will pursue their claims with an ability to backdate six years, although there may also be a separate challenge to the six-year limitation.
- It seems unlikely the government will stand idly by: it could remove group relief even in a UK-to-UK context (there is precedent for this in changes to the transfer pricing rules).

Long-term effects

But perhaps the longer-term ramifications are more interesting. The EU's Economic and Financial Affairs Council (ECOFIN) is already examining plans to introduce a common consolidated tax base for Europe. A majority of EU finance ministers back the plan, but not Ireland or the UK. The proposal is to create a common tax base by harmonising member state rules, introduce consolidation across Europe, and divide the tax among the member states. Such a step might be welcomed by multinationals as a move to avoid multiple compliance.

Others might be concerned at the minimisation of the possibility of reducing tax liability through taking advantage of differences in tax systems.

Another way may be to allow a parent company to be taxed on a consolidated basis in accordance with the laws of the parent company's jurisdiction by electing to be subject to the tax law of a particular member state. Austria, Denmark and Italy have already introduced changes to expand their group rulings. The question remains whether UK domestic group relief rules will be changed to avoid discrimination claims.

The UK government is more sensitive than others in the European Union to attacks on corporate taxation as its receipts from that sector are higher in percentage terms than many other jurisdictions.

Even after the Advocate-General speaks, the judgment itself won't be given until early autumn 2005. If the verdict is as expected, then whatever British politicians may want, M&S may have to take the credit for provoking a by-the-back-door EU harmonised direct tax system.

Peter Williams

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- The briefing was based on a paper by Tom Daltry of Eversheds LLP. Tom Daltry can be contacted at tomdaltry@eversheds.com