

FUTURA PARTICIPATIONS:¹ LUXEMBOURG ACCOUNT-KEEPING REQUIREMENT UNLAWFUL

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In May the ECJ again concluded that a provision of domestic tax law of a Member State, this time Luxembourg, was inconsistent with Article 52 of the EC Treaty.

On this occasion, the essential basis of the decision was that a Luxembourg prerequisite to the carry forward of tax losses had an effect disproportionate to the objective it sought to achieve. The applicable principle here is that, whilst *prima facie* discriminatory action may possibly be permitted where it pursues a legitimate aim compatible with the Treaty and is justified by public interest considerations, it may only be permitted where the measure in question does not go beyond what is necessary for the purpose.

Futura Participations SA was a French company. It had a Luxembourg branch known as "Singer". The dispute concerned Futura's liability to Luxembourg tax for 1986 in respect of Singer's activities. In computing its liability, Singer wished to bring forward a proportion of Futura's total losses incurred between 1981 and 1986.

This claim was resisted by the Luxembourg tax authorities. They relied upon a domestic law requirement that losses carried forward from previous years could only be utilised in the manner intended by Futura "provided that they are economically related to income received locally and that accounts are kept within the country". According to Luxembourg law, the relevant accounts had to comply with Luxembourg requirements; such accounts had not in fact been kept in relation to Singer's activities. Instead, following the approach which was permitted in

¹ *Futura Participations SA & Singer v Administration des Contributions* Case C-250-95: judgment given 15th May 1997.

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Luxembourg in relation to the determination of (positive) income, Singer sought to take into account an apportionment of Futura's total losses for the relevant loss-making years. The Luxembourg authorities denied the set-off of losses on this basis. On appeal to the Conseil d'État, the proceedings were stayed and the question of the compatibility of the Luxembourg rules with the Treaty was referred to the ECJ.

The question for the ECJ was as follows:

"Are Article 157 of the Law on Taxation of Revenue and, insofar as is necessary, Article 4 and the second sub-paragraph of Article 21(2) of the France-Luxembourg Convention on Double Taxation compatible with Article 52 of the EEC Treaty in as much as they make application to non-resident taxpayers having a permanent establishment in Luxembourg of provisions on the carrying forward of losses subject to the condition that the losses should be related to income received locally and that accounts should be duly kept and held within the country?"

Article 157 imposed the "economically related" and account keeping pre-conditions to the carry-forward to losses. Article 4(2) of the France/Luxembourg double tax treaty required each state to tax only the income derived from operations of the respective permanent establishment situated within its territory. Article 21(2) of the DTA, the non-discrimination provision, provided that a French domiciled taxpayer with a Luxembourg PE should be subject to the same conditions as regards the carry-over of losses, in relation to the Luxembourg PE, as for Luxembourg-domiciled taxpayers.

In fact, the application of the DTA provisions is not discussed at all in the decision of the ECJ. For that matter, the condition in Article 157 of the Luxembourg Law that losses carried forward must be economically linked to the income earned in Luxembourg is addressed with surprising brevity.

The Court observed that, for non-Luxembourg resident taxpayers, only profits/losses from their Luxembourg activities are taken into account in calculating Luxembourg tax payable by them. On the other hand, Luxembourg resident taxpayers were in principle taxable on their world-wide activities (even though in some cases exemptions may be available). Having thus focused upon the territorial nature of the Luxembourg tax system, the Court duly rejected any notion that such a system would be discriminatory in a manner prohibited by the Treaty. No doubt this is right, but the issue of economic, as opposed to territorial, linkage does not receive any real discussion.

The second condition imposed by Article 157 was that the taxpayer must have kept accounts, complying with Luxembourg national rules, physically in Luxembourg during the loss-making years.

The Court was very ready to find that this type of condition was in principle prohibited by Article 52 of the Treaty. But the precise basis for forming this view is less than clear. The Court observes that, under Luxembourg rules, in order to benefit from the carry-forward of branch losses, a company must keep, in addition to its own accounts complying with the rules in its state of residence, separate accounts for the branch activities complying with Luxembourg rules. The Court also notes that the separate accounts must be held at the branch rather than the company's seat. But this seems just to re-state the question, rather than provide a coherent explanation of how the conclusion is reached. The judgment does not analyse the accounting requirements for Luxembourg resident companies, and so the existence or nature of any discrimination against Singer, in relative terms, is unclear from the decision. (Note: the classic definition of discrimination as "the application of different rules to comparable situations or the application of the same rule to different situations": see e.g. the citation in *Schumacker*.³ Undoubtedly, a separate branch accounting requirement will have represented an administrative burden upon Singer, particularly when taken in conjunction with French accounting requirements (i.e. in Futura's state of residence). But query whether the accounting rule would have so readily been found to be in breach of Article 52 if, which is presumably not the case - but this is not apparent from the judgment, Luxembourg companies were required, as a pre-condition to loss carry-forward, to maintain separate accounts in respect of their Luxembourg activities (i.e. excluding their foreign activities).

Having identified a potential breach of Article 52, the Court moves on to the question of justification by reference to public interest. The Court was clear that "the effectiveness of fiscal supervision constitutes an overriding requirement of general interest capable of justifying a restriction on the exercise of fundamental freedoms guaranteed by the Treaty". It was therefore acceptable for Luxembourg to have rules enabling relevant income and losses to be ascertained clearly and precisely.

However, the Court concluded that it was not essential, in order to satisfy what they saw as the "sole concern" of the Luxembourg authorities to ascertain the losses, that the only way in which a non-resident taxpayer may demonstrate the amount of the losses was that prescribed by Article 157. In other words, although Luxembourg could require Futura to demonstrate clearly and precisely the amount

³ *Finanzamt Köln-Alstadt v Roland Schumacker* Case C-279/93, ECR [1995] I-255 page 259, para 30.

of the losses attributable to Luxembourg activities, it was not lawful, in view of the freedom guaranteed by Article 52 of the Treaty, to insist upon the holding in Luxembourg of accounts complying with Luxembourg national rules. Article 157 therefore represented a requirement which was disproportionate to the end it sought to attain.

Following the pattern set by a number of previous cases⁴ the Court observed that under the EC Mutual Assistance Directive 77/799/EEC, 19th December, 1977 the Luxembourg authorities could request the French tax authorities to provide them with all the information enabling them to ascertain the correct amount of revenue tax payable by Futura in Luxembourg. In other words, the inability to check such issues with the tax authorities in another Member State is itself no justification for discrimination. (One might think there is a degree of idealism here as regards the extent to which adequate information might promptly be provided by other competent authorities under the MAD.)

The Court was unpersuaded by the Commission's submission that the Article 157 accounting rule was unnecessary given that the Luxembourg authorities could always ascertain the amount of Luxembourg losses by referring to the accounts kept by Futura in France under French rules. The Court thought that, even if accounting rules could be assumed to be adequately harmonised (which itself seems highly debatable), the home state accounts would not necessarily provide sufficient information to enable the Luxembourg authorities to determine the measure of Luxembourg losses. This of itself seems pretty uncontroversial.

The Court, in concluding that the Luxembourg account keeping requirement was unlawful, did not, however, consider Luxembourg obliged to accept a calculation of Luxembourg losses by reference to an apportionment of total losses. Such an approach would of necessity imply inaccuracies.

In summary, therefore, the Court's ruling was as follows:

- Article 52 did not preclude a Member State requiring that losses which were to be carried forward must be economically related to the income earned by the taxpayer in the relevant state (provided that resident taxpayers did not receive more favourable treatment);

⁴ See, for example, *Bachmann v Belgium* Case C-204/90 [1992] ECR I-249 at page 320 para 20; *Halliburton Services BV v Staatssecretaris van Financiën* Case C 1/93 [1994] ECR I-1137 at page 1157 para 22.

- Article 52 did preclude loss carry-forward being subject to the pre-condition that accounts must have been kept and held in the state in which the activities were carried on;
- the Member State could however require the non-resident taxpayer to demonstrate clearly and precisely the amount of the losses to be claimed for carry-forward.

By and large, *Futura Participations* does not, in the writer's view, represent a dramatic leap forward in the ECJ's direct tax law jurisprudence. The Luxembourg authorities should not have been surprised to lose. And although some further commentary on the Luxembourg rules applicable to domestic Luxembourg companies would have been helpful, the French authorities should not have been astonished to see their application to have the case struck out (on grounds of there being insufficient information in the Luxembourg court judgment) despatched to the boundary.

On the other hand, the UK Inland Revenue, ever ready to intervene in proceedings such as these (though perhaps sharing some of the anxiety of the boy with his finger in the dyke) will, one presumes, have come away with a feeling of quiet satisfaction that the Court (i) refrained from making unnecessarily broad-brush comments about the legality in general of branch tax accounting requirements, and (ii) did not take the opportunity to unravel further the tax authorities' comfort-blanket that is the *Bachmann* "cohesion" (sic) principle.