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'

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Panel members

- 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)

Hedging losses

CanCo

Foreign MiningCo

Sale at spot price

Foreign HedgeCo

3rd parties

Low-tax jurisdiction

Untaxed gains Stranded losses

Forward sales
A real life situation
Stranded losses (2/2)

Operational losses

- UK
- Germany
- France
- Belgium

No cross-border group relief
Agenda

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

- Here: Only corporate losses
- Reduction of taxable basis
- Negative income in other jurisdiction
- Not: Deduction and allocation of expenses
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

- Worldwide taxation for residents:
  - Domestic and foreign income taxable
  - Inclusion of foreign source income and losses
  - Potential exception: exemption under DTTs

- Territorial taxation for residents:
  - Domestic source income taxable only
  - Exclusion of foreign source income and losses
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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Other entities’ losses
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Systematic and policy considerations
Systematic considerations

Purpose / object of loss utilisation

- Principle of total income
- Limitations
- Conclusions
Policy considerations

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

European Union

Fundamental freedoms

EU Commission policy
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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Possibilities and limitations
Own losses – EU perspective

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

- Deduction of final losses only
- „Exemption“ of foreign PE losses

German HO

Lux PE
Possibilities and limitations

Own losses

Discussion

[XCo]
[HO]

[PE]
Possibilities and limitations

Foreign group company losses

Foreign group company losses

- Direct
- Indirect
Possibilities and limitations

Foreign SubCo’s losses – indirect effects

“Own” (capital) losses at parent level

Facts of case:
- 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

- SubCo: equity of $10m
- SubCo suffers loss of $9m
Possibilities and limitations
Foreign SubCo’s losses – indirect effects

“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?
Possibilities and limitations
Foreign group company losses – EU

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

 Deduction of final losses only

UK

No cross-border group relief

Germany

France

Belgium
Possibilities and limitations
Foreign group company losses – France

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

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

Discussion

Loss transfer

SubCo

XCo
HO

“Own loss”
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

“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

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

Specific limitations
- Interest expense deduction
- Intercorporate dividend deduction

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

Anti-avoidance
- General anti-avoidance rule
- CRA administrative policies

Loss utilisation systems
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

**Ongoing:**
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

Ongoing:
4. Interest payment
5. Dividend payment
6. Interest payment
The planning angle
The planning angle
Business perspective

“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

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)

Initial situation

1. Claim
   - Principal amount: 100
   - FMV: 10
The planning angle
Sale of shares (2/3)

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)

Sale of shares

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

Result:
   - Tax deduction up to loss (90).
   - No profit recognition on the level of SubCo.
The planning angle
Recapitalisation (1/3)

Initial situation

- ParentCo

+ CanCo

- $100 invested share capital (paid-up capital – “PUC”) in CanCo
- ParentCo: losses
- CanCo: profitable
The planning angle
Recapitalisation (2/3)

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)

After recapitalisation

Result:
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 to SubCo as a capital contribution or in exchange for shares in SubCo
2. Taxable income is moved out of ParentCo and into SubCo
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

- 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