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Annex to the

**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL, THE
EUROPEAN PARLIAMENT AND THE ECONOMIC AND SOCIAL COMMITTEE**

Tax Treatment of Losses in Cross-Border Situations

Technical Annexes

{COM(2006) 824 final}

Cash-flow effects of cross-border loss relief

Example:

Operation 2 incurs a loss of 100 in year t and a profit of 100 in t+1; the results for operation 1 are + 100 in the tax years t and t+1. The tax rate is 25 %. Two cases can arise:

- a) Immediate compensation of the loss of operation 2 by the positive tax base of operation 1;
- b) No immediate loss compensation in tax year t but a loss carry-forward and thus compensation against future profits of the same operation.

It is assumed that taxes are always paid in midyear.

Illustration (a): Taxation with immediate loss-compensation

	t	t+1	Σ	Net present value ¹
Tax base operation 1	100.00	100.00	200.00	
Tax base operation 2	- 100.00	100.00	0	
Overall Tax Base	0	200.00	200.00	
Total taxes	0	50.00	50.00	45.35 ²

Illustration (b): Taxation with loss carry-forward

	t	t+1	Σ	Net present value
Tax base operation 1	100.00	100.00	200.00	
Tax base operation 2	- 100.00	0 ³	0	
Taxes operation 1	25.00	25.00	50.00	
Taxes operation 2	0	0	0	
Taxes total	25.00	25.00	50.00	46.49 ⁴

Explanation:

In both illustrations, the overall result of the two operations amounts, over the 2 tax years considered, to the same tax base of 200,00 on which total tax of 50.00 is due. Illustration (a) demonstrates that by obtaining loss relief in the same year, it is possible to avoid the cash-flow disadvantage (which may be quantified as the difference in net present value, i.e. discounted cash-flow, between the two alternatives). Such a cash-flow disadvantage will always arise in situations where losses cannot be set-off against profits generated in any given year. For the sake of completeness it should be mentioned that the same result could also be achieved at the level of the loss-sustaining entity by way of a loss carry-back which would result in a refund of taxes paid in previous tax years. As a result, the loss carry-back would, within the limits of a positive tax payment due or already made, display certain aspects of a negative tax.

¹ The interest rate $i = 5\%$.

² $50 \times 1.05^{-2} = 50 / 1.05^2 = 45.35$

³ The profits amounting to 100 in year t+1 are absorbed by the loss carried forward from year t. The tax base therefore amounts to 0.

⁴ $25 \times 1.05^{-1} + 25 \times 1.05^{-2} = 25 / 1.05^1 + 25 / 1.05^2 = 23.81 + 22.68 = 46.49$

The application of domestic and cross-border loss relief within a company and within a group of companies – an overview

	<u>Domestic</u> relief of losses	<u>Cross-border</u> relief of losses
Within one company (“permanent establishment”)	<p>Automatically available</p> <p>All 25 Member States</p>	<p>Available in most cases</p> <ul style="list-style-type: none"> • Belgium • Czech Republic • Spain • Ireland • Italy • Cyprus • Latvia • Lithuania • Malta • Netherlands • Austria • Portugal • Slovenia • Slovak Republic • Finland • Sweden • United Kingdom
Within a group of companies (“parent” and “subsidiary”)	<p>Available under specific rules in most Member States</p> <ul style="list-style-type: none"> • Denmark • Germany • Spain • France • Ireland • Italy • Cyprus • Malta • Latvia • Luxembourg • Netherlands • Austria • Poland • Portugal • Slovenia • Finland • Sweden • United Kingdom 	<p>In principle not available, with very few exceptions</p> <ul style="list-style-type: none"> • Denmark • France • Italy • Austria

Losses incurred by permanent establishments and their tax treatment under the applicable Double Taxation Agreements at the level of the head office in 24 Member States *) and Acceding Countries

Credit method	Exemption method ...	
	... with (temporary) loss deduction	... without loss deduction
<ul style="list-style-type: none">• Czech Republic• Ireland• Italy• Latvia• Lithuania• Malta• Portugal• Slovenia• Slovak Republic• Finland• Sweden• United Kingdom	<ul style="list-style-type: none">• Belgium• Spain• Cyprus• Netherlands• Austria	<ul style="list-style-type: none">• Denmark• Germany• Greece• France• Luxembourg• Hungary• Poland • Bulgaria• Romania

Note: In practice Member States may apply both methods for the elimination of double taxation. This classification therefore reflects the predominant preference of the Member States for the credit or the exemption method in their Double Taxation Agreements.

*) In the missing Member State, Estonia, retained earnings are not taxable; corporate income tax is, in principle, only levied once earnings are distributed to the shareholders. As only profits may be distributed, this implies that losses must have been taken into account.

Overview of domestic group taxation schemes in Member States and Accessing Countries

No group taxation scheme available	Intra-group loss transfer	“Pooling” of results of a group	Full tax consolidation
<ul style="list-style-type: none"> • Belgium • Czech Republic • Greece • Lithuania • Hungary • Slovakia • Bulgaria • Romania (• Estonia) *) 	<p>a) “Group relief”</p> <ul style="list-style-type: none"> • Ireland • Cyprus • Latvia • Malta • United Kingdom <p>b) “Intra-group contribution”</p> <ul style="list-style-type: none"> • Finland • Sweden 	<ul style="list-style-type: none"> • Denmark • Germany • Spain • France • Italy • Luxembourg • Austria • Poland • Portugal • Slovenia 	<ul style="list-style-type: none"> • Netherlands
<p>No loss compensation available, i.e. a group of companies is disregarded for tax purposes</p>	<p>Every group member is taxed separately; losses may be transferred on a definitive basis from one group member to another</p>	<p>Each group member determines its tax base which is then pooled at the level of the parent company</p>	<p>Legal personality of each group member is disregarded for tax purposes, the result of the subsidiaries are treated as if realized by the parent company</p>

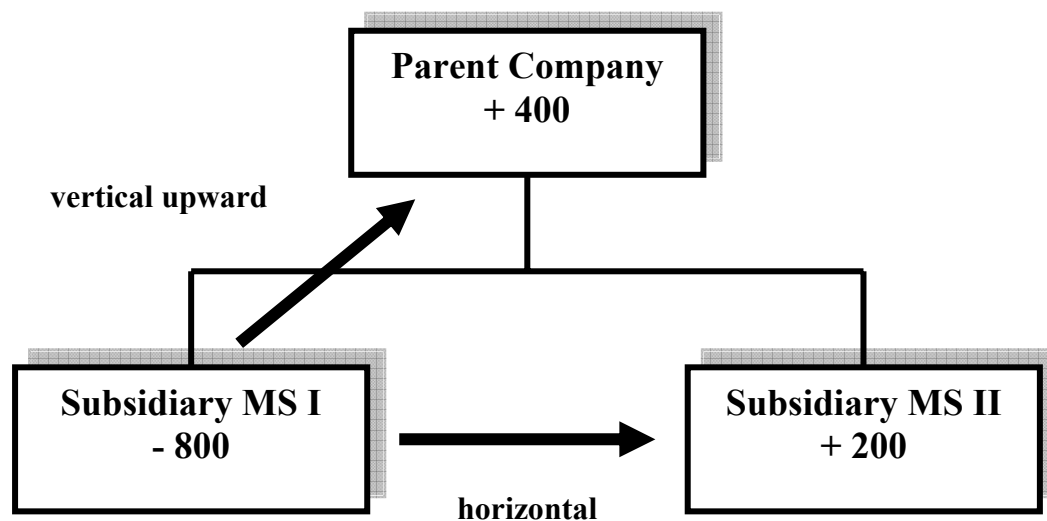
*) In Estonia, corporate income tax is triggered only where profits are distributed. A profit distribution by a group is therefore possible only where the consolidated balance sheet shows a profit, i.e. after taking into account losses of (foreign) group members. If the consolidated balance sheet shows a loss, no profit distribution is possible and therefore no corporate income tax is due – which leads to symmetrical treatment of profits and losses.

Overview of methods applied for domestic and cross-border loss relief in those Member States which allow loss relief in both cases

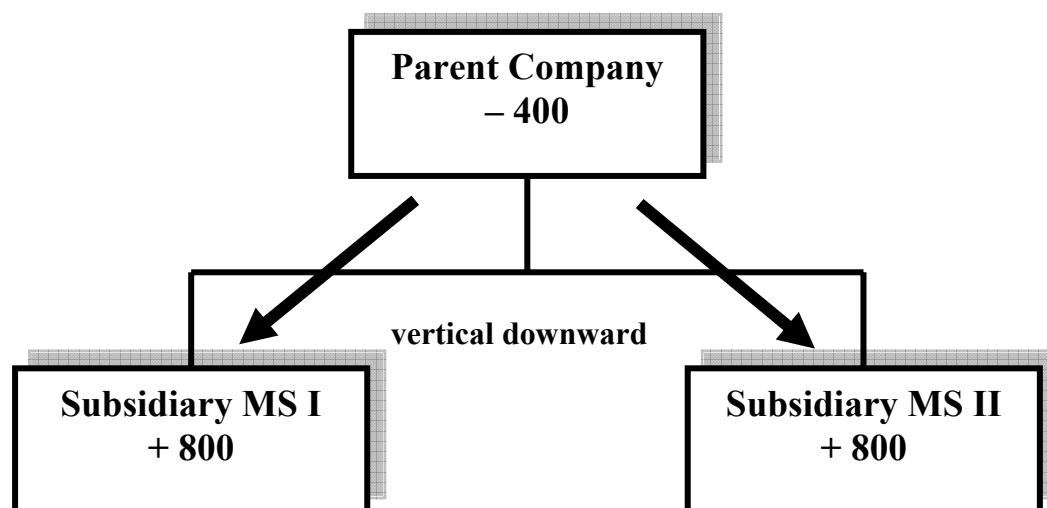
Countries applying cross-border loss relief	Method applied	
	domestically	cross-border
Denmark	Pooling	System of consolidated profits – comprehensive scheme
France	Pooling	System of consolidated profits - comprehensive scheme
Italy	Pooling	System of consolidated profits – comprehensive scheme
Austria	Pooling	Deduction/Reintegration
<i>Spain *</i>	<i>Pooling</i>	<i>Deduction/Reintegration</i>

*) The Spanish regime applies only to holdings owned by Spanish companies in non-listed foreign subsidiaries and corresponds to a write-down of the cost of the stake in the amount of the tax loss of the foreign subsidiary.

Possibilities for loss relief within a group of companies



Allotment of losses for “vertical downward” set-offs – The issue of the tax value of the loss



Tax rate = 35 %

Tax value of loss = 140

(- 400 x 35 %)

Tax rate = 20 %

Tax value of loss = 80

(- 400 x 20 %)

Rules for loss carry-forward and carry-back in Member States

	Loss carry-back	Loss carry-forward
Belgium	No	Unlimited
Czech Republic	No	5 years
Denmark	No	Unlimited
Germany	1 year optional	Unlimited
Estonia	n.a.	n.a.
Greece	No	5 years
Spain	No	15 years
France	3 years optional	Unlimited
Ireland	1 year optional	Unlimited
Italy	No	5 years
Cyprus	No	Unlimited
Latvia	No	5 years
Lithuania	No	5 years
Luxembourg	No	Unlimited
Hungary	No	Unlimited
Malta	No	Unlimited
Netherlands	3 years compulsory	Unlimited
Austria	No	Unlimited
Poland	No	5 years
Portugal	No	6 years
Slovenia	No	7 years
Slovakia	No	5 years
Finland	No	10 years
Sweden	No	Unlimited
United Kingdom	1 year optional	Unlimited

Rules for domestic and cross-border group taxation schemes

	Group Taxation Schemes		
	Group taxation	Minimum holding	Cross-border
Belgium	No	–	
Czech Republic	No	–	
Denmark	Sambeskatning	> 50 %	Yes
Germany	Organschaft	> 50 %	
Estonia	n.a.	n.a.	
Greece	No	–	
Spain	Consolidación fiscal	≥ 75 %	
France	Intégration fiscale	≥ 95 %	Only few exceptions
Ireland	Group relief	≥ 75 %	
Italy	Consolidato nazionale	> 50 %	Yes
Cyprus	Group relief	≥ 75 %	
Latvia	Intra-group loss transfer	≥ 90 %	
Lithuania	No	–	
Luxembourg	Intégration fiscale	≥ 95 %	
Hungary	No	–	
Malta	Group relief	≥ 51 %	
Netherlands	Fiscale eenheid	≥ 95 %	
Austria	Gruppenbesteuerung	> 50 %	Yes
Poland	Pooling	≥ 95 %	
Portugal	Lucro consolidado	≥ 90 %	
Slovenia	Pooling	≥ 90 %	
Slovakia	No	–	
Finland	Konserniavustus	≥ 90 %	
Sweden	Koncernbidrag	≥ 90 %	
United Kingdom	Group relief	≥ 75 %	