Cross-border loss utilisation

THE 33rd CONGRESS, COPENHAGEN 1979

'THE EFFECT OF LOSSES IN ONE COUNTRY ON THE INCOME TAX TREATMENT IN OTHER COUNTRIES OF AN ENTERPRISE OR OF ASSOCIATED COMPANIES ENGAGED IN INTERNATIONAL ACTIVITIES'

Mr. E. Moeller, Prof. I. Claeys Boúúaert, Dr. G. Laule, Mr. J.F. Spierdijk, Prof. A. Yoran, Prof. H.J. Ault, Prof. A. Fantozzi (Panellists in the Panel on the Discussion on Subject II)

Panel members

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- Jürgen Lüdicke, Germany, chair
- Carolin Lange-Hückstädt, Germany, secr.
- Jürg B. Altorfer, Switzerland
- Koichi Inoue, Japan
- Daniela Hohenwarter-Mayr, Austria
- Steve Suarez, Canada
- Gauthier Blanluet, France

A real life situation

Stranded losses (1/2)

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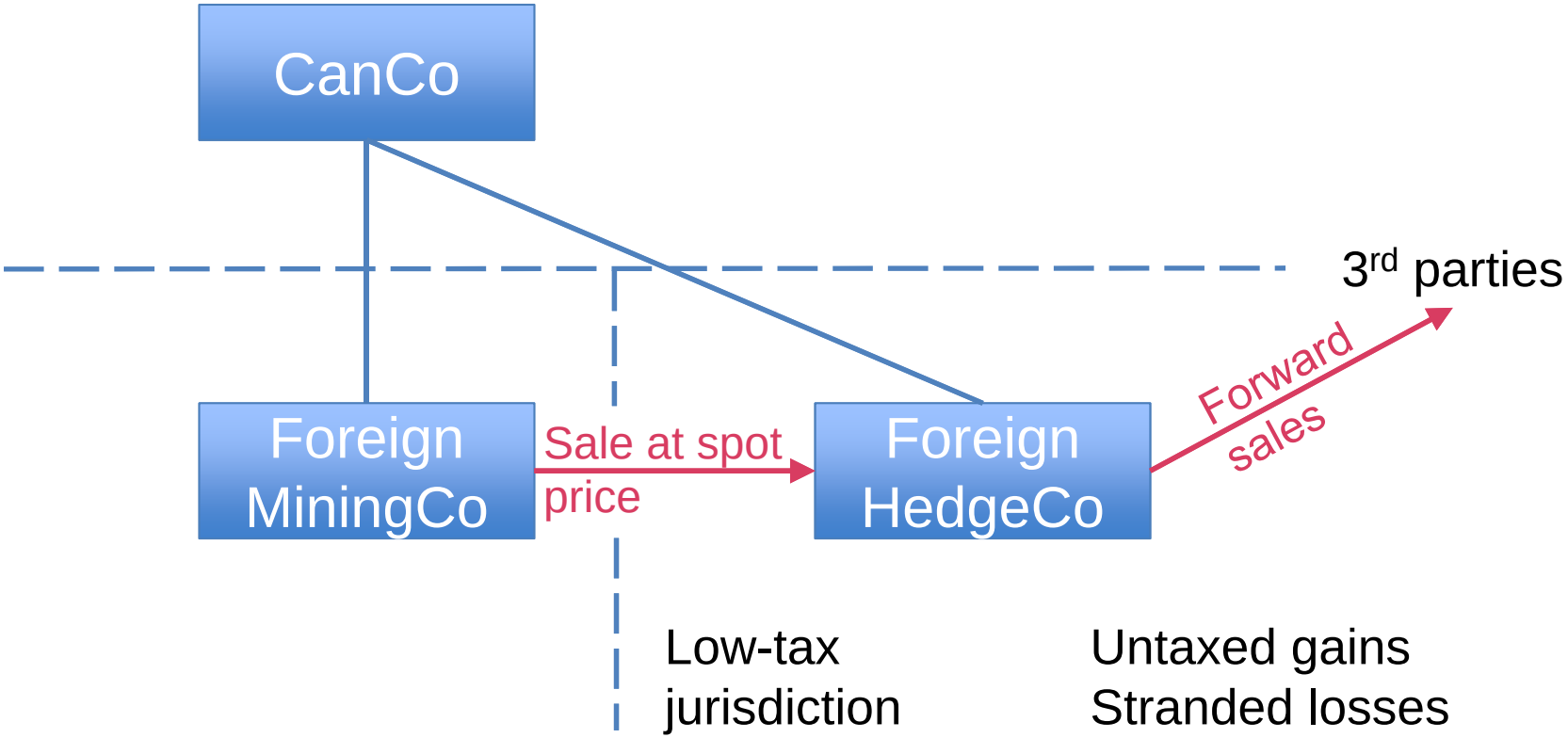
Hedging losses



A real life situation

Stranded losses (2/2)

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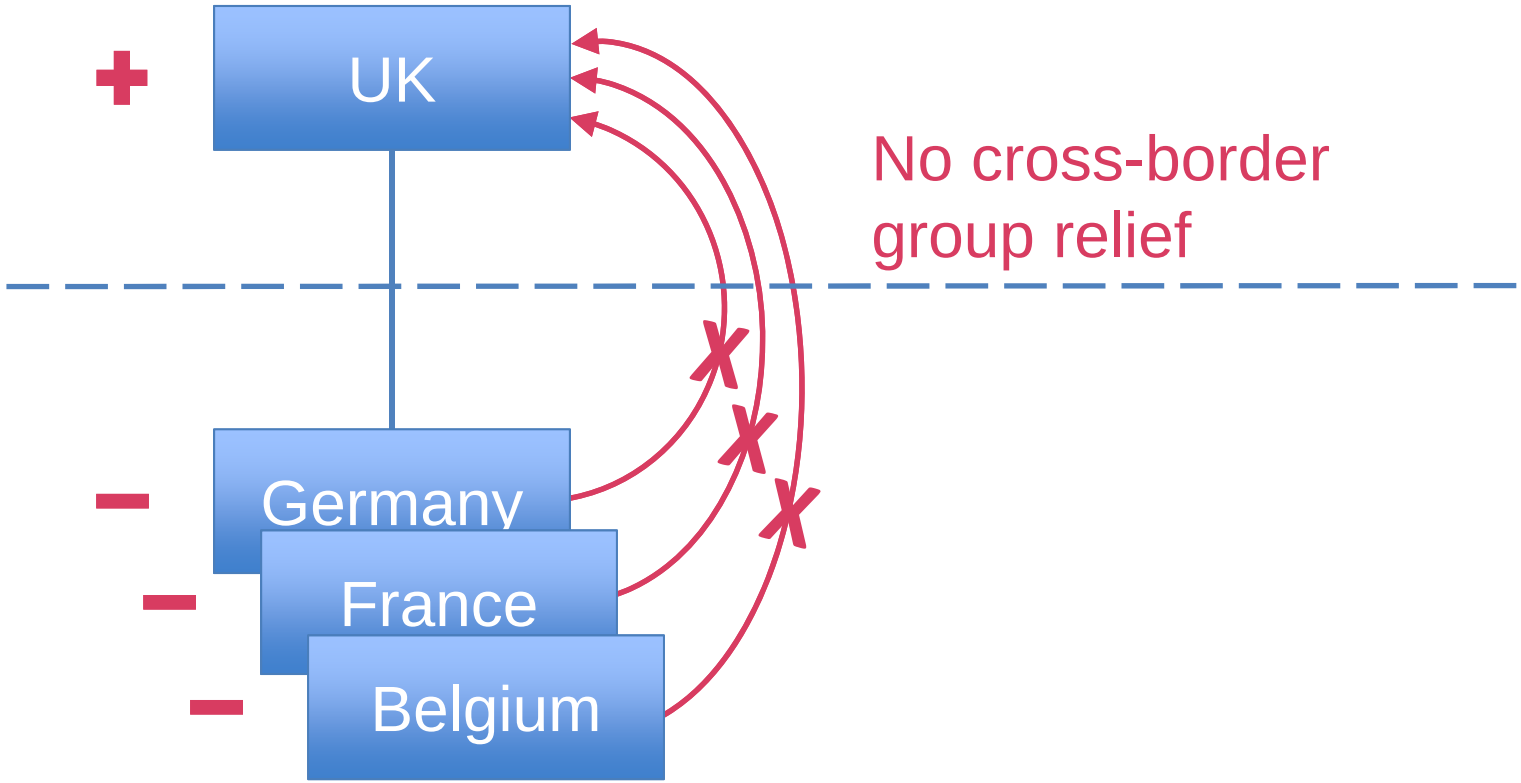
Operational losses



Agenda

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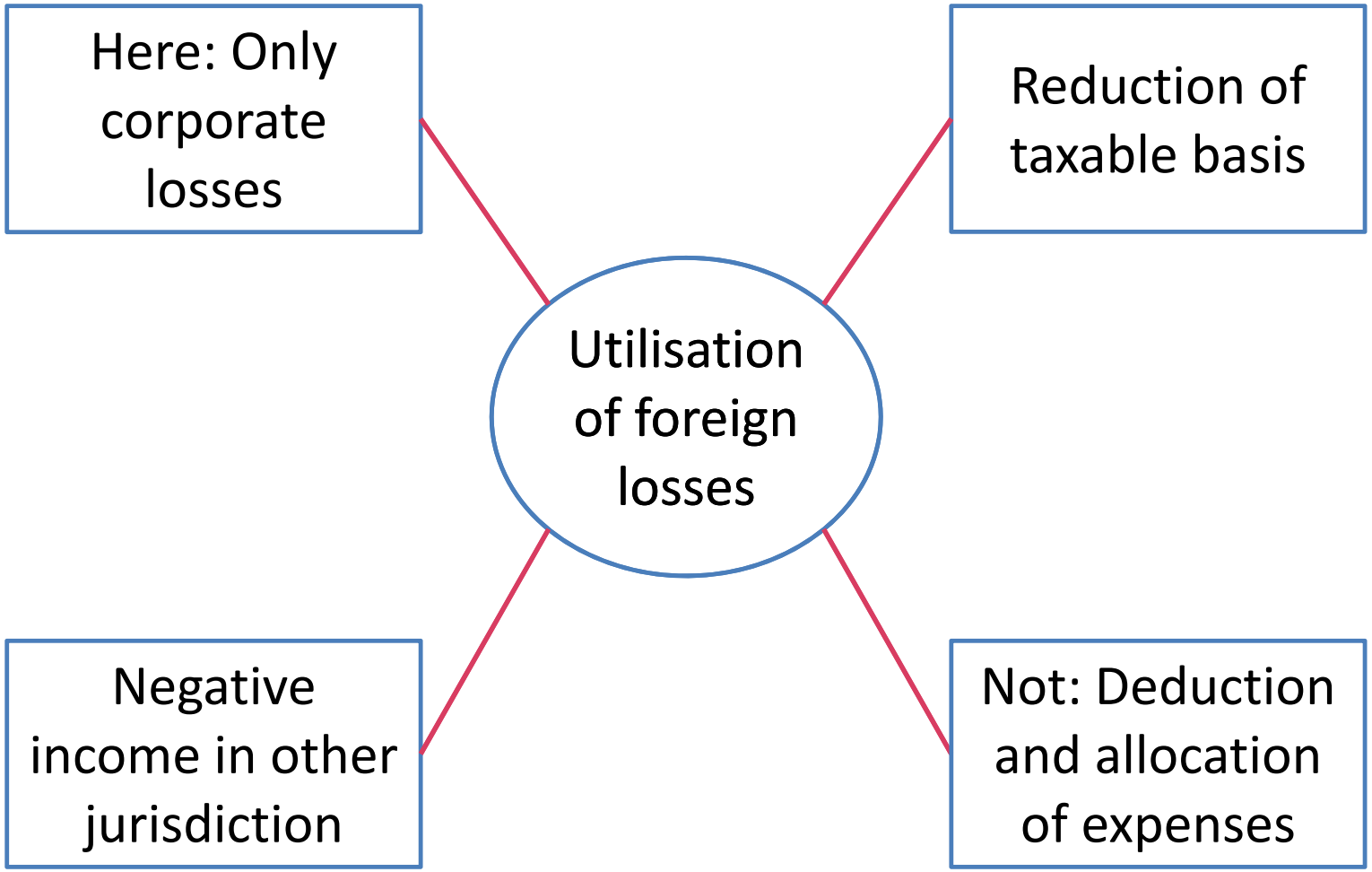
- Scope and definitions
- Policy considerations
- Possibilities and limitations
- Specific anti-avoidance rules
- The planning angle
- Outlook and conclusions

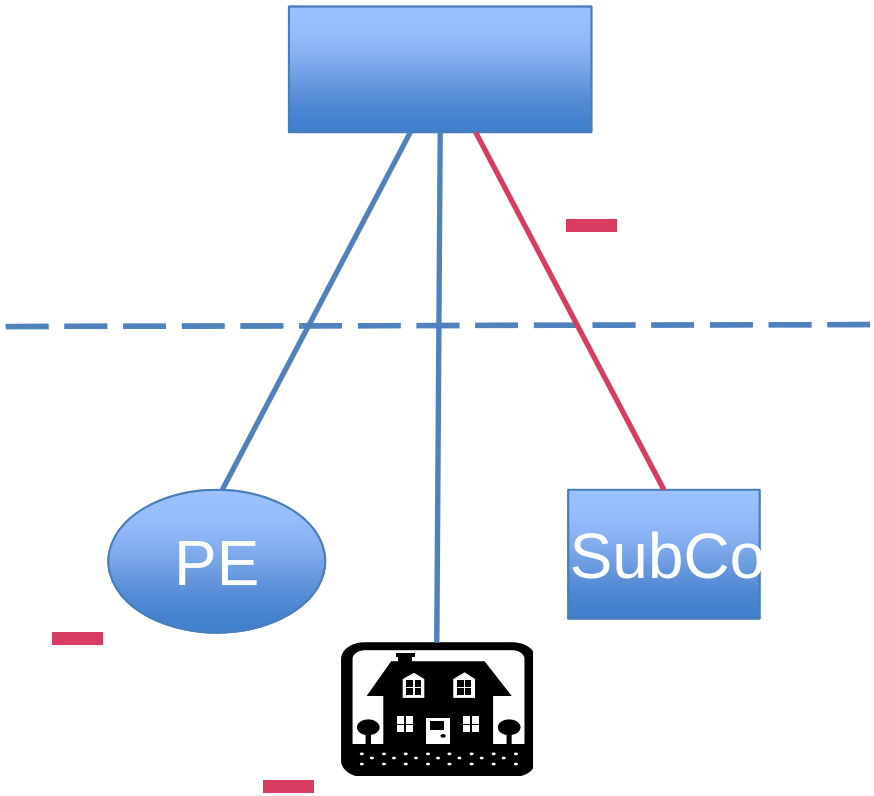
Scope and definitions

Scope and definitions



Scope and definitions

Situations of cross-border loss utilisation



Own losses:

- PE
- Real estate
- Foreign group companies
  - Current value write-downs
  - Capital losses
  - Liquidation losses

Scope and definitions

Worldwide vs. territorial system

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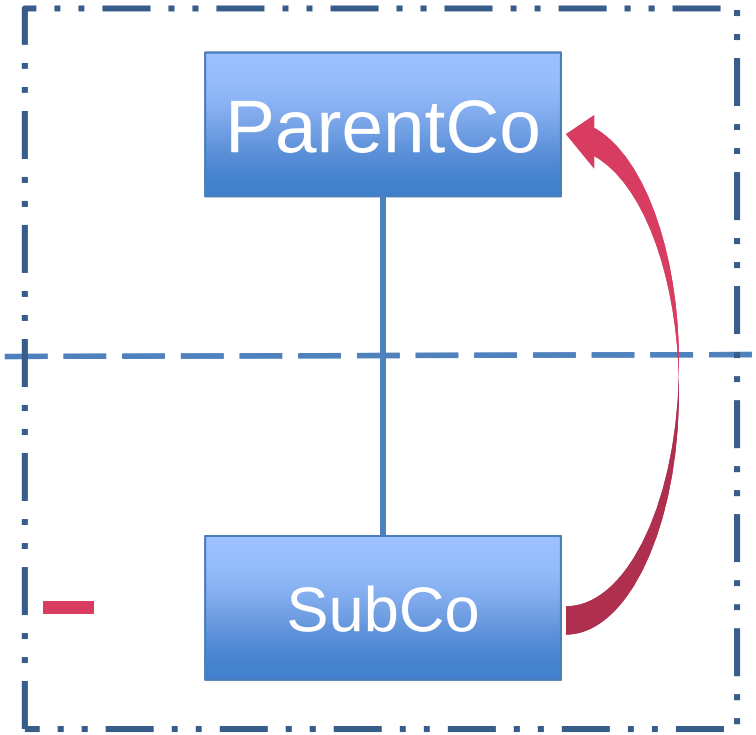
- Worldwide taxation for residents:
  - Domestic <u>and</u> foreign income taxable
  - Inclusion of foreign source income <u>and losses</u>
  - Potential exception: exemption under DTTs
- Territorial taxation for residents:
  - Domestic source income taxable only
  - Exclusion of foreign source income <u>and losses</u>

Scope and definitions

Situations of cross-border loss utilisation

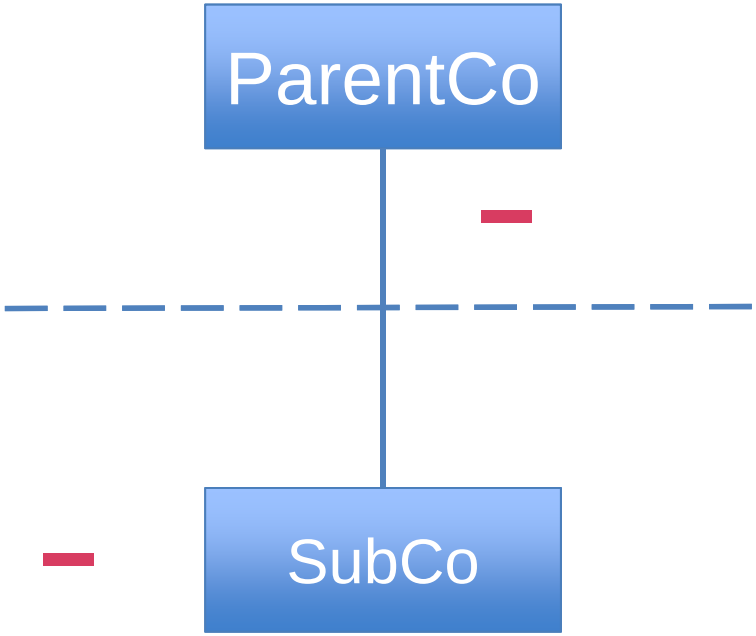


Other entities' losses

- Cross-border group taxation
- Current value write-down / capital loss
- Disregarded and hybrid entities

Scope and definitions

Situations of cross-border loss utilisation



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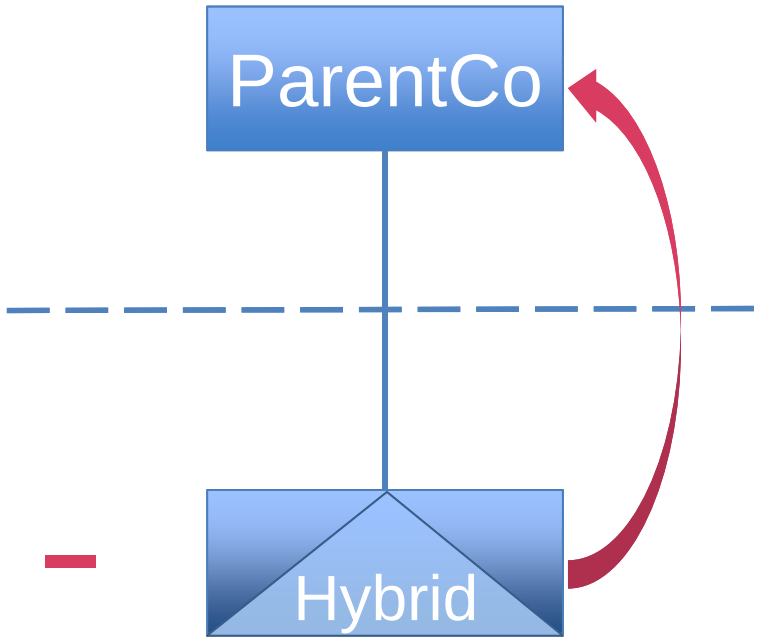
Scope and definitions

Situations of cross-border loss utilisation



Other entities' losses

- Cross-border group taxation
- Current value write-down / capital loss
- Disregarded and hybrid entities

Systematic and policy considerations

Systematic considerations

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Purpose / object of loss utilisation

- Principle of total income
- Limitations
- Conclusions

Policy considerations

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Improving cross-border loss utilisation rules

- No impact of taxes on business decisions?
- Full offsetting of losses with future profits?
- Optional systems for cross-border loss situations?
- Improving desirable?
- Avoiding tax planning and tax driven structures?
- Other policy consideration?

Policy considerations

EU impact

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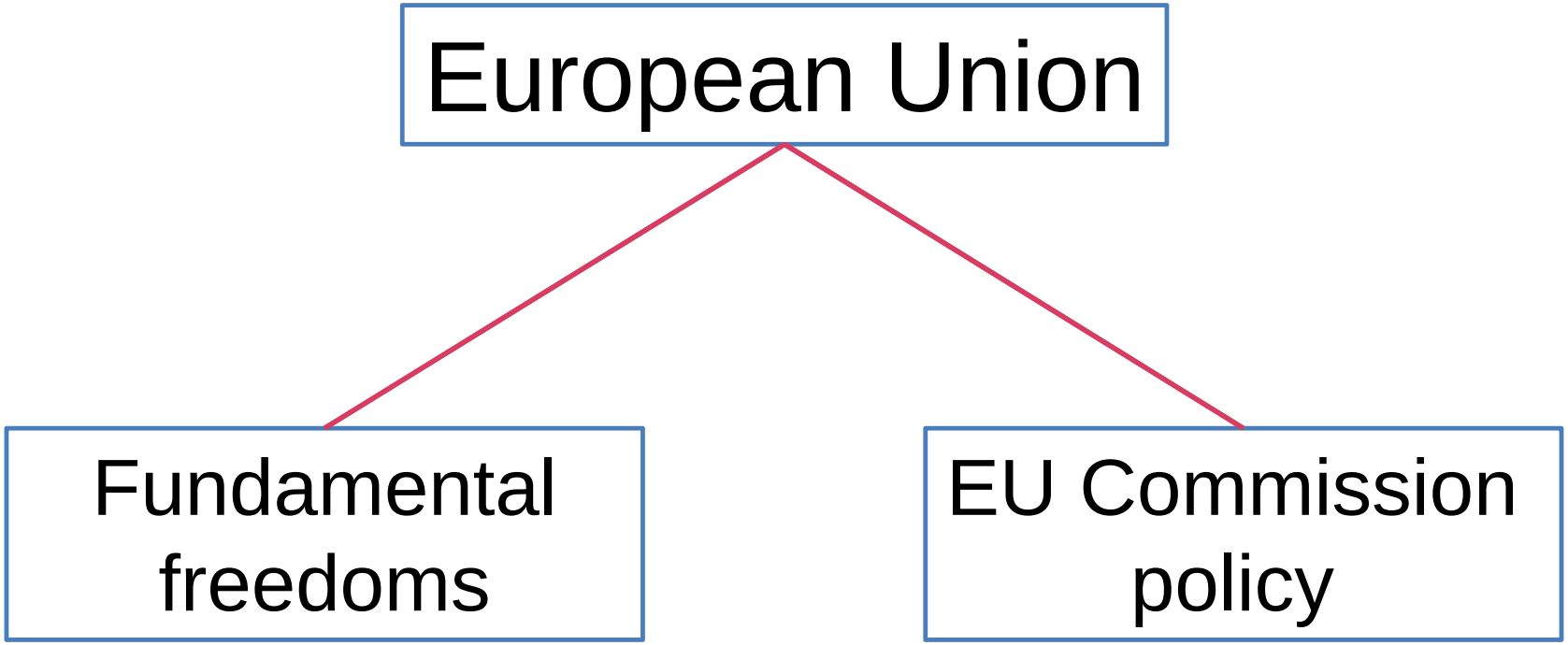
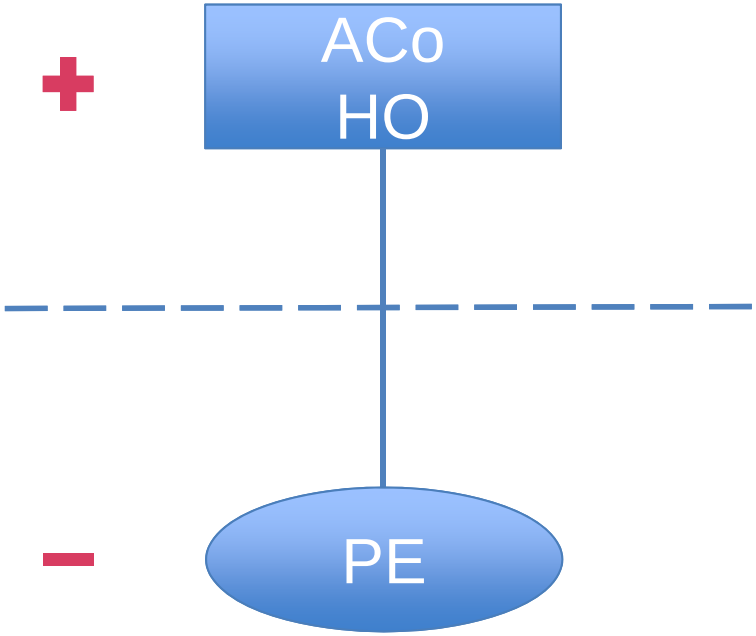


DH/GB

Possibilities and limitations

Possibilities and limitations

Own losses – PE case (1/2)



Facts of case:

- Head office (HO) state and PE state tax rates = 30%
- No loss carry-back in PE state
- HO year 1: +100 profit
  year 2: +100 profit
- PE year 1: +100 profit
  year 2: –100 loss

Possibilities and limitations

Own losses – PE case (2/2)

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		Year 1		Year 2		Total		
P/L	PE	+100		–100		+/– 0		
	HO	+100		+100		+200		
Exemption								
Tax	PE		30		0		30	} **90**
	HO		30		30		60	
Exemption with claw-back								
Tax	PE		30		0		30	} **60**
	HO		30		0		30	
Credit								
Tax	PE		30		0		30	} **60**
	HO		30		0		30	

Possibilities and limitations

Own losses – EU perspective

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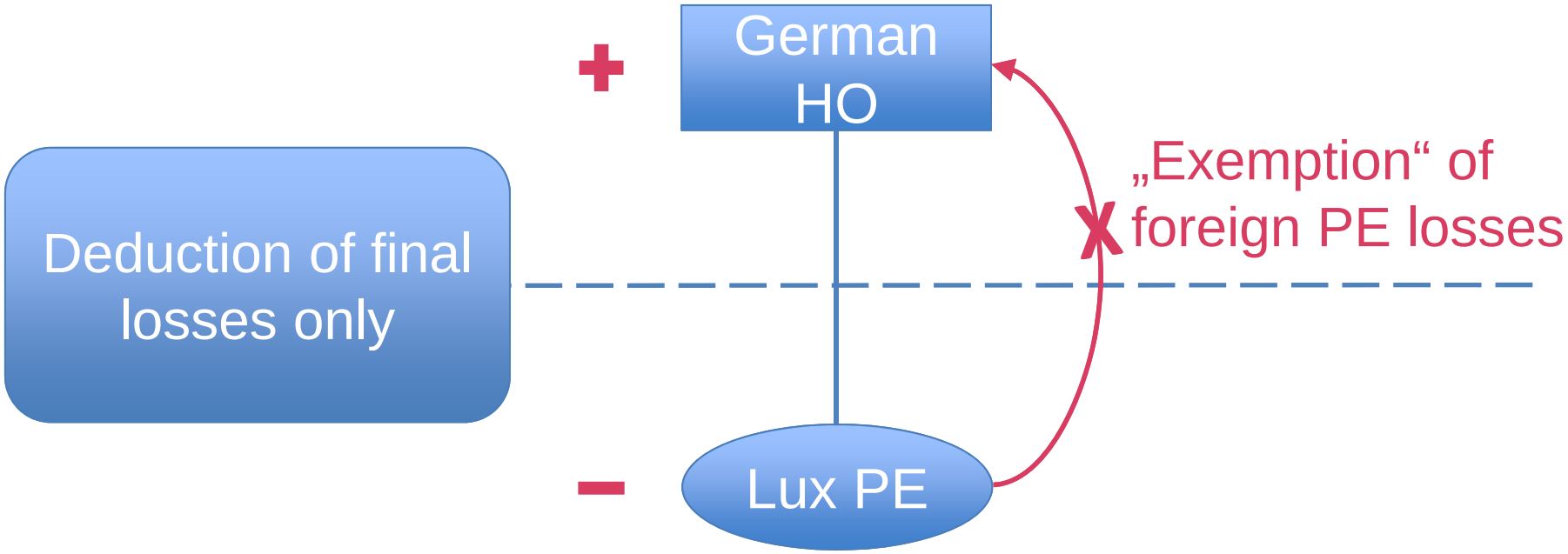
ECJ: *Lidl Belgium* (C-414/06)



Possibilities and limitations

Own losses

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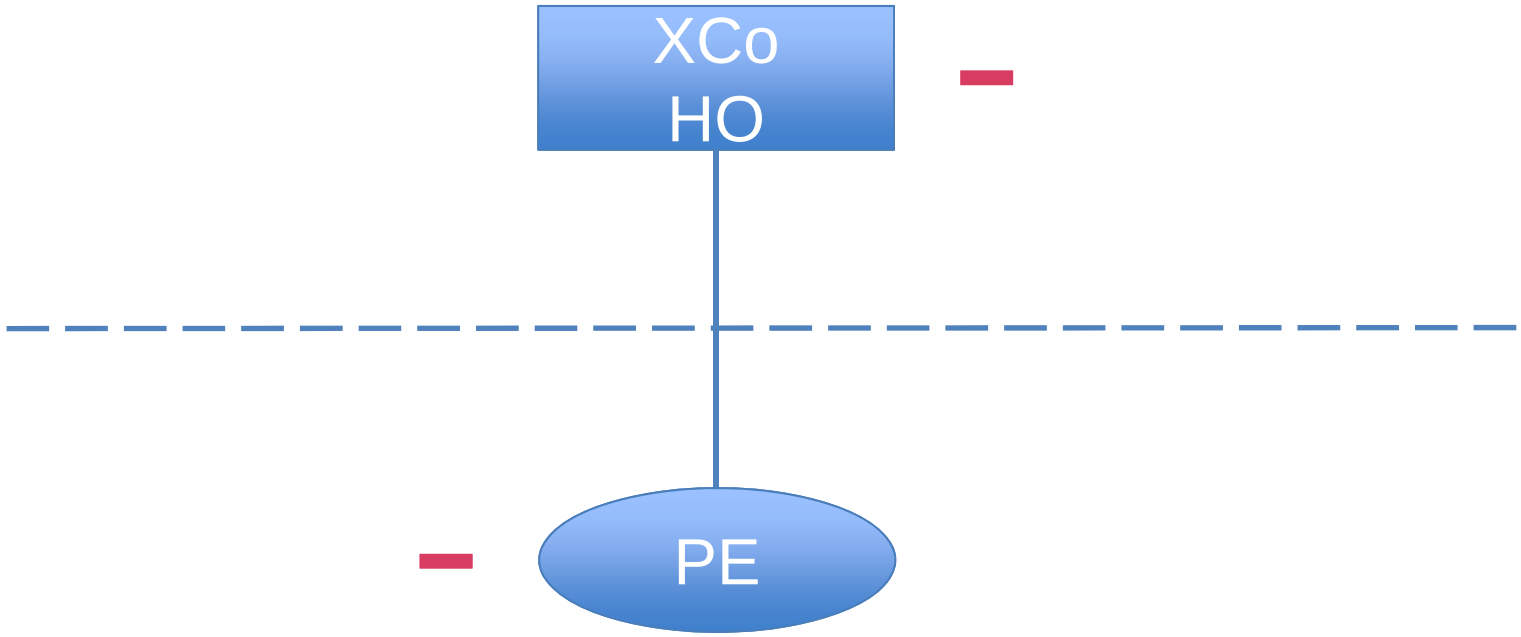
Discussion



ALL

Possibilities and limitations

Foreign group company losses

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Foreign group company losses

- Direct
- Indirect

Possibilities and limitations

Foreign SubCo's losses – indirect effects

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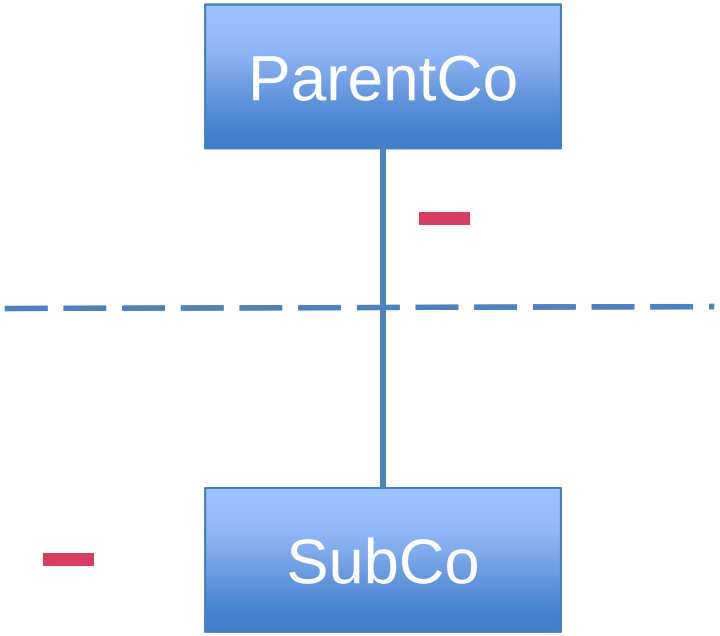
"Own" (capital) losses at parent level



<u>Facts of case:</u>

- SubCo: equity of $ 10m
- SubCo suffers loss of $ 9m
- Alternative scenarios:
  - – Current value write-down to $ 1m
  - – Liquidation proceeds $ 1m
  - – Sales price $ 1m
  - ➔ParentCo has „own" loss of $ 9m

Possibilities and limitations

Foreign SubCo's losses – indirect effects

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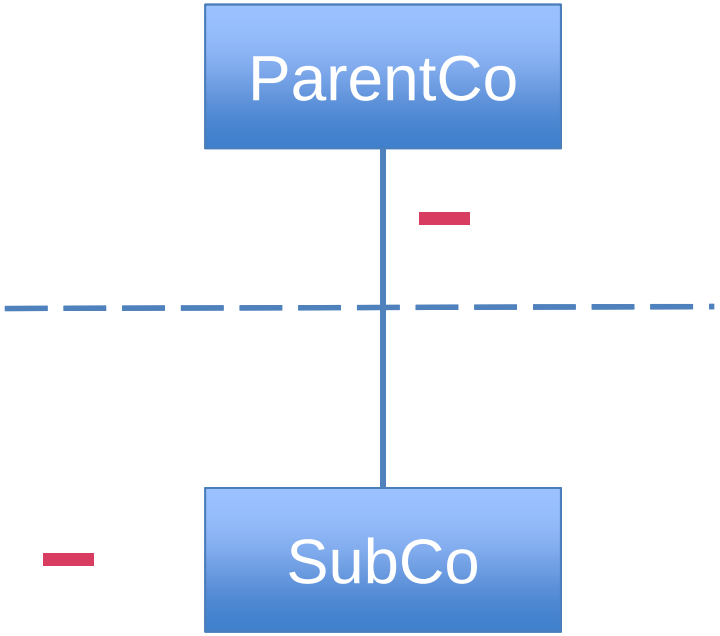
"Own" (capital) losses at parent level



Discussion:

- Should ParentCo be able to deduct loss of $ 9m?
- Current write-down?
- Capital loss upon liquidation or disposal?
- Dependent on whether SubCo's loss carry-forward persists?

ALL

Possibilities and limitations

Foreign group company losses – EU

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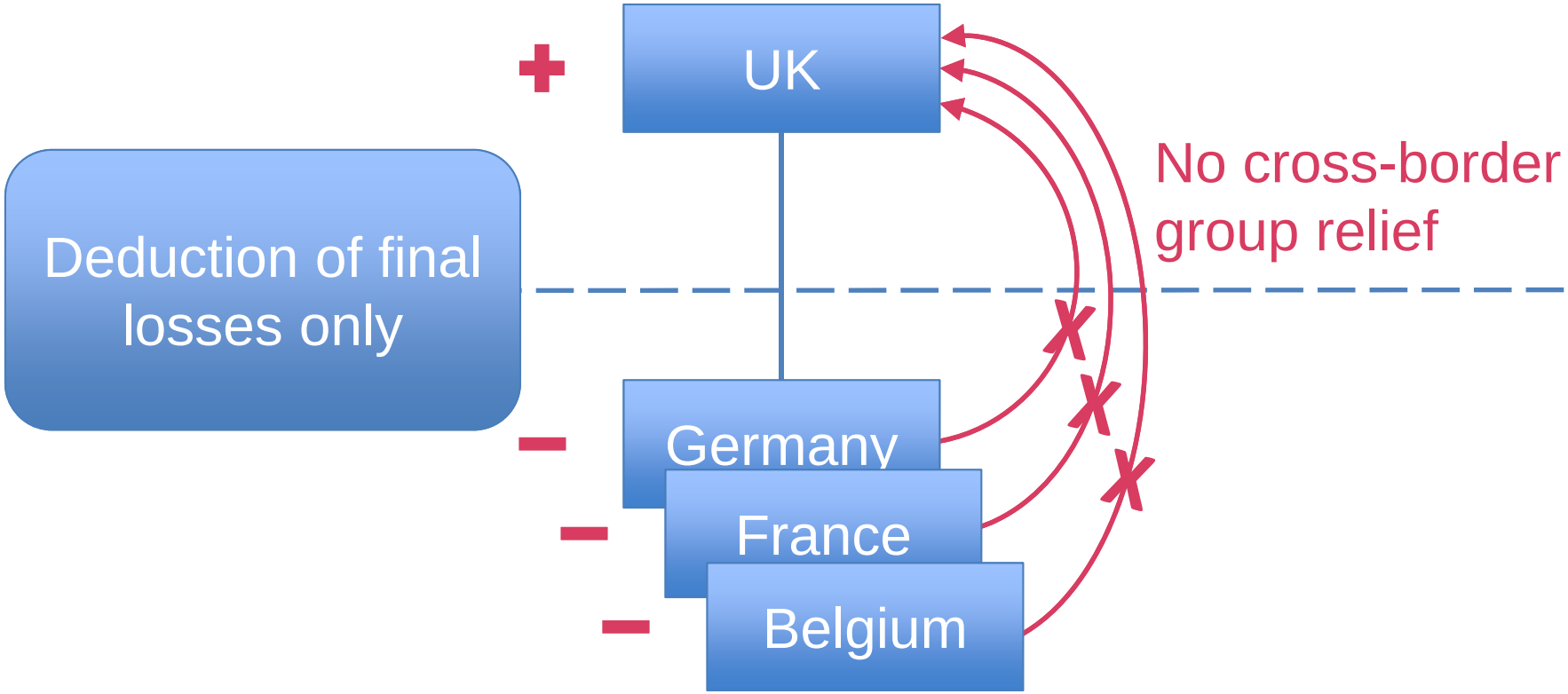
ECJ: *Marks & Spencer* (C-446/03)



Possibilities and limitations

Foreign group company losses – France

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French worldwide tax consolidation

- Subject to ruling
- Foreign PEs and > 50% controlled subsidiaries
- Foreign tax credit
- 5 year tax credit carry-forward
- Foreign losses deductible

Abolishment in 2011

- International groups not really interested anymore

Possibilities and limitations

Foreign group company losses – Austria

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Austrian cross-border group taxation

- General aspects
  - System of income attribution → no consolidation
  - Direct or indirect financial integration > 50%
- Foreign group companies
  - Attribution of losses only combined with a claw-back mechanism
  - Limitations

Possibilities and limitations

Foreign group company losses

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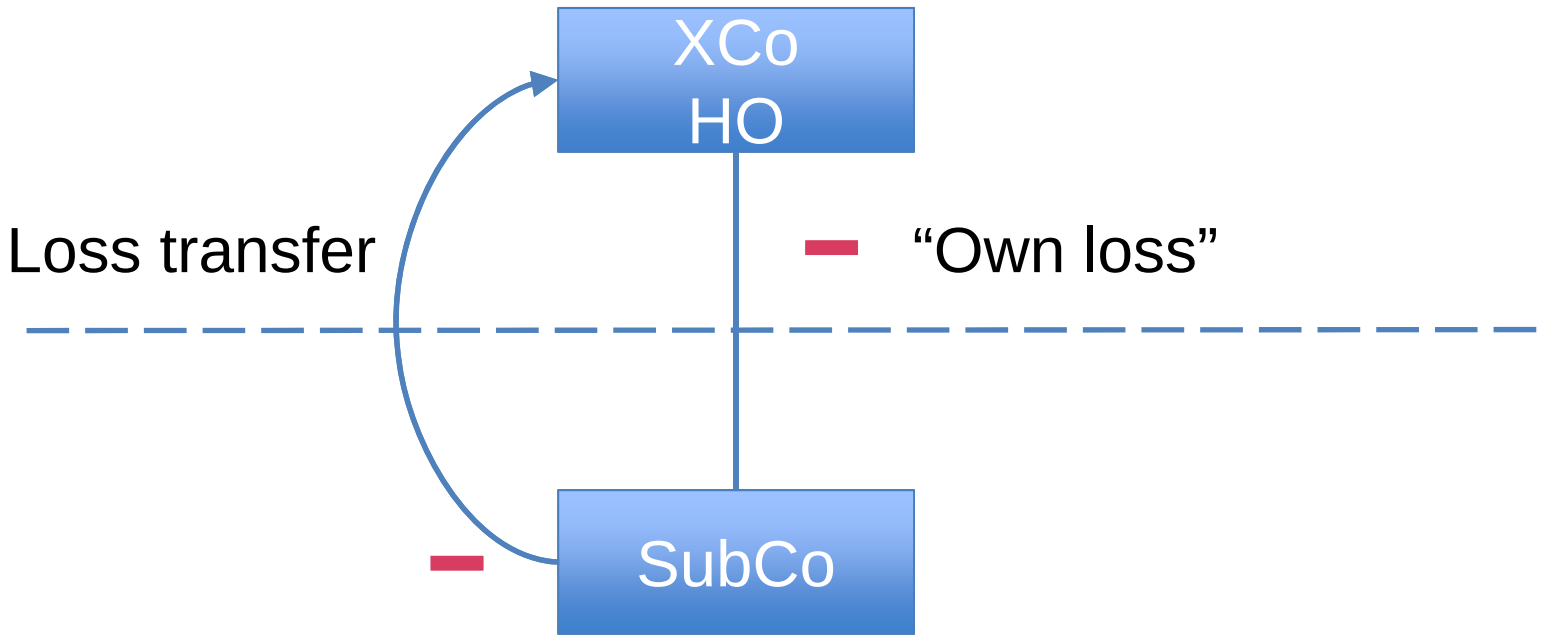
Discussion



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Resolution of the 33rd Congress:

1. Extension of provisions for carry forward and carry back of losses
2. Extension of the ‘indirect’ method of relief for the parent against losses of the subsidiary
3. Option for all of the parent’s subsidiaries to be treated as PE for purposes of the parent’s taxation (subject to restrictions in order to avoid misuse)

Anti-avoidance

Anti-avoidance
OECD

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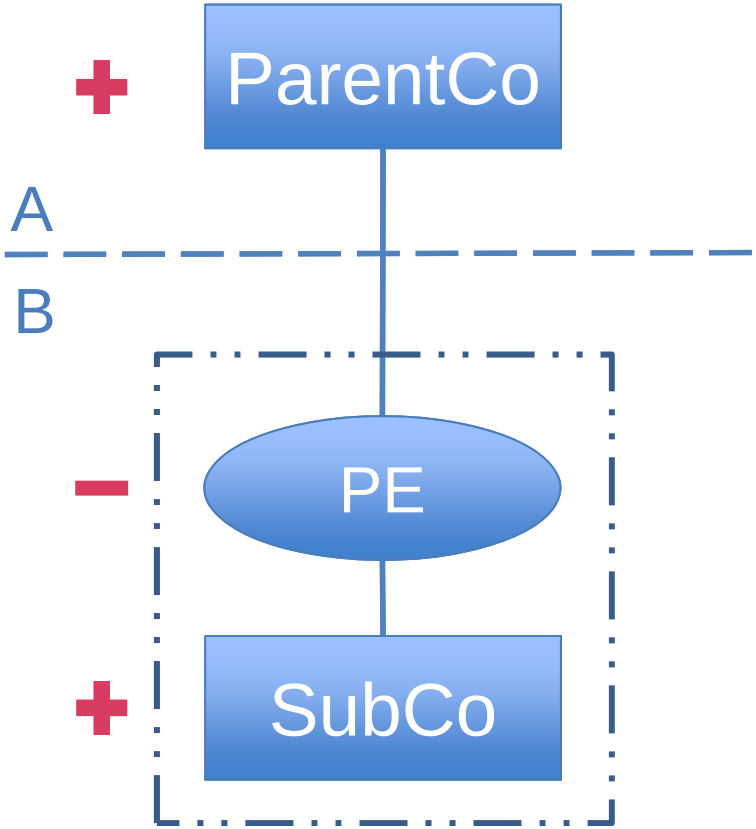
"Corporate Loss Utilisation through Aggressive Tax Planning"

- Shifting profits or losses
- Avoiding loss carry-over restrictions
- Creating artificial losses
- Claiming multiple deductions for the same loss

Anti-avoidance

Dual consolidated loss rules



ParentCo country:

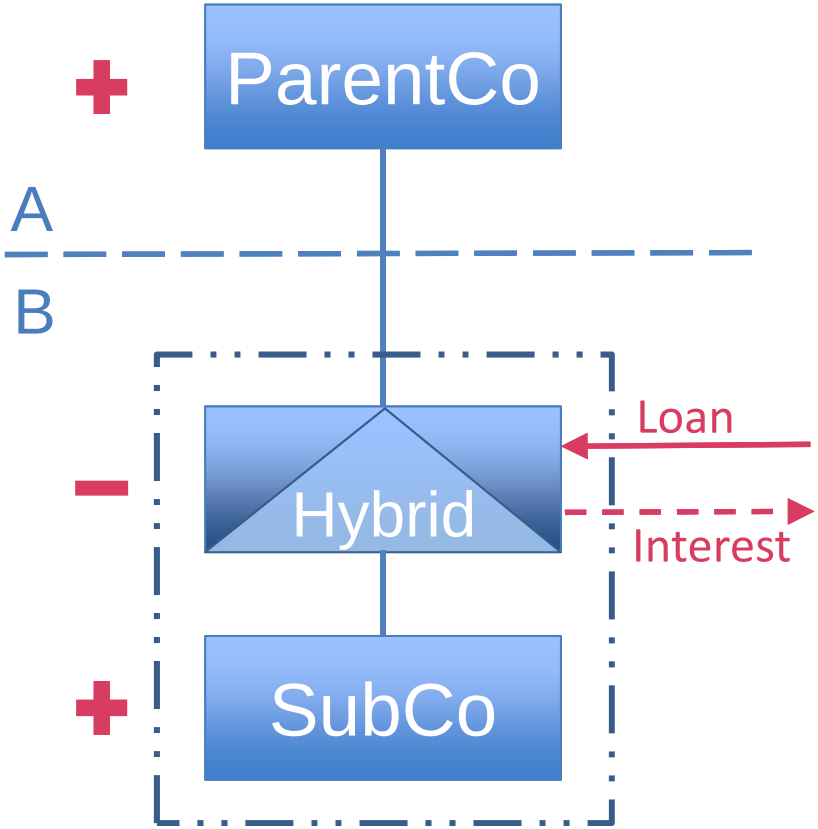
- Credit / exemption with claw-back

PE and SubCo:

- Bona fide existing
- Operating
- In a tax group

Anti-avoidance

Hybrid entities



Hybrid entity:

- Transparent in ParentCo country A
- Non-transparent in residence country B
- No significant income
- Interest payment on 3rd party loan

Anti-avoidance

Canadian loss utilisation rules

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Loss recognition / application

- Capital vs. non-capital
- Carry-forward / carry-back
- Denial / suspension rules

Specific limitations

- Interest expense deduction
- Intercorporate dividend deduction

Loss utilisation systems

Loss transfer rules

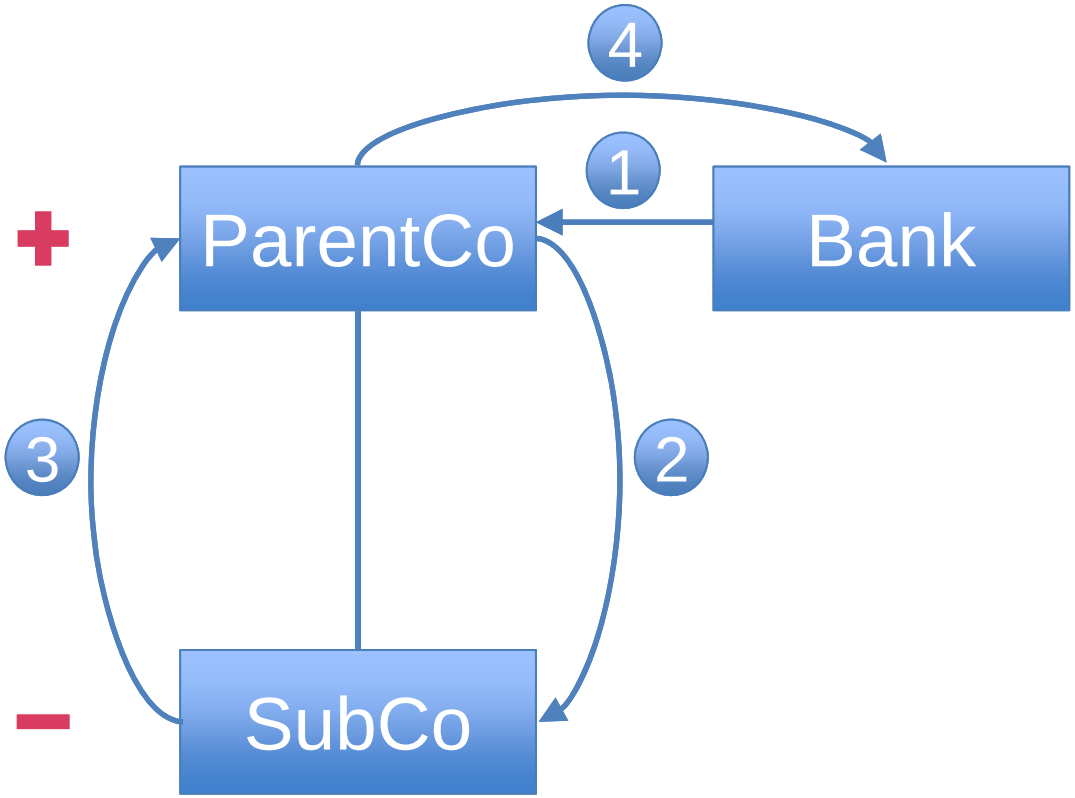
- Acquisitions of control
- Amalgamation / wind-ups
- Use by unaffiliated persons

Anti-avoidance

- General anti-avoidance rule
- CRA administrative policies

Anti-avoidance

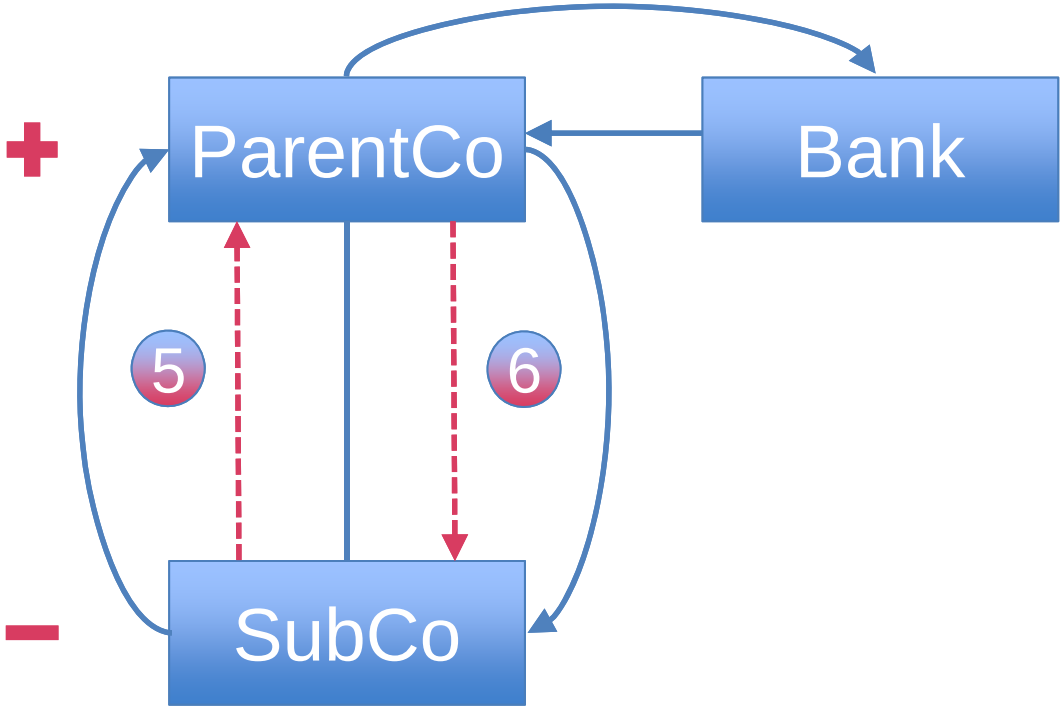
Domestic loss consolidation (1/2)



1. Loan
2. Subscription for new shares
3. Loan
4. Repayment

Anti-avoidance

Domestic loss consolidation (2/2)



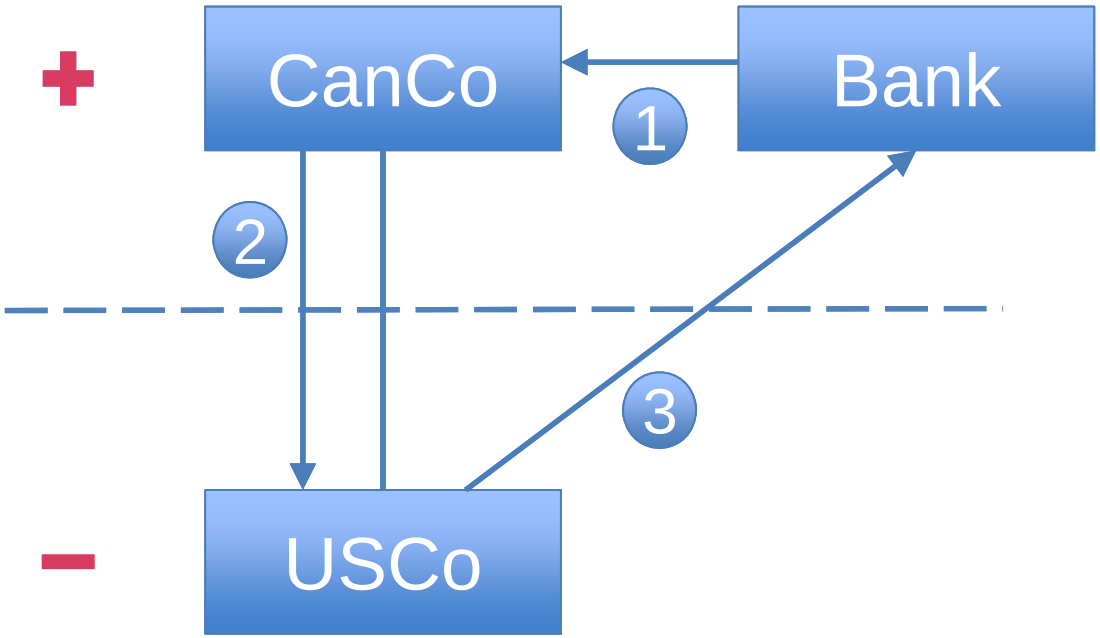
1. Loan
2. Subscription for new shares
3. Loan
4. Repayment

<u>Ongoing:</u>

5. Dividend payment
6. Interest payment

Anti-avoidance

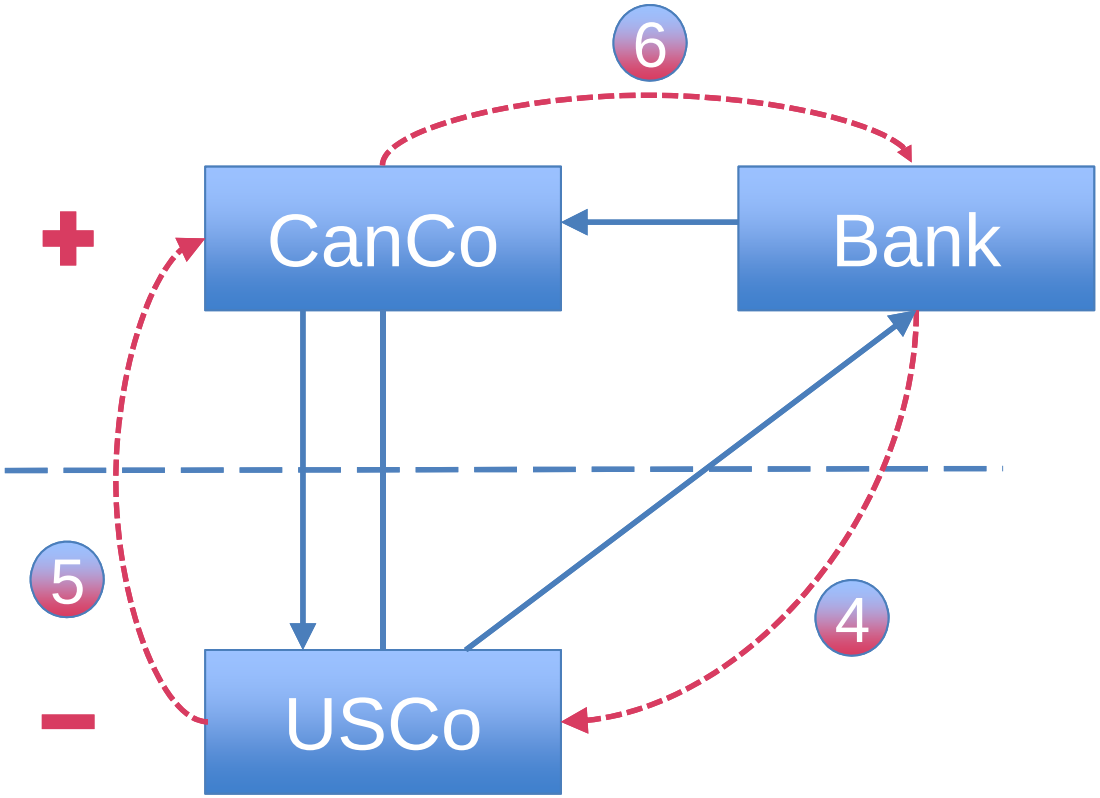
Mark Resources (93 DTC 1004) (1/2)



1. Loan
2. Capital contribution
3. Term deposit

Anti-avoidance

Mark Resources (93 DTC 1004) (2/2)



1. Loan
2. Capital contribution
3. Term deposit

<u>Ongoing:</u>

4. Interest payment
5. Dividend payment
6. Interest payment

The planning angle

The planning angle

Business perspective

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"With tax losses being deferred and often treated as non-deductible in an international context, how can global companies be criticised for trying to re-establish a closer proximity between economic results and relevant tax base through international tax planning?"

Ex Global Head of Tax, German DAX 30 Company

The planning angle

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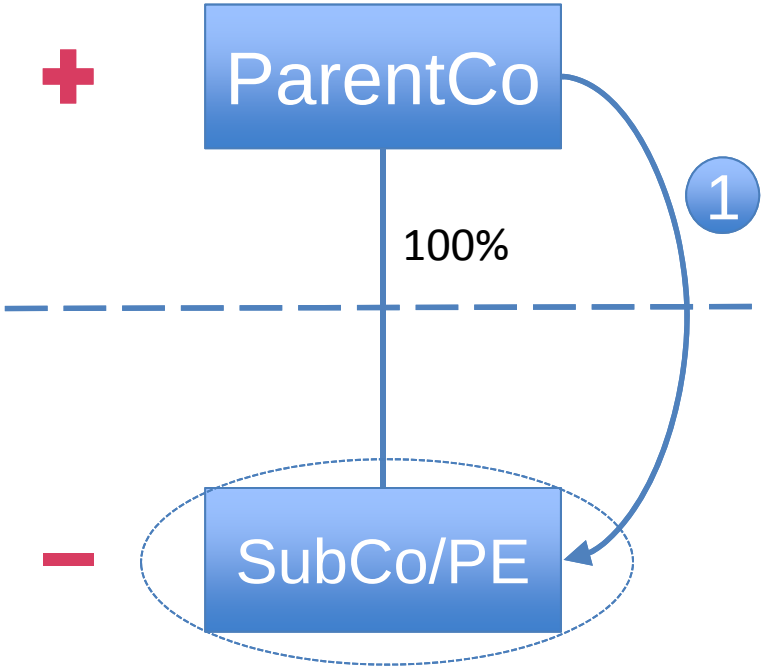
Approaches

- Financing
- Business transformation / reorganisation

The planning angle

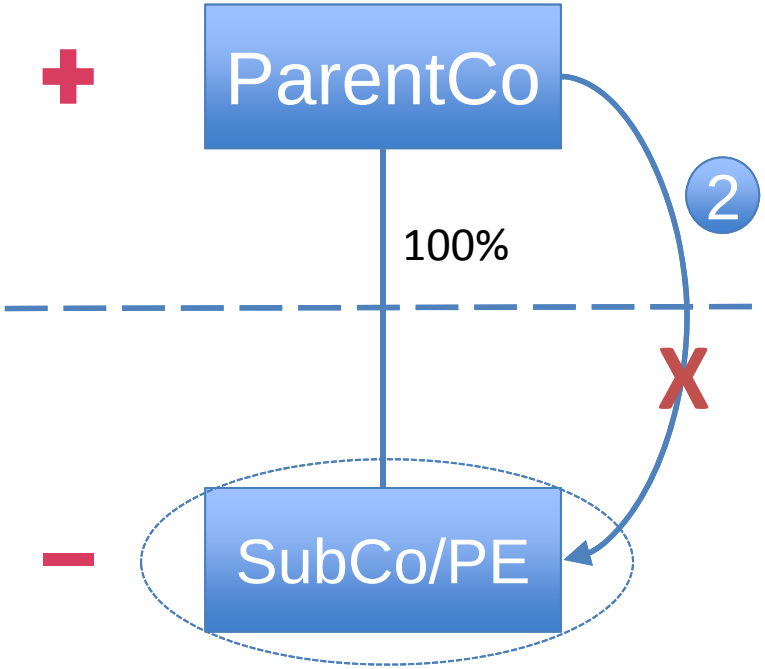
Debt waivers and subsidies (1/2)



1. Profit-making ParentCo provides financing to loss-making SubCo or PE

The planning angle

Debt waivers and subsidies (2/2)



1. Profit-making ParentCo provides financing to loss-making SubCo or PE
2. ParentCo waives whole or part of its claim against SubCo / subsidises foreign PE

The planning angle

Sale of shares (1/3)

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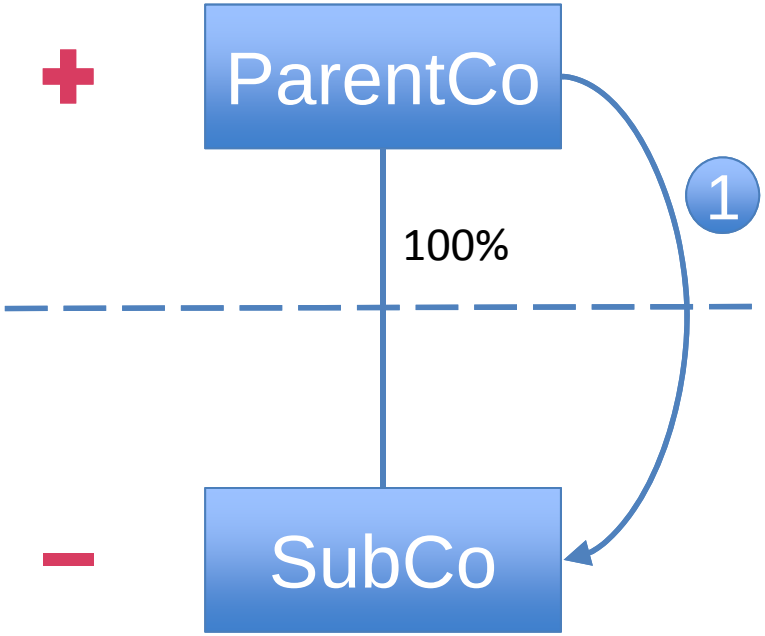
Initial situation



1. Claim
   - Principal amount: 100
   - FMV: 10

The planning angle

Sale of shares (2/3)

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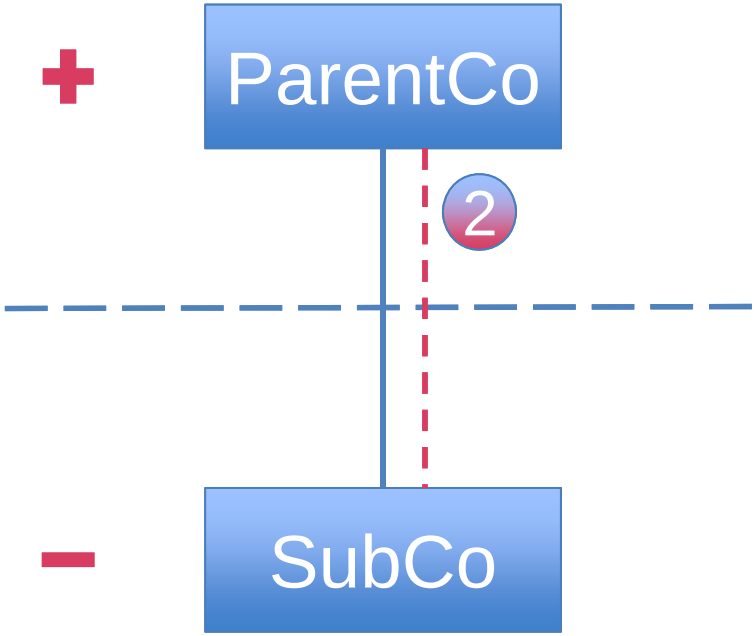
Subscription for new shares



2. ParentCo subscribes for new shares and pays the issued shares with its claim
   - Book value: 100 [increase of share capital]
   - FMV of new shares: 10

The planning angle

Sale of shares (3/3)

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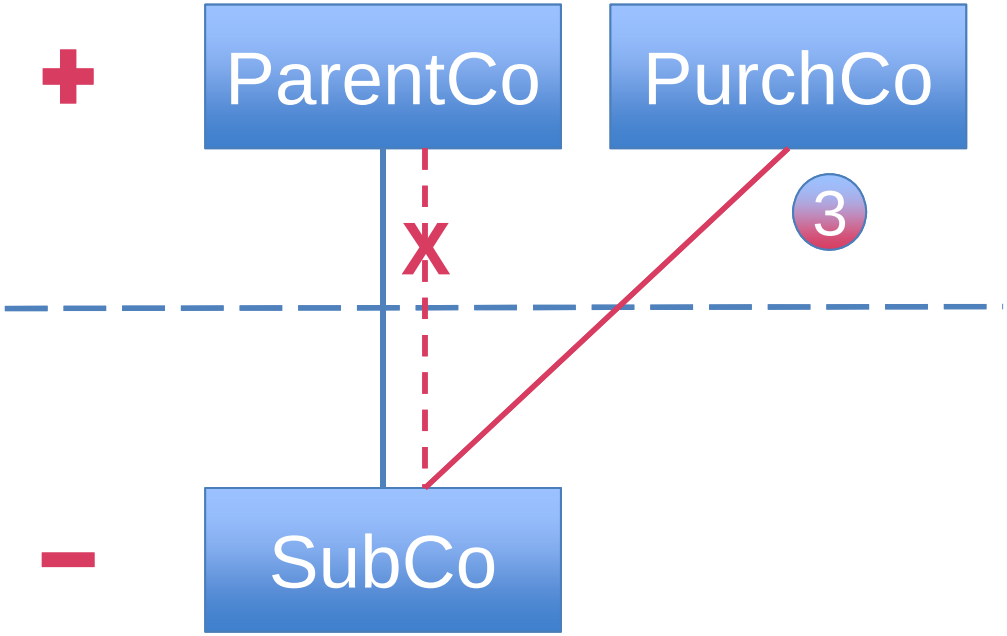
Sale of shares



3. ParentCo sells new shares to PurchCo
   - Tax basis: 100
   - Purchase price: 10

<u>Result:</u>

- Tax deduction up to loss (90).
- No profit recognition on the level of SubCo.

The planning angle
Recapitalisation (1/3)

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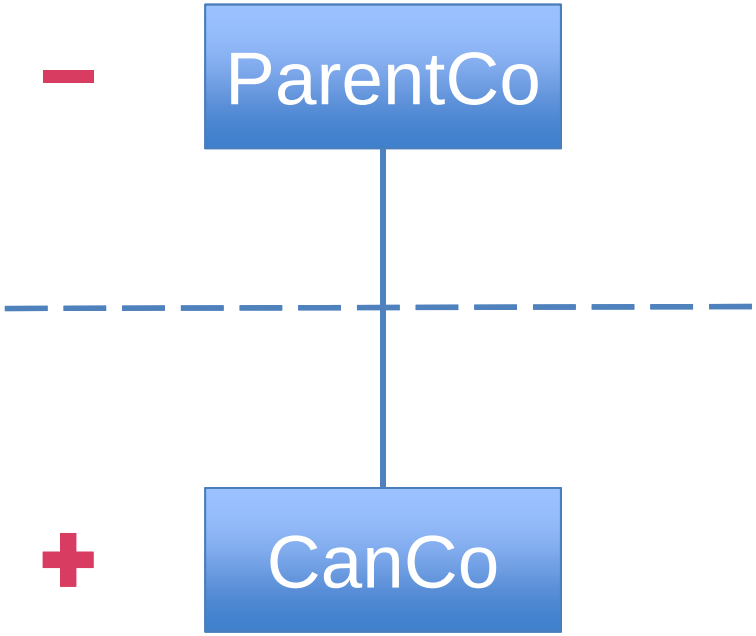
Initial situation



- $ 100 invested share capital (paid-up capital – "PUC") in CanCo
- ParentCo: losses
- CanCo: profitable

The planning angle
Recapitalisation (2/3)

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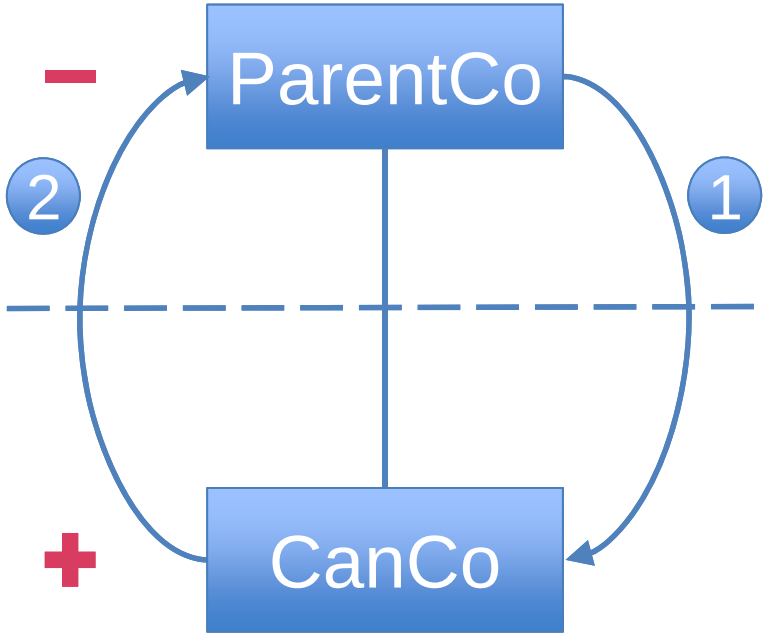
Equity replaced with debt



Steps:

1. ParentCo loans funds to CanCo ($ 40 loan)
2. CanCo uses funds to return invested share capital to ParentCo ($ 40 share capital distribution)
   - $ 60 PUC

The planning angle
Recapitalisation (3/3)

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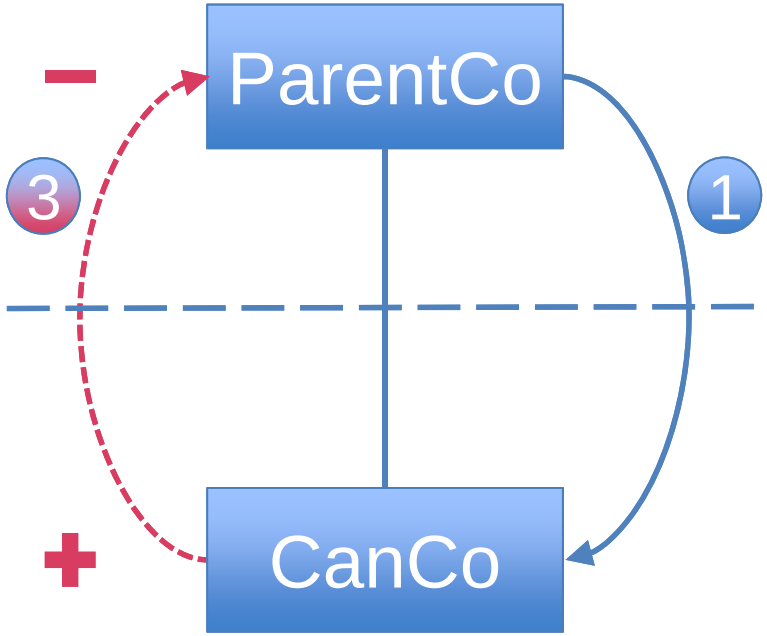
After recapitalisation

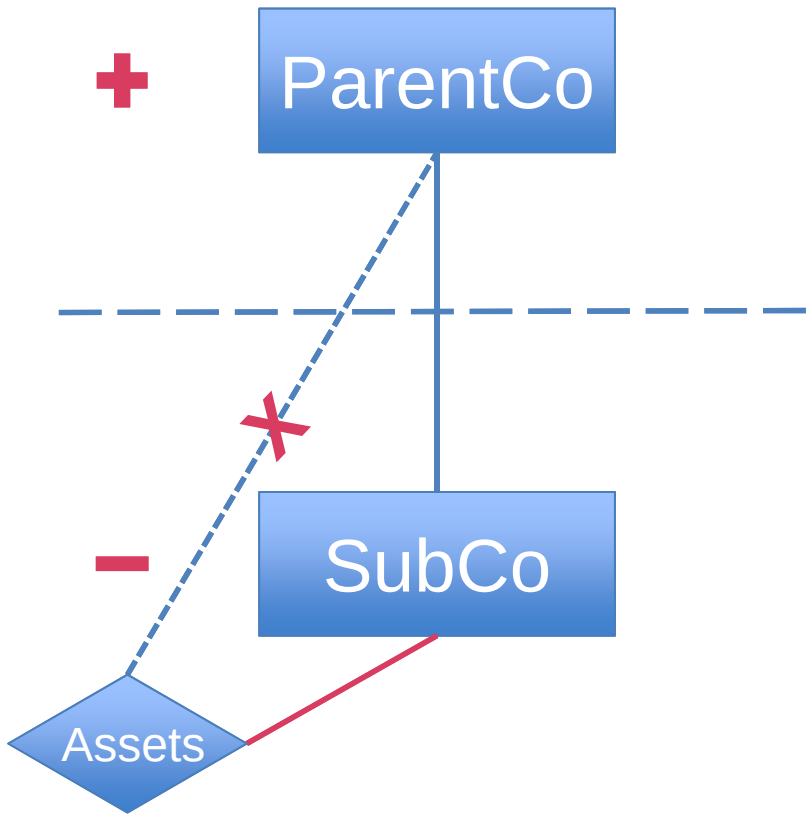


<u>Result:</u>

3. Interest payment
   - CanCo incurs deductible interest expense (subject to thin capitalisation limits)
   - ParentCo receives interest income, absorbed by losses

The planning angle

Transfer of income-generating assets

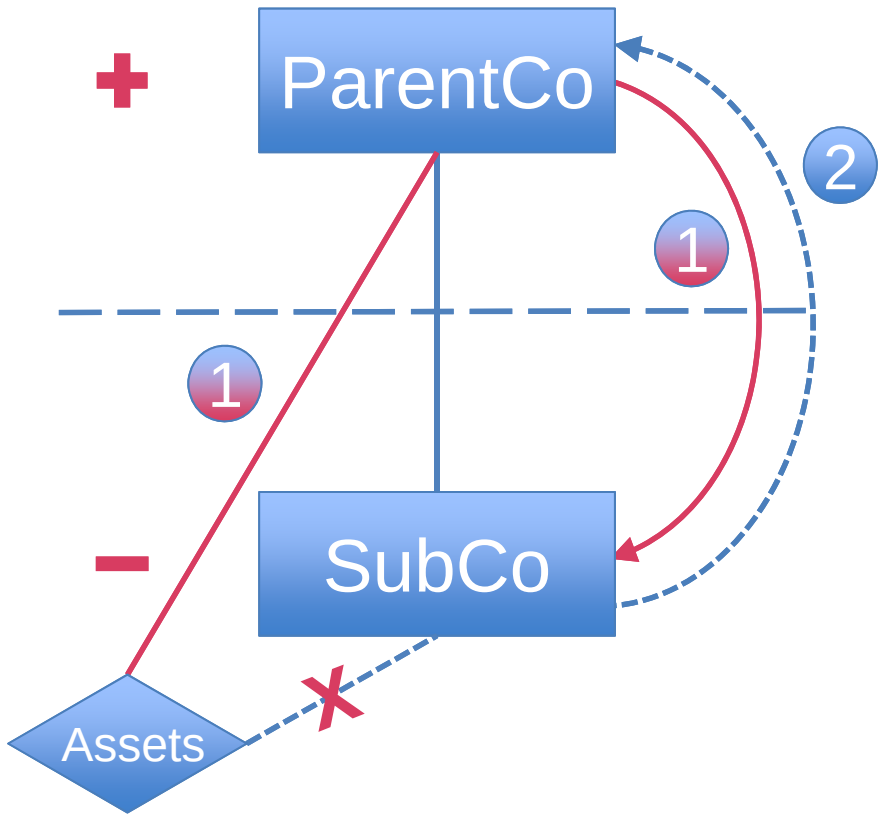


1. ParentCo transfers income-generating assets <u>to</u> SubCo as a capital contribution or in exchange for shares in SubCo
2. Taxable income is moved out of ParentCo and into SubCo

SS

The planning angle

Sale of low / no income-generating assets



1. SubCo sells low / no taxable income-generating assets (e.g., shares of another subsidiary) to ParentCo in exchange for interest-bearing debt
2. ParentCo deducts interest expense

Outlook

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- OECD BEPS
- OECD loss utilisation through aggressive tax planning
- EU developments
- Business needs in case of “real” losses in the group / a certain entity

Conclusions