

# M&S LOSES TAX BATTLE WITH INLAND REVENUE

**First Marks & Spencer got into a fight with Customs over the VAT reclaim period (see page 46 of the November 2002 issue of *Financial Director*) and now it's lost out to the Inland Revenue over group relief for overseas losses.**

At the start of the year, Marks & Spencer (M&S) lost its appeal to the special commissioners over the refusal of the Inland Revenue to accept group relief claims for losses incurred by M&S's continental EU subsidiaries.

The issue considered by the special commissioners was whether, by virtue of European law, the company was entitled to relief for losses incurred by subsidiaries established and resident in Belgium, France and Germany against the profits of the UK resident parent company.

## Foreign subsidiaries

M&S had established subsidiaries, incorporated and resident for tax purposes, in Belgium, France and Germany. There were 26 stores in all with 1,500 employees. In the period in question – from 31 March 1998 to 31 March 2001 – trading losses amounted to around £98m.

M&S had sufficient other profits to absorb the foreign subsidiaries' losses in the four years concerned and made group relief claims accordingly. However, the Inland Revenue refused to allow claims for group relief for the first three years (1998, 1999 and 2000) on the basis that the foreign subsidiaries were not resident in the UK as required by section 413(5) of the

Income and Corporation Taxes Act 1988. This requirement was repealed by the Finance Act 2000. This meant that for accounting periods beginning on or after 1 April 2000, group relief is available in cases in which the loss-making company is either resident in the UK or carrying on a trade in the UK through a branch or agency. As M&S's overseas subsidiaries did not satisfy either the residency or the trade test, the Inland Revenue also refused M&S's claim for group relief for 2001.

M&S conceded that as a matter of UK law none of the overseas subsidiaries were entitled to surrender the trading losses it incurred for any of the years concerned or to any other member of the M&S group. However, the company believed that by denying the right of its subsidiaries in other member states to surrender to M&S their trading losses, UK legislation infringes Article 43 of the EC Treaty. And the European Court of Justice has stated that although direct taxation is a matter for member states, they must exercise their direct taxation powers consistently with Community law.

## Article 43

This states: "Restrictions of the freedom of establishment of nationals of a member state in the territory of another member state shall be prohibited. Such prohibition shall also apply to restrictions of the setting up of agencies, branches or subsidiaries..."

However, M&S's arguments did not convince the special commis-

sioners. In their ruling they said: "The UK did not seek to tax the foreign subsidiaries in respect of their activities in France, Belgium and Germany and we therefore do not think it disproportionate to deny them relief for the losses they suffered in those activities.

"It's obviously possible to suggest that the UK government should adopt a more generous approach to the losses (and the same might be said to the French, Belgium and German governments) but that does not mean that the UK's failure to provide relief is a disproportionate response."

## Reasons for dismissal

The special commissioners gave four main reasons for dismissing M&S's appeal:

- Article 43 requires that establishments in other member states receive no less favourable treatment than that accorded to nationals of the member state concerned. Subject to that, the tax treatment accorded to one form of establishment may be more favourable than that accorded to the other.
- The UK is not required to accord the same group relief for losses incurred by M&S's foreign subsidiaries as it does for losses incurred by a UK subsidiary. The foreign subsidiaries are not in an objectively comparable situation to a UK subsidiary that's within the scope of UK tax in respect of its worldwide activities.
- Failure to obtain relief for the losses incurred by M&S's foreign subsidiaries does not infringe Article 43. Instead, it derives from the allocation of fiscal jurisdiction among member states and their failure to agree appropriate measures for the harmonisation of their direct tax systems.
- Even if the UK group relief rules create an obstacle to the right of establishment in other member states which needs to be justified,

the denial of UK relief for losses on activities whose profits are not subject to UK tax can be justified as necessary to maintenance of the coherence of the UK's tax system and proportionate.

Although M&S confessed disappointment with the decision, tax experts were still predicting a victory for M&S on appeal. This could lead to tax repayments leading to hundreds of millions of pounds for many companies.

Peter Cussons, international corporate tax partner at PwC said: "This decision is both surprising and disappointing. The conclusion is disputable. Not all the relevant case law was considered and some of the case law considered was misconstrued.

"In order for UK companies to continue to protect their position, they should still consider making High Court claims for commercial damages and restitution in respect of tax paid in the previous six years. Where companies are within the appropriate time frame they should also consider making prospective group relief claims," he said.

*Peter Williams.*

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