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Implications of Marks & Spencer case in ECJ

You may be aware that Marks & Spencer has been pursuing its group relief case through the courts and this was referred to the European Court of Justice ("ECJ") in July 2003. The ECJ was asked to rule on whether the UK Government had infringed EU law by refusing to allow tax losses that Marks & Spencer had made in separate subsidiaries in other European countries to be offset against UK profits made by another Marks & Spencer company in the UK. Marks & Spencer argued that the refusal of the UK Government contravenes the fundamental right of a company to establish anywhere in the EU without discrimination.

The Advocate General, senior adviser to the ECJ, delivered his opinion on 7 April 2005, saying that the UK group relief rules preventing the use of overseas losses are incompatible with European Community law. Although his opinion is not binding, in practice the ECJ often agrees with the decision of the Advocate General.

The Advocate General concluded that UK's existing UK group relief system does constitute a restriction on the freedom of establishment under EU law, however, such a restriction is not prohibited under EU law if it is imposed for legitimate reasons compatible with EU law. However, he went on to draw a distinction in situations where relief for the losses could be obtained in the overseas territories as then the UK should be entitled to oppose a claim for the transnational transfer of those losses. This is to ensure that companies do not obtain a deduction for the losses in two jurisdictions. The position is not clear and this will be considered by the ECJ.

This is clearly a positive outcome for Marks & Spencer and significantly influences the various joint legal actions being taken by the companies in respect of specific areas of UK direct tax law which are considered to be in breach of EU law or the non-discrimination articles of the Double Taxation Treaties. This applies specifically to Japanese companies in the UK who could not surrender losses between each other for periods prior to FA 2000 as they were not held by a common UK parent company.

If this opinion is followed by the ECJ, the UK Government is likely to introduce changes in the group relief regulations in the UK, however, the scope of the changes and the position of Marks & Spencer and other group relief litigants is still uncertain. The ECJ is expected to provide a ruling in the next 3 to 6 months.

Actions to be considered

Background

Prior to 1 April 2000, losses could not be surrendered as group relief between UK companies with a common non-UK resident parent. In addition, it was also not possible to surrender losses between a UK subsidiary and a UK branch of a non-UK resident company. Therefore, the UK companies and branches of Japanese companies could not group relieve losses to each other since the ultimate parent company was in Japan. Following the ICI Plc v Colmer case, legislation introduced which ensured that all companies whether resident or non-resident, may be taken into account in establishing a group from 1 April 2000 and therefore, losses can be group relieved between the UK subsidiaries of a non UK parent group from 1 April 2000.

Alternative forms of Action

Where a company considers that tax is being levied in breach of the EC law or the Double Taxation Treaty between the UK and countries outside the EU, there are a number of options open to it:

Litigation as part of the Group Litigation Order (GLO)

Treaty Based Filing

Each option has its advantages and disadvantages and which is the best option will depend upon each company's individual facts and circumstances. A summary of the relevant factors is set out below while more detailed information is considered further below and in the attached appendices:

Treaty based filing	Litigation
Company does not pay tax	Company pays tax but then seeks compensation
Heard by Special Commissioners in first instance	Usually heard by High Court in first instance - although in some cases jurisdiction may still lie with Special Commissioners
Special Commissioners can only award repayment of tax plus interest	High Court may award damages in excess of tax paid
No equivalent of GLO procedure - dealt with on company by company basis	Group Litigation Order (GLO) enables companies to share costs and identify test cases
Relatively low profile	May lead to adverse publicity
Tax return remains open - may impact on returns for subsequent periods	No impact on UK filing position
Normal Taxes Act time limits apply - although these may themselves be in breach of EU law	Limitation period in High Court may be longer than Taxes Act time limits in some cases

Group Litigation Order (GLO)

The company could file its return and pay tax in accordance with UK law as it currently stands and then challenge the legality of that provision. Several companies are taking joint action in respect of specific areas of UK direct tax law which are considered to be in breach of EU law or the non-discrimination articles of the Double Taxation Treaties. The companies are pursuing the group relief claim through the courts using the GLO procedure. Companies have joined the GLO against the Inland Revenue to obtain group relief for periods prior to FA 2000 and this Pre FA 2000 group relief claim is a sub group within the main GLO claim.

The costs for joining the litigation can be substantial and the company would then bear a proportion of the litigation costs going forward. The advantage of going down this route is that the company is entitled to damages and can potentially recover the litigation costs. The company will also be entitled to receive interest on any tax repayments due to the company,

which is calculated at a rate significantly in excess of the normal interest rate on tax repayments.

Treaty Based Filing

Where a company considers that a provision of UK tax law is in breach of the EC treaty or the relevant Double Taxation Treaty, it may file tax returns and make tax payments on the basis that the domestic provisions should be interpreted in light of the EU law or the non discrimination article of the Double Taxation Treaty. Essentially this is a protective claim to avoid certain time limits expiring. The company will be required to submit an amended tax return which would include a claim for group relief. The costs for submitting an amended return are quite small compared with the costs of joining the litigation. A company may choose litigation as an alternative or in addition to the Treaty Based Filing. However, the company is not entitled to any damages and cannot recover costs incurred in making the claim and the company is only entitled to receive interest on any resulting tax repayments at the normal interest rate (significantly below that usually awarded in a GLO).

You will see from the above that this is a complicated area and we do not suggest that any decision should be taken without professional advice as this article only provides a background of the issues to consider

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