FELIXSTOWE - IS IT A CASE FOR THE CJEU?

Nerissa Pace[1]

Introduction

On the 1st April 2014, the Court of Justice of the European Union ("CJEU") delivered a judgement in the case *Felixstowe Dock and Railway Company Ltd and Others v The Commissioners for Her Majesty's Revenue & Customs*[2], in relation to the compatibility of United Kingdom consortium group relief rules with the freedom of establishment. The UK group relief rules have been under scrutiny in previous decisions of the CJEU[3], and this is the second time that the consortium relief rules were in found to be in breach of EU law.[4] The CJEU held in *Felixstowe* that the tax rules at issue were precluded by Articles 49 and Article 54 on the Treaty of the Functioning of the European Union (TFEU). The rules at issue state that losses can only be transferred to a UK resident company which is a member of a group, by a company also resident in the UK, which is a member of the consortium if the link company[5] is also resident in the UK or carries on business in the UK through a permanent establishment. The UK consortium relief rules did not permit the transfer of losses if the link company was resident in another Member State.

---

1 Nerissa Pace, B.Accountancy (Hons), University of Malta, CPA. LLM Tax Law Candidate, Queen Mary University of London; e-mail: nerpace@gmail.com

2 See Judgement in *Felixstowe*, C-80/12, EU:C:2014:200

3 To this effect see: Judgement in *Marks and Spencer,* C-446/03, EU:C:2005:763 and Judgement in *Philips Electronics UK*, C-18/11, EU:C:2012:131

4 The first case relating to consortium group relief rules brought before the CJEU was Judgement in *ICI*, C-264/96, EU:C:1998:370.

5 A "link company" is a company which forms part of a group and also part of a consortium of companies. This means that it is considered to be the 'link' between the group companies and the consortium companies.

Facts of the case

The claimant companies (Felixstowe Dock and Railway Company Ltd and others) are resident in the UK and belong to a group which is owned by an ultimate parent company having its corporate seat in Hong Kong. Hutchison 3G Investment Sarl (the "Link Company") is resident in Luxembourg, forms part of the Hong Kong owned group and also forms part of a consortium with other companies, namely another UK Company ("Consortium Company").

In terms of UK law, consortium relief works in a similar manner to group relief, i.e. a surrendering company will surrender its losses to the claimant companies in return for a consideration. In consortium relief situations, a consortium company can transfer its losses to a group company by means of a Link Company. However, in terms of UK law, the Link Company must be a UK resident or carry on trade in the UK through a permanent establishment. In *Felixstowe*, the Link Company was resident in another EU Member State, Luxembourg, and had no permanent establishment in the UK.

HMRC denied the granting of consortium relief from to the claimant companies, despite both companies being UK resident on the basis that the Link Company was a company which was not resident in the UK.

Which freedom?

The preliminary question in *Felixstowe* refers to the freedom of establishment and the Court makes its judgement based on whether UK tax legislation precluded the freedom of establishment. However, the Advocate General in his opinion made reference to the free movement of capital and highlighted the difference between the free movement of capital and freedom of establishment. Taking into account the facts of the case, he correctly determined that the freedom of establishment was the predominant freedom in this case. Previous case law provides us with discussions about the determination of the predominant freedom, as we see in *Thin Cap GLO* and more recently in *Kronos*.[6]

Kronos

Kronos is a German resident company with shareholdings in Germany and other Member States. German national rules allowed for an exemption from tax in Germany on dividends received from foreign subsidiaries; however an imputation

6 See Judgement in *Thin Cap GLO*, C-524/04, EU:C:2007:161 and Judgement in *Kronos*, C-47/12, EU:C:2014:2200.

system was applied for dividends received from German subsidiaries. Both the exemption and imputation systems cater for the elimination or reduction of economic double taxation of dividends received by German resident companies.[7]

One of the issues in *Kronos* was that German national rules only granted an exemption to dividends received from non-German subsidiaries when the shareholding of the company receiving the dividend in the subsidiary distributing dividend was at least 10%.[8] The Court pointed out that this shareholding threshold was not sufficient to establish whether direct influence existed or not, and, therefore, the national rules were not clear about whether they referred to shareholdings with a direct influence or those without.[9]

The Court held that where a predominant freedom cannot be determined in an intra-EU situation (i.e. the freedom of establishment or the freedom of capital), the Court should refer to the facts of the case to determine which freedom, if any, was predominant.[10]

Similarly, in *Felixstowe*, the Advocate General interpreted the national rules on consortium relief as not being applicable solely to direct influence shareholdings, and, therefore, the facts of the case needed to be applied to determine the predominant freedom.

The Court accepted that the *Felixstowe* situation fell within the scope of the freedom of establishment and noted that the loss relief in these proceedings offers a tax advantage to the companies concerned as losses are used up in a more efficient manner, and can be used quicker against profits of other companies within the group.[11] The Court went on to say that giving a different treatment to a consortium which has its Link Company established in another Member State than to a consortium which has its Link Company resident in the United Kingdom makes freedom of establishment more restrictive:

> "That difference in treatment makes it less attractive in tax terms to establish a link company in another Member State, since the applicable national legislation grants the tax advantage at issue only where link companies are established in the United Kingdom."[12]

---

7 See T. O'Shea *'CJEU Finds German Exemption Regime Acceptable'*, Tax Notes Int'l, February 2015, pp.427-431

8 Judgement in *Kronos,* EU:C:2014:2200, paragraph 33

9 *Id* [5] pp. 428

10 *Id* [6] Para 37

11 Judgement in *Felixstowe*, EU:C:2014:200, paragraph 19

12 *Id.* para 21

What is the comparator?

In *Felixstowe*, the determination of the comparator was not so straightforward. Here, there was a difference in treatment depending on the where the Link Company was resident. Had the Link Company been resident in the UK, then conditions under UK legislation would be fulfilled and consortium relief may be granted. Yet, no consortium relief is granted if the Link Company is resident in another Member State. This difference in treatment gave rise to a restriction which may only be justified by one of the public interest justifications.[13] If comparability is established, and no justification exists for the difference in treatment, then this treatment may constitute a restriction or discrimination.[14]

In *Felixstowe*, this was not so clear-cut. Both the consortium and the group companies were UK resident and had not exercised an EU freedom. Therefore, the comparison had to involve the comparison of the UK companies in *Felixstowe* with companies in a similar situation which had a UK Link Company in place of a Luxembourg Link Company as was the case in *Felixstowe*. The Court accepted that UK companies in a consortium which were linked by a UK company and companies in a consortium linked by a company established in another EU Member State were in an objectively comparable situation. The Court came to this conclusion since the losses in both instances were sustained in the United Kingdom.[15]

Despite the fact that it was not the UK company which exercised the freedom of establishment, a restriction still applied. The Court clarified a point made previously in *Philips Electronics* that "a company may, for tax purposes, rely on a restriction of the freedom of establishment of another company which is linked to it in so far as such a restriction affects its own taxation." [16]

Justifications

Notwithstanding the Court's assessment that the UK legislation did in fact preclude the freedom of establishment as a result of the restriction provided by the consortium relief rules, the UK failed to bring forward any justifications for its legislation[17]. However, for the benefit of providing guidance to the national court

13 Judgement in *Marks and Spencer,* EU:C:2005:763, paragraph 35

14 See T O'Shea, *EU Tax Law and Double Tax Conventions* (Avoir Fiscal Limited, London 2008) p.42

15 See Judgement in *Felixstowe,* EU:C:2014:200, paragraph 26.

16 *Id.* paragraph 23

17 *Id.* paragraph 27

to enable it to deal with any justification arguments, the CJEU analysed whether any general interest justification could be applied to the UK legislation at issue, which might justify the restriction on the freedom of establishment.

Preservation of the balanced allocation of taxation powers

The first justification analysed by the Court was the preservation of the balanced allocation of taxing rights between the Member States. The Court's analysis showed how this justification could not be accepted in this case. The Court recognised that it had been accepted as a valid justification in previous cases, such as *Marks and Spencer* and *Lidl Belgium*[18]. In *Lidl Belgium*, German rules disallowed losses incurred in the Luxembourg PE from being deducted against profits of the German company with the Luxembourg PE. One of the submissions to the Court was the preservation of the balanced allocation of the powers of taxation between the Member States. In that case, the Court pointed out that German rules safeguarded the "symmetry between the right to tax profits and the right to deduct losses."[19]

However the facts are different in *Felixstowe,* since the profits and losses arise in the same Member State, as both the company surrendering the losses and the company claiming the losses are resident in that State. It is only the Link Company (which does not claim or surrender any of the losses, and, therefore, does not receive any tax advantage) which is not a resident of the UK. Therefore, the UK has in this scenario both the right to tax profits (for the claimant companies) and the right to surrender losses (for the surrendering company.) In *Felixstowe*, the Court clarified this understanding and made reference to *Philips Electronics* where it had applied the same reasoning.

Combatting tax avoidance

The need to combat tax avoidance is a stand-alone justification in the Court's jurisprudence since *ICI*[20]. It is also used in conjunction with the need to preserve the balanced allocation of taxing rights between the Member States.[21] The Court ruled that the need to prevent the risk of tax avoidance was acceptable as a justification in cases where the legislation was specifically targeted at wholly artificial arrangements designed to circumvent the national tax system.[22] The Court

18 See Judgement in *Lidl Belgium*, C-414/06, EU:C:2008:278

19 *Id* paragraph 33.

20 See Judgement in *ICI*, C-264/96, EU:C:1998:370

21 See Judgement in *SGI* C-311/08, EU:C:2010:26

22 See Judgement in *Felixstowe* paragraph 33.

stated that any national legislation targeted at combatting such arrangements will not preclude the freedom of establishment. The Court cited *Cadbury Schweppes*[23] in support.[24] Nevertheless, in its analysis the Court recognised that the purpose of the national legislation was solely to grant a tax advantage to group/consortium companies,[25] and there was no element of tax avoidance or wholly artificial arrangements involved.

The Court's Conclusion

The Court concluded that that there was a restriction on the freedom of establishment by not granting consortium relief where the Link Company was resident in another EU Member State, and there was no acceptable general interest justification available. Therefore, the UK legislation regarding consortium relief breached Article 49 and 54 TFEU.[26]

Should EU law apply?

Third Countries involvement

Initially, one might interpret *Felixstowe* as a non-EU case. The fact that the group of companies is owned by a third country company might raise the question as to whether this case should be argued in the CJEU, as this would mean that a third country company is availing itself indirectly of EU law rights. The TFEU expresses in Article 49 that the freedom of establishment applies to nationals of EU Member States.[27] Nevertheless, the TFEU also goes on to say that companies formed in a Member State and whose central place of business is in one of the Member States are to be given the same treatment as nationals of a Member State.[28] In *Felixstowe*, the Link Company was a Luxembourg resident company and, therefore, was in a position to exercise its EU freedom of establishment irrespective of where its shareholders were resident. The TFEU imposes no requirement on where the shareholders are resident as long as there is a genuine

23 See Judgement in Cadbury Schweppes, C-196/04, EU:C:2006:544

24 See Judgement in *Felixstowe,* EU:C:2014:200 paragraph 31

25 *Id* paragraph 19

26 *Id* paragraph 42

27 This is extended to nationals of EEA States under the Agreement on the European Economic Area, Article 31

28 Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, 2010/C 83/01, TFEU, Article 54

company within the EU. Thus, the decision of the Hong Kong parent company to invest in companies established in the EU provided it with the opportunity to access EU advantages, indirectly.

Furthermore, it is not the first time that the CJEU has had to deal with third country companies accessing EU 'tax advantages'.[29] In the *Halliburton* case[30] an American company had established two subsidiaries in two different EU Member States, Germany and the Netherlands. The German subsidiary established a branch in the Netherlands. The group underwent a corporate re-organisation and it was decided that the branch of the German company would be transferred to the Dutch subsidiary. This triggered a tax charge in the Netherlands, which would not have arisen had the transfer taken place between two Dutch companies. This treatment was challenged successfully on grounds of freedom of establishment. The Court held that the difference in treatment constituted discrimination on grounds of nationality.

The *Halliburton* judgment demonstrates that through the establishment of two European subsidiaries, the American parent company indirectly accessed the advantages of the freedom of establishment. Similarly, in the case at hand, the Hong Kong parent company had indirect access to the benefit of freedom of establishment, through its subsidiaries established in EU Member States. The Court clarified in *Felixstowe* what it had stated in the *Halliburton* judgment

> "…it does not follow from any provision of European Union law that the origin of the shareholders, be they natural or legal persons, of companies resident in the European Union affects the right of those companies to rely on freedom of establishment."[31]

Was there an exercise of freedom of establishment?

Another reason why this case might not have been brought before the CJEU is that the taxpayer does not appear to have exercised the freedom of establishment. The claimant companies, and the surrendering company are both UK resident and have not "exercised" any of the freedoms. In the Court's case law, it is the taxpayer who has exercised the freedom and receives unequal tax treatment.[32] Nonetheless, this is also not the first time in the Court's case law where the taxpayer is not the

29 See T. O'Shea. "Accessing EU 'tax advantages"*, Int'l Tax Rep.* Mar. 2009 pp. 6-8.

30 See Judgement in *Halliburton*, C-1/93, EU:C: 1994:127

31 See Judgement in *Felixstowe* EU:C:2014: 200 paragraph 40.

32 See Judgement in *Bouanich*, C-265/04, EU: C: 2006:51 and Judgement in *Commission v France* Case 270/83, EU:C: 1986:37.

person who exercises the freedom but is still negatively affected because of a restriction or a discrimination. A case in point is *Schempp*.[33]

It was Schempp's ex-spouse who exercised her freedom of movement to another Member State. Mr. Schempp, a German resident, paid alimony payments to his wife, but could not claim a tax deduction on these payments, since Mrs. Schempp was not taxed on these payments in her new state of residence. Had she remained in Germany or moved to a State where the maintenance payments were taxed, Schempp would have qualified for the tax deduction. In this case, despite the fact that Mr. Schempp did not exercise his freedom of movement, he was still affected in his tax calculation because of his wife's exercise of her right of free movement.
Similarly, in *Felixstowe*, it was not the claimant companies or the surrendering company which exercised their freedom of establishment as such. The fact that the Link Company was established in another Member State however, affected their tax calculation in a negative way. The Court reaffirmed its *Philips Electronics* reasoning, and stated that a company may "rely on a restriction of the freedom of establishment of another company which is linked to it in so far as such a restriction affects its own taxation"[34]

Losses which are not cross-border

The fact that the surrendering of losses did not take place cross border may be another argument which questions the relevance of EU law in *Felixstowe*. Unlike *Marks and Spencer*, *Felixstowe* does not deal with the cross-border surrender of losses, i.e. the surrendering of losses from a surrendering company resident in one Member State to claimant companies resident in another Member State.[35] The transfer of losses in this case is between two UK companies, and, therefore, it might be argued that there is no issue of EU law. However, since the type of relief granted in this case is not a group relief but a consortium relief, there is a condition which needs to be met in terms of the UK legislation in order for the relief to be granted. The link company connecting the surrendering company to the claimant companies in this case also needs to be a UK resident – a requirement which was not fulfilled in this case, since the Link Company was resident in Luxembourg. This fact gave rise to different in treatment between companies resident in the UK with a UK link company and companies resident in the UK with a link company resident in another Member State.[36] It is this difference in treatment which gives rise to the discrimination and it is the UK legislation which

33 See Judgement in *Schempp*, C-403/03, EU: C: 2005:446.

34 See Judgement in *Philips Electronics,* C-80/12, EU: C: 2012:131, paragraph 39.

35 See Tom O'Shea, '*U.K. Consortium Group Relief are Defective, CJEU says'*, Tax Notes Int'l 69 (September 2014) pp.759-762

36 See Judgement in *Felixstowe*, EU:C:2014:200, paragraph 20.

is hindering the Link Company from establishing itself in another Member State, which is contrary to the EU freedom of establishment.

Conclusion

In *Felixstowe* the Court confirmed its earlier judgement in *Philips Electronics* on two different points. Firstly, despite the fact that the transfer of losses was not cross border, the UK rule could still be in breach of EU law. Given that the losses were sustained in the UK, this differentiated *Felixstowe* from *Marks and Spencer*, and this is why the balanced allocation of taxing rights and the need to prevent tax avoidance were not accepted as justifications by the Court.[37] In *Marks and Spencer*, the losses were generated outside the United Kingdom, and therefore, using these losses against UK profits would have negatively affected the balanced allocation of taxing rights.[38] Secondly, *Felixstowe* demonstrates that the taxpayer may rely on a restriction of freedom of establishment of another company, on the condition that the restriction affects its own taxation. The claimant companies and the surrendering companies did not exercise any of the EU freedoms, and yet they were affected negatively because the link company did exercise its freedom of establishment.[39]

On a final note, the Court's judgement in *Felixstowe* was another clear showcase of how third country companies can legitimately access the EU freedoms in an indirect manner by investing in EU resident subsidiaries. The presence of a non-EU/EEA company higher-up the chain in the group structure had no impact on the CJEU's analysis.[40] The residence of the shareholders of the EU resident company did not affect the CJEU's decision that there was a restriction of the freedom of establishment. National treatment had to be granted to the Luxembourg resident company. The granting of the consortium relief from the consortium company to the group companies meant that a tax advantage was granted and was benefitted by the whole group whose parent company's corporate seat was in Hong Kong. [41]

---

37 See Judgement in *Felixstowe,* EU:C:2014:200 paragraph 30 and paragraph 35.

38 See Tom O'Shea, '*U.K. Consortium Group Relief are Defective, CJEU says'*, Tax Notes Int'l 69 (September 2014) pp.759-762

39 *Id* paragraph 22

40 *Id* paragraph 37

41 *Id* paragraph 19