justified on genuine business grounds but had to be considered as a plan to avoid taxation of the subsidiary's profits. Since this decision was within the discretion of the Council, the decision is not covered by the Act on Binding Advance Rulings. Consequently, the decision can probably not be appealed to the National Tax Tribunal (landsskatteretten).

Second decision

In the second case, a British-owned Danish parent company with share capital of 300,000 Dkr. had, in the course of several years, bought all the shares of a Swiss manufacturing company with a loan guaranteed by the British shareholders. The parent company, whose only activity was to hold the shares of the Swiss subsidiary, used the dividends received from the subsidiary to pay the interest on the loan and to repay the loan (in installments). The parent company had no staff and its registered office was a solicitor's office.

For the tax year 1983/84, the Danish parent company reported a taxable income of approximately 50,000,000 Dkr. of which about 29,000,000 Dkr. were dividends from the subsidiary and about 7,000,000 Dkr. consisted of income from the sale of goods abroad which was invoiced through the Danish company.

The Danish company applied for permission to be taxed jointly with its Swiss subsidiary. If permission were granted, the company would obtain relief for foreign business operations (in accordance with Sec. 17(2) of the Corporation Tax Act) and would be exempt from Danish tax (in accordance with Art.7 of the Danish-Swiss double tax treaty). The Danish company also applied for subsidiary company relief under Sec. 17(3) of the Corporation Tax Act. If this were allowed and if permission for joint taxation were granted, the Danish company's Danish tax liability would be nil. With the structure of the company and the placing of income and expenditure, the Danish company really functioned as a so-called "stepping stone company" because it would also avoid paying Swiss tax on its Swiss-source dividends under Art. 10 of the Danish-Swiss double tax treaty.

In its decision (SD 360-4419-782), the Inland Revenue Directorate denied permission for joint taxation because it considered the arrangement not to be justified on genuine business grounds.

► European Communities ◄

Proposed Directive

■ COMMISSION PROPOSES DIRECTIVE RELATING TO TAX ARRANGEMENTS FOR LOSS CARRY-OVERS

The Commission of the European Communities recently submitted to the Council a proposal for a Council Directive on the harmonization of the laws of the Member States relating to tax arrangements for the carry-over of losses of undertakings.[1] In connection with the proposed Directive, the Commission submitted an Explanatory Memorandum with an Annex. The text of the proposed Directive and related documents are reproduced below.

Explanatory Memorandum

General

The Commission considers that in the field of taxation the approximation of tax charges is a fundamental objective for the Community. Such a convergence is really indispensable if production costs, the location of investments and the rate of return on capital invested are not to be influenced to a marked degree between one country and another by taxation and if fair competition is to be established between undertakings of different Member States.

It is obvious that such an ambitious goal can only be attained progressively because it requires a series of actions relating, not only to the structure of tax systems and to tax rates, but also to the wide and complex field of the rules for the determination of the taxable profits of undertakings.

The Commission took an important step in this matter when in 1975 it sent to the Council a proposal for a directive concerning the harmonization of systems of company taxation and of withholding taxes on dividends.[2] That text has as its main aim the harmonization of corporation tax systems on

1. COM(84) 404 final, Brussels, 6 September 1984.
2. Official Journal of the European Communities No. C 253 of 5 November 1975.

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the basis of a common system of tax credits but it also makes provision for a first coming together of corporation tax rates. In other respects, in accordance with the programme it has established and with the wishes of the European Parliament, the Commission has undertaken work in the field of the base for the imposition of taxes on profits of business undertakings in such a manner as to be in a position to make proposals on this topic at the earliest possible date.

In the course of this work the Commission has established, as it has indicated elsewhere in its communication to the Council on fiscal and financial measures favouring investment,[3] that the question of the carry-forward and the carry-back of losses of business undertakings has a particular importance.[4] In fact judiciously drafted rules in this matter can contribute to the improvement of the tax environment of undertakings by facilitating their investments and by improving their competitiveness world-wide. There is then a very great advantage in providing arrangements of this sort at Community level, since everyone is agreed that the way out of the economic crisis will come about through a relaunch of productive investment and an improvement in the competitive position of European undertakings.

The foregoing considerations, allied with the fact that, from the technical point of view, the harmonization of the rules for the carry-forward or carry-back of losses can take place without waiting for that in other areas of the tax base, have lead the Commission to present now a proposal limited to this subject.

To attain the desired objective, the text proposed by the Commission fixes the rules in as liberal a manner as possible, without affecting unduly tax receipts or encouraging fraud or abuse. In this spirit the carry-forward of losses of a tax period to later periods has been allowed without time limit. For the same reason the carry-back of losses to preceding periods is provided, limited however to two years for budgetary reasons. This last provisions is particularly interesting for undertakings, since it generally results in a refund of tax which improves their cash position. In the same spirit, the order of the carry-back or carry-forward of losses is not imposed on undertakings. In the case of carry-back, they have the option of setting off these losses only against non-distributed profits; further, they can exclude from the set-off exempted profits or those profits taxed at a reduced rate.

Finally the Commission considers that its proposal is at the same time simple, useful and efficient and that for these reasons it should be welcomed without reserve and rapidly adopted by the Council.

Explanatory notes on certain articles

Article 1

The present Directive will be binding on all undertakings – regardless of their judicial form – which draw up annual accounts, consisting of a balance sheet and a profit and loss account for tax purposes.

This condition will permit the exclusion, from the field of application, of small undertakings, notably in the retail commercial and annual trade sectors, which are not in general involved in international trade.

Member States remain, of course, free to apply the system laid down by the Directive to all other categories of undertakings.

Article 2

This Article defines the terms "loss" and "profit" for the purpose of the application of the common system of carry-back and carry-forward of losses established by the Directive. The following points merit emphasis:

(a) The profit or loss of an undertaking for any tax period is to be established according to the taxation provisions of the Member States in which it is taxable. The Directive is not intended to harmonize the corresponding national rules; this harmonization will be the subject of further proposals.

(b) When the undertaking is that of a natural person, the profit or loss for a tax period shall take into account, as the case may require, not only the income from the undertaking itself but also the other income of the owner.

(c) The provisions laid down will apply not only to resident undertakings but also to permanent establishments taxable in a Member State.

(d) Only the profits or losses of the undertaking, realized within the State in which it is taxable, are to be taken into account, to the exclusion of those realized abroad by permanent establishments or subsidiaries. The question of the set-off of profits or losses within the same group across frontiers, which raises very difficult problems, is being examined elsewhere by Commission services.

3. COM(83) 218 final of 28 April 1983.
4. See annexed the present situation on this question in Member States and certain third countries.

Article 3
Paragraph 1

The guiding principle of this provision is to leave to the undertaking total freedom in the matter of carry-back or carry-forward, account being taken of the limitation in the case of carry-back to the two preceding years. It will thus be in order to maximise the reductions or repayments of tax.

Paragraph 2

This provision covers the problem of the calculation of the refund of tax in the case where the loss is set off against a profit, which, at the time of its distribution, carried the right to a tax credit. It is necessary in this case to avoid double repayment of tax; on the one hand in the form of a credit to the shareholder and on the other hand in the form of a refund to the undertaking following the carry-back. For this reason it is provided that the tax credit given is to be deducted from the total tax to be refunded, but not if a compensatory tax which cancelled the tax credit was charged.

Paragraph 3

Certain Member States apply different rates of taxation to certain types of profit, either by reason of their nature (for example capital gains) or by reason of their geographical source (for example, a reduced rate applied to profits realised in development regions).

This provision is intended to allow Member States to provide that losses must be set off against corresponding profits in the same tax category, while providing that this restriction can not be retained beyond the fifth year following the fiscal year in which the loss arose.

ANNEX TO EXPLANATORY MEMORANDUM

Tax system for the carry-forward and carry-back of losses in Member States and in certain third countries

	CARRY-BACK TO PRECEDING YEARS	CARRY-FORWARD
Belgium	–	5 (unlimited for losses resulting from force majeure or depreciation also for starting up losses)
Denmark	–	5
Germany	2 (limited to DM 10,000,000)	5
France	–	5 (unlimited for losses resulting from depreciation)
Greece	–	5 (3 years for undertakings having a commercial activity)
Ireland	1 (3 years in the case of a cessation of trading)	unlimited
Italy	–	5
Luxembourg	–	5 (unlimited up to a level of 50% of losses resulting from depreciation in sectors experiencing a crisis)
Netherlands	3	8 (unlimited for start up losses)
United Kingdom	1 (3 years in case of cessation and for losses attributable to first year depreciation allowance)	unlimited
Canada	1	5
Japan	1	5
United States	3	7

Proposed Directive

PROPOSAL FOR A DIRECTIVE OF THE COUNCIL

on the harmonization of the laws of the Member States relating to tax arrangements for the carry-over of losses of undertakings.

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 100 thereof,
Having regard to the proposal from the Commission,
Having regard to the Opinion of the European Parliament,
Having regard to the Opinion of the Economic and Social Committee,

Whereas as regards taxation, the approximation of tax burdens on undertakings constitutes, principally for reasons of competition, one of the fundamental objectives of the Community; whereas that approximation implies, in addition to the harmonization of systems of company taxation and of the rates of such taxation, the harmonization of the

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rules governing the tax base, that is to say the rules for the determination of the taxable profits of undertakings;

Whereas in the matter of the rules governing the tax base, those relating to the carry-over of losses are of special importance because they affect the investment capacity and competitiveness of undertakings; whereas the improvement of the position of Community undertakings in this regard is a high-priority objective in the present economic situation;

Whereas, from the technical point of view, harmonization of the rules governing the carry-over of losses can be achieved immediately and independently of those governing other aspects of the tax base;

Whereas, to attain the desired objective, the rules governing the carry-over of losses must be as liberal as possible; whereas in this spirit, the carry-over of losses from one financial year must be possible not only to later but also to earlier years in such a way as to allow undertakings to obtain a refund of tax; whereas no time limit would appear to be justified in the case of carry-forward of losses to later years but for budgetary reasons carry-back of losses to earlier year should be limited to the two preceding years;

Whereas, in the case of a corporation tax system allowing a tax credit on distributed profits, the refund of taxation, in the case of the offsetting of losses against such profits, should be reduced by an amount corresponding to the credit granted so as to place an obligation on a State to refund a higher amount of taxation than it has actually collected;

Whereas it is necessary to leave undertakings free to choose the order in which losses are carried over; whereas it is moreover necessary to permit them in the case of carry-back to previous years to limit that carry-back to non-distributed profits and to permit them to exclude from the set-off profits exempted from taxation or taxed at a reduced rate;

Whereas, when different rates are applied to different categories of profits, it is necessary to leave to Member States the power to provide for the offsetting of losses category by category, on condition that such a rule does not lead to undue delay in the offsetting of a loss against a later profit;

Whereas provisions regarding the carry-over of losses must not lead to fraud or abuse on the part of undertakings;

HAS ADOPTED THIS DIRECTIVE:

Article 1

1. The States shall adopt, in accordance with the following articles, the tax arrangements for the carry-over of the losses of undertakings which are subject to one of the taxes listed in paragraph 2, in so far as they draw up for tax purposes, in accordance with conditions laid down by national law, annual accounts consisting of a balance sheet and a profit and loss account.

2. The taxes referred to in paragraph 1 are the following:

for BELGIUM:
Impôt des personnes physiques – Personenbelasting
Impôt des sociétés – Vennootschapsbelasting
Impôt des non-résidents – Belasting der niet-verblijfshouders

for DENMARK:
Indkomstskatten til staten
Selsskabsskat
Den kommunale indkomstskat
Den amtskommunale indkomstskat

for GERMANY:
Einkommensteuer
Körperschaftsteuer

for GREECE:
Φόρος εισοδήματος φυσικών προσώπων
Φόρος εισοδήματος νομικών προσώπων
Φόρος επί των εταιρειών

for FRANCE:
Impôt sur le revenu
Impôt sur les sociétés

for IRELAND:
Income tax
Corporation profits tax
Capital gains tax

for ITALY:
Imposta sul reddito delle persone fisiche
Imposta sul reddito delle persone giuridiche
Imposta locale sui redditi

for LUXEMBOURG:
Impôt sur le revenu des personnes physiques
Impôt sur le revenu des collectivités

for the NETHERLANDS:
Inkomstenbelasting
Vennootschapsbelasting

for the UNITED KINGDOM:
Income tax
Corporation tax
Capital gains tax

or any other identical or substantially similar taxes which are imposed in addition to, or in place of, those taxes.

Article 2

For the purposes to this Directive, profit or loss of a financial year shall mean the positive or negative results of an undertaking ascertained, after any possible set-off against other income in accordance with the tax rules of the State in which it is subject to tax, no account being taken of results recorded abroad by permanent establishments or subsidiaries of the undertaking.

Article 3

1. Where the result of a given financial year for an undertaking shows a loss, that loss shall be offset at the choice of the undertaking

- either against the profits of one or of the two preceding financial years, or against the non-distributed portion of those profits, notwithstanding the definitive nature of the taxation of those financial years;
  then, if need be, against the profits of the following financial years in chronological order;
- or against the profits of the following financial years in chronological order.

However, the undertaking may choose not to offset losses against profits which have not been taxed in the State where it is subject to tax or which have been taxed at a reduced rate.

2. Where, under the provisions of paragraph 1, a loss has been set off against profits which have been distributed and which at the time of their distribution carried entitlement to a tax credit, the resulting repayment of tax shall be reduced by the amount of that tax credit to the extent to which it has not been covered by a compensatory tax.

3. When a Member State, which applies different rates of taxation to different categories of profit, provides that losses must be set off category by category, it shall refrain from applying that provision where a loss could not be set off against profits of the same category at the end of the fifth financial year following that in which it arose.

Article 4

The provisions of this Directive shall not preclude the application of national laws for the prevention of fraud or abuse.

Article 5

Member States shall take the measures necessary to comply with this Directive not later than 1 January 1986. They shall forthwith inform the Commission thereof.

Article 6

This Directive is addressed to the Member States.

BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION – November 1984

- Alternative forms of corporation tax by *Sijbren Cnossen*
- Morocco: Tax incentives for foreign investment by *Servaas van Thiel*
- Sierra Leone: Budget 1984-85
- Thailand: Taxation of royalties, license fees, etc., paid to non-resident licensors by *M. Hongskrailers and K.S. Jap*
- Bangladesh: Some highlights of the 1984-85 Budget by *K.A. Gofran*
- Tax reform in Jamaica – The 1984-85 Budget by *H.W.T. Pepper*
- Jamaica: Budget 1984-85
- United States: Options for systems replacing worldwide unitary taxation

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