The Compensation of Losses within Groups of Companies

by Daniela Hohenwarter

Summary of the main conclusions

Author: Daniela Hohenwarter, LL.M.
Accepting university: Vienna University of Economics and Business (WU)
Subject: Tax Law
Program: Business Law
Supervisor and first evaluator: Univ.-Prof. Dr. Claus Staringer
Second evaluator: Univ.-Prof. Dr. Josef Schuch
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1. Selection of topics and research aims

Losses and in particular their compensation are among the core issues of direct taxation, not only in times of a global economic crisis. For the treasury losses correspond to tax deficits and therefore have a negative meaning. Contrariwise, taxpayers have an ambivalent relationship to them. On the one hand, losses are not wanted if they are “real” losses; on the other hand they regularly lead to a reduction in the taxable base and thus to a lower tax burden. Undoubtedly, losses are a major tax planning tool. Therefore, the legislators not surprisingly try to counteract excessive loss compensation schemes. However, in Austria this ambition has led to an enormous amount of specific rules and provisions dealing with and restricting the compensation of losses. These rules are the point of departure for this thesis, the aim of which is to test the current rules on direct loss compensation for their compatibility with constitutional law, EC law and tax treaty law. Thereby, not only existing discrepancies and differences in treatment are revealed but also the requirements and limits for future reforms are established.

Subject of the thesis at hand is the compensation of losses within groups of companies. This demarcation makes the subject on the one hand manageable, as the focus is placed on corporate tax law but on the other hand also enables the analysis of all facets of the topic of loss compensation. Furthermore, the corporate tax dogmatics associated with the compensation of losses is generally based on the principles of income tax law.

In order to achieve this goal, the relevant loss compensation rules for international groups of companies are identified and critically analyzed before verifying their conformity with constitutional law, EC law as well as tax treaty law. Special emphasis is put on the issue of cross-border loss utilization, the concept of which is a central but also highly polarizing subject in the case law of the ECJ. Using among others the example of the Austrian group taxation regime, the consequences and boundaries of this case law are explored. The thesis is confined to the issue of “direct” loss compensation, thus the compensation of losses in the hands of the taxable person incurring these losses. These cases are completed by the provisions of group taxation according to Sec. 9 KStG, where the law itself allows for the set-off of losses between different taxable subjects, thus the compensation of losses accrued by one taxable person at the level of another taxpayer. “Indirect” loss compensation, such as the loss-induced current-value depreciation of shares in subsidiaries, are not separately analyzed, especially because comprehensive literature on this issue has already recently been presented in Austria. Indirect loss compensation is only taken into account where - as the example of group taxation shows - direct loss compensation excludes indirect loss compensation.
2. Structure of the thesis

Given the overall research aims of this thesis its structure can be broken down as follows: First it presents the constitutional and Community law framework for the compensation of losses within groups of companies (Part 2). On the basis of these criteria the provisions regarding the (direct) compensation of domestic losses in the case of unlimited and limited tax liability are examined (Part 3). Part 4 then discusses the compensation of domestic losses within groups of companies as provided for by Sec. 9 para. 6 KStG. Subsequently, the focus is placed on the compensation of foreign losses. In a first step, the case law on the subject of cross-border loss compensation and the criteria developed by the Austrian Supreme Administrative Court (VwGH) and the European Court of Justice (ECJ) are analyzed (Part 5). This analysis functions as the basis for the argumentation in the following chapters, with Part 6 on the compensation of losses accrued in legally dependent sources of income pursuant to Sec. 2 para. 8 no. 3 EStG being the point of departure. After an in-depth analysis of legal rules in Sec. 9 para. 6 no. 6 KStG on the compensation of foreign losses within groups of companies contained - thus the compensation of losses accrued in legally independent sources of income (Part 7) - the provisions of Sec. 2 para. 8 no. 3 EStG and Sec. 9 para. 6 no. 6 KStG are compared with each other from the perspective of neutrality of legal forms, both with regard to constitutional law and Community law (Part 8). This is then followed by a discussion of certain specific issues relating to the compensation of losses in an international context such as the compensation of domestic losses incurred by foreign group members (Part 9) or the compensation of losses in groups of companies with foreign parent companies (Part 10). Given the scope of this dissertation (more than 600 manuscript pages) and the wealth of detailed discussions and analyses contained therein, its content can only be summarized to a limited extent. At the end of the thesis the reader finds a summary of the 87 main conclusions of this work,\(^1\) which will also be addressed for the purpose of this summary. Detailed substantiations have to be omitted, however.

3. Constitutional and Community law framework for the compensation of losses within groups of companies

3.1. Obligations imposed by constitutional law on the compensation of losses within groups of companies

The first substantive part of this thesis is aimed at revealing the constitutional law framework for the issue of fiscal loss compensation in general. It therefore examines the question of which of the fundamental rights provided by laws with constitutional status could possibly guarantee taxpayers a right to loss compensation, or to put it differently which restrictions of the compensation of losses are allowed without violating these basic rights. For this purpose the provisions of Art. 5 of the Basic

\(^1\) Part 11, pp. 655 et seq.
Law of the Republic of Austria (Staatsgrundgesetz hereinafter referred to as StGG) in conjunction with Art. 1 of the 1st Protocol to the European Convention of Human Rights (hereinafter referred to as ECHR), Art. 6 para. 1 StGG and Art 7 para. 1 of the Austrian Federal Constitutional Law (Bundesverfassungsgesetz hereinafter referred to as B-VG) are analyzed. The main conclusions in this respect can be summarized as follows:

Although tax statutes as such may lead to an interference with the property rights guaranteed by Art. 5 StGG and Art. 1 of the 1st Protocol to the ECHR, the impact of these provisions on the question of loss compensation is only minor. This is due to the fact that limiting the use of losses for tax purposes may only constitute a violation of Art. 5 StGG and Art. 1 of the 1st Protocol to the ECHR if the restriction results in an “excessive” taxation. However, such an “excessive” taxation only exists if the statutory denial of the losses to be taken into account causes a taxation that is massively disproportional to the amount of income earned so that not even the core of the result yielded by an economic activity is preserved; in other words if the tax levied is of a confiscating nature. So far, the Austrian Constitutional Court (Verfassungsgerichtshof hereinafter referred to as VfGH) has never declared a tax statute unconstitutional because of a violation of Art. 5 StGG and/or Art. 1 of the 1st Protocol to the ECHR. Behind that background it seems very unlikely that the Court will do so with respect to provisions that limit the use of losses.2

Similar conclusions can also be drawn as regards the right to be gainfully employed or self-employed according to Art. 6 para. 1 StGG. In order for a legal provision to constitute an infringement of Art. 6 para. 1 StGG it must objectively address specific professions or activities. The potential scope of application of Art. 6 para. 1 StGG with respect to provisions that restrict the use of losses in corporate groups is therefore limited. This is not only due to the fact that companies within the meaning of Sec. 7 para. 3 KStG by means of a fiction only receive business income. Furthermore, it can also be traced back to the wide political leeway the VfGH concedes to the legislator when the provision in question only curtails the (ongoing) exercise of a certain profession or activity but does not represent a restriction on admission.3

The most important standard for testing loss compensation rules on their compatibility with constitutional law is the principle of equality provided for by Art. 7 para. 1 B-VG. This is true not only for outbound cases but - despite the (prima vista) restrictive wording of Art. 7 para. 1 B-VG - also for inbound cases involving (non-resident) foreign nationals.4 However, in this respect it has to be noted

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2 Part 2 chapter A.I, pp. 9 et seq.
3 Part 2 chapter A.II, pp. 15 et seq.
4 For the development of the argument based on the prohibition of racial discrimination according to the Federal Constitutional Law prohibiting racial discrimination see pp. 23 et seq. Alternatively foreign nationals may - in the course of a complaint of unconstitutionality of the notice of assessment according 144 B-VG - also invoke other fundamental rights which are not limited to Austrian nationals (such as Art. 5 StGG) in order to object to a violation of the principle of equal treatment.
that the VfGH is rather reluctant in requiring equal treatment of resident taxpayers subject to unlimited tax liability and non-residents subject to limited tax liability on the basis of Art. 7 para. 1 B-VG. Contrary to the fundamental freedoms of Community law, Art. 7 para. 1 B-VG also addresses reverse discrimination. One major aim of this part of the thesis was to show the similarities and differences of the discrimination analysis carried out by the VfGH and the discrimination analysis under Community law.

The last chapter of part 2 is devoted to the disputed ability-to-pay-principle and its dogmatic foundation as a separate constitutional standard independent from the principle of equality. Taking into account the opposing views on this issue and assessing them, the author basically acknowledges the relevance of the ability to pay principle which is enshrined in law in the form of the objective-net-principle (according to which the object of taxation must not be the gross income but the net income after deduction of related expenses or losses) but nevertheless comes to the conclusion that the net or ability-to-pay-principle does not really qualify as an own constitutional standard. At best, one may qualify the objective-net-principle derived from the ability-to-pay as a regulatory principle (Ordnungsprinzip) chosen by the legislator itself. Following the relevant case law of the VfGH any deviation from this regulatory principle is only admissible, if and when it is objectively justified. Consequently, any deviation from this obligation imposed on the ordinary legislator to allow for the fiscal compensation of losses, requires a justification. However, the legal standard in this regard is not to be found in the ability-to-pay-principle itself (this principle does not have the clarity and selectivity required to be employed as a separate constitutional standard), but rather in the constitutional principle of equality. Thus, the supposedly separate constitutional relevance of the net or ability-to-pay-principle can be reduced to general issues of equality. Summing up it may be said that the ability-to-pay-principle does not represent a separate constitutional standard for the author. This is after all only the principle of equal treatment according Art. 7 para. 1 B-VG.

3.2. Obligations imposed by Community law on the compensation of losses within groups of companies

As demonstrated in sections I to IV of part 2, constitutional law in its current interpretation and application by the VfGH only provides for a limited scope of protection against discrimination when it comes to cross-border situations including cross-border groups of companies. However, in this context, the fundamental freedoms of Community law have proven to be a main source of protection against discrimination. This is mainly due to the fact that so far all attempts to harmonize the compensation of losses within groups of companies by means of secondary Community law have failed. The beginning of chapter B of part 2 deals with these attempts, starting with the legal basis for

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5 Part 2 chapter A.III, pp. 18 et seq.
6 Part 2 chapter A.IV, pp. 29 et seq.
the approximation of laws within the EU and continuing with a summary of the cornerstones of the existing drafts and proposals (including Art. 7 of the 1960 proposal for a Parent-Subsidiary Directive, Art. 281 of the 1975 and 1991 proposal for a regulation on the statute for the European Company and the proposal for a directive concerning the compensation of losses incurred in foreign PEs and subsidiaries). The final part of this section is then devoted to the latest achievement of the European Commission in this respect: the Communication on the tax treatment of losses in cross-border situations of December 19, 2006. The aim and value of this section is first to make the reader aware of the struggle to find a common European solution and second to show the fundamental principles and common structure of these drafts and proposals. This approach helps to analyze and understand the current “loss”-case law of the ECJ. The main emphasis of chapter B is however placed on the dogmatic analysis of the fundamental freedoms in the field of direct taxation. The most important results can be summarized as follows:

Even though the prevailing opinion is that the fundamental freedoms contain not only a prohibition of discrimination but also a prohibition of restriction, the author is of the opinion that the fundamental freedoms (still) have to be understood as comprehensive prohibitions of treating cross-border (economic) activities and situations less favourable than comparable purely domestic activities and situations. The ECJ implies nothing else when it defines a restrictive measure prohibited by the EC-Treaty as one that renders “less attractive” the exercise of e.g. the freedom of establishment or the free movement of capital. Logically, such a conclusion may, however, only be drawn on the basis of a comparison, which in turn is the core element of every discrimination analysis. Consequently, also the restriction analysis as carried out by the ECJ is firmly anchored in a relative approach based on a comparison. Since there is no structural difference between a hidden discrimination and a restriction understood as a measure that places cross-border economic activities at a disadvantage, it is well founded to understand the fundamental freedoms - at least in the field of direct taxation - further on as comprehensive non-discrimination clauses.

Based on this understanding, the elements of the discrimination analysis carried out by the ECJ in relation to those Treaty freedoms that are most relevant for the compensation of losses within groups of companies, i.e. the freedom of establishment according to Art. 43 EC and the free movement of capital according to Art. 56 EC, are analyzed. This includes not only an analysis of the substantive and personal scope of Art. 43 and 56 EC as such but - based on the ECJ’s case law - also of the question of how to demarcate the substantive scope of Art. 43 from Art. 56 EC in the case of

7 Part 2 chapter B.I, pp. 32 et seq.
8 Part 2 chapter B.I, pp. 35 et seq.
9 Part 2 chapter B.I, pp. 45 et seq.
10 Part 2 chapter B.II, pp. 48 et seq.
11 Part 2 chapter B.II, pp. 53 et seq.
third country situations. This question is particularly relevant in relation to third countries where the freedom of establishment cannot offer protection anyway and therefore the question arises whether transactions within the meaning of Art. 43 EC - which *prima vista* also come under the free movement of capital - are capable of being protected by Art. 56 EC. Against the background of the theory of applying Art. 43 and Art. 56 EC in parallel (which was the prevailing opinion in the past), the recent case law of the ECJ on the mutual exclusivity of the fundamental freedoms (including *Fidium Finanz, Test Claimants in the Thin Cap Group Litigation, Lasertec, A and B*) is critically reviewed and analyzed. Although the approach taken by the ECJ in these cases is not convincing from a dogmatic point of view, it has to be accepted as prevailing case law by now. Contrariwise the question of how to draw the borderline between Art. 43 and Art. 56 EC and even more important of how to establish an order of precedence between them is still not clear and highly disputed. According to the case law of the ECJ this question has to be answered by taking into consideration the “**purpose of the legislation concerned**”. Looking at the cases mentioned above, this phrase, however, represents nothing more than empty words. This is due to the fact that in these cases not only the purpose of the law in question but also the factual situation at stake pointed at an (exclusive) application of Art. 43 EC. Following this case law, two theories of how to distinguish Art. 56 from Art. 43 EG in third country cases have emerged: the one taking into consideration the purpose of the law in question (Theorie der Maßgeblichkeit der nationalen Norm) and the other one looking at the facts of the case (Theorie der Maßgeblichkeit des Sachverhalts). Proponents of the first theory consider their approach as having been proven by the ECJ in the *Holböck* case. Here the author demonstrates that the *Holböck* case does not answer the question of priority at all since the Court denies the existence of an infringement of Community law on the hypothesis that Art. 56 EC was applicable to a person holding two thirds of the share capital of a company established in a third country (“*... even if a Member State national who holds two thirds of the share capital of a company established in a non-member country were justified in invoking the prohibition of restrictions on the movement of capital between Member States and non-member countries set out in Article 56(1) EC [...]*”) but does not say that Art. 56 EC was applicable as a matter of fact. Also the A case did not really clarify this issue as the actual amount of shares held by the taxpayer was unknown. In the light of this case law, the author demonstrates several deficiencies in distinguishing the scope of application and thereby also the order of priority between Art. 56 EG and Art. 43 EC on the basis of the object and purpose of the

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12 Part 2 chapter B.II, pp. 66 et seq.
13 This conclusion may - among others - be linked to the standstill provision of Art. 57 para. 1 EC, according to which restrictions on the free movement of capital to or from third countries involving e.g. direct investments and establishments can be upheld, provided they have already existed on or before December 31, 1993. Since the applicability of this clause - which explicitly refers to capital movements such as direct investment and establishment - requires at least in theory that Art. 56 EC as such is initially applicable to such transactions, this goes against the theory of mutual exclusivity propounded by the ECJ, which states that the free movement of capital cannot be invoked in such cases from the outset. To this extent, the reasoning of AG *Bot* in his opinion on the A case is to be supported which, as the *Burda, KBC Bank* and *Aberdeen* cases show, has still not been addressed by the ECJ, however.
national law in question. These concerns have been indirectly confirmed by the ECJ in the cases *Burda, KBC Bank* and *Aberdeen*, in which the Court answered the question of priority by referring to the facts of the case although the scope of application of the national laws in question did not distinguish between the amount of shares held by the taxpayer. These cases therefore support the second theory - the theory of relying on the facts of the case - which after all is at least more convincing than referring simply to the purpose of the law. Regardless of whether the scope of application of Arts. 56 EC and 43 EC and the order of priority between these provisions is to be answered by reference to the object and purpose of the law in question or the actual facts of the case, group taxation systems such as Sec. 9 KStG do not fall under Art. 56 EC. This is due to the fact that Sec. 9 para. 2 in conjunction with para. 4 KStG requires a controlling relationship between the individual members of the fiscal group. Therefore, corporate groups involving third country companies are - as a rule - not protected by the fundamental freedoms of EC law. Consequently, restrictions with respect to the compensation of losses of subsidiaries resident in third countries or with respect to losses relating to subsidiaries of third country parent companies can not be challenged on the basis of primary EC law.

Once the protective scope of the fundamental freedoms is opened, the existence of a restrictive discrimination has to be established. This requires - as already mentioned - a comparison and thus the determination of an adequate comparator.\textsuperscript{14} Here the author demonstrates that the wording as well as the object and purpose of the fundamental freedoms point to a vertical pair of comparison, both in inbound and outbound situations.\textsuperscript{15} Only by comparing the cross-border situation to the respective (purely) domestic situation the contradiction between the requirements of the common market on the one side and the fiscal sovereignty of the Member States on the other side can be surmounted since it enables acting against restrictions which specifically work to the detriment of cross-border situations while still respecting the sovereignty of the Member States. In order to come to this conclusion the case law of the ECJ on the question of horizontal differentiations caused by domestic law, particularly the cases *van Hilten van der Heijden, Cadbury Schweppes* and *Columbus Container Services* were analyzed and contrasted to the most-favored-nation cases such as *D, Test Claimants in Class IV of the ACT Group Litigation and Orange European Smallcap Fund*. Although the ECJ accepts in these cases a horizontal pair of comparison in a first step, the Court, in a second step always denies the comparability of the situations. In the end, the result is similar: no protection against horizontal differences in treatment is granted. The dogmatic preference for a vertical pair of comparison as defended by the author remains valid also after taking into account cases like *A and Commission/Netherlands*, in which the ECJ seemingly based its argumentation on a horizontal comparison between two different cross-border situations. Taking, however, a closer look at these cases, it becomes obvious that the discrimination or restriction challenged therein can already be

\textsuperscript{14} Part 2 chapter B.II, p. 80 et seq.

\textsuperscript{15} Part 2 chapter B.II, pp. 81 et seq.
traced back to a vertical discrimination revealed by comparing the respective cross-border situation to the purely domestic situation. This is due to the fact that in both cases - similar to the Cadbury Schweppes case - the mentioned cross-border situations that were treated differently from other (similar) cross-border situations were treated like the purely domestic cases. Thereby the alleged horizontal aspect of the comparability analysis carried out by the ECJ has no meaning of its own as it is only the result of an abridged comparability analysis based on a vertical pair of comparison.

This preference for vertical pairs of comparison also takes effect in the context of neutrality of legal forms. Here the author establishes that Art. 43 EC does not contain a separate obligation to provide for taxation that is neutral as to the legal form of the establishment. This conclusion is - with the exception of the CLT-UFA case - also supported by the case law of the ECJ. In inbound cases the demand for neutrality of legal forms does not have an autonomous meaning as any differentiation between resident subsidiaries and the PEs of non-resident taxpayers can already be addressed by the prohibition of vertical discriminations on grounds of residence or nationality contained in Art. 43 EC. From that perspective neutrality of legal forms in inbound cases represents a mere reflex to the obligation to ensure that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State. In outbound cases differences in treatment between subsidiaries and legally dependent types of establishment such as agencies or PEs result from the choice made by the taxpayer to pursue his activities in a particular way but not (exclusively) from the place of establishment. Thereby any discrimination that could be established by drawing a horizontal pair of comparison is missing the specific transnational element. If, however, the fundamental freedoms shall establish an internal market by specifically prohibiting the discrimination of cross-border business, there is simply no room for a neutrality of legal forms on grounds of Community law. In other words this means that the Member States are at liberty to determine the conditions and the level of taxation for different types of establishments chosen by national taxpayers operating abroad provided that those taxpayers are not treated in a manner that is discriminatory in comparison with comparable national establishments. This vertical approach achieves the principle of equality and maintains the fiscal autonomy of the Member States.

The final part of the comments on the general dogmatics of the fundamental freedoms and their application to tax law is devoted to the justification and proportionality analysis, both in intra-community and in third country situations. Here, not only the individual justifications accepted or

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16 Part 2 chapter B.II, pp. 104 et seq.
17 In this judgment the ECJ interprets Art. 43 EC as an obligation to provide for neutrality of legal forms in an inbound case. However, this conclusion - which has to be criticized on several grounds - so far has not been confirmed by the ECJ in a second case. The main criticism concerns the fact that the ECJ by bluntly requiring equal treatment of subsidiaries and PEs fails to appreciate the object and purpose as well as the systematic functioning of the tax rule in question. A vertical pair of comparison would have allowed a more sophisticated analysis.
18 Part 2 chapter B.II, pp. 113 et seq.
rejected by the ECJ are described but also their similarities and differences as well as their
development over time are expounded. This is e.g. true for the relationship between the principle of
territoriality and the preservation of the allocation of the power to impose taxes between the
Member States or the avoidance of double non-taxation and the principle of cohesion and the
preclusion of tax avoidance and tax evasion. Finally an outlook to the rule of reason analysis in third
country situations is given. In this context the author shows the extended latitude for justifying
restrictions vis à vis third countries but also points out the limits.

4. The compensation of domestic losses with regard to separate taxable entities

4.1. Compensation of domestic losses and unlimited tax liability

After demonstrating the dogmatic foundations upon which the thesis is built, Part 3 deals with
the direct compensation of domestic losses from (legally) dependent sources of income in the case of
limited and unlimited tax liability - either by means of a loss set-off in the year in which they accrue
or by means of a loss carryforward to subsequent taxable years. Chapter A starts with an analysis of
the legal provisions referring to the tax treatment of losses under unlimited tax liability. For this
purpose the loss set-off under Sec. 7 para. 2 and 3 KStG and its restrictions according to Sec. 2 para.
2a EStG19 as well as the loss carryforward under Sec. 8 para. 4 no. 2 KStG in conjunction with Sec. 18
para. 6 and 7 EStG and its limitations according to Sec. 2 para. 2b no. 2 EStG are taken into account.20
The main results of this chapter are:

There are good reasons to believe that the limitation to set off losses pursuant to Sec. 2 para. 2a
EStG as such is in conformity with the principle of equality according to Art. 7 para. 1 B-VG. The
higher taxation that is caused by the protraction of the loss set-off is justifiable on grounds of
preventing professional loss allocation schemes. Since Sec. 2 para. 2a EStG does not lead to a total
exclusion of such losses to be used for tax purposes but only to a protraction (the losses may be set-
off against future profits relating to the respective business or source of income) also the principle of
proportionality should be satisfied.21 However, concerns arise in the light of legal certainty as
provided for by Art. 18 B-VG. Nevertheless, against the background of the relevant case law of the
VfGH a repeal of the law due to a violation against Art. 18 B-VG seems unlikely.22 From the point of
view of the principle of equal treatment, however, a different treatment that is only provided for corporations seems problematic. According to Sec. 7 para. 2 KStG the loss set-off limitation under
Sec. 2 para. 2a EStG is only applicable to losses from “participations”. Thereby - which is also
supported by a historical interpretation of the provision - it becomes clear that corporations are only

19 Part 3 chapter A.I and II, pp. 141 et seq.
20 Part 3 chapter A.III and IV, pp. 153 et seq.
21 Part 3 chapter A.II, p. 147 et seq. and p. 152 et seq.
22 Part 3 chapter A.II, p. 145 et seq.
subject to the limitation according to Sec. 2 para. 2a first indent EStG. Sec. 2 para 2a second indent EStG is on the other hand not applicable. Since there is no objective justification for this difference in treatment - with the losses concerned by the first indent and those concerned by the second indent being comparable - the presumption of an infringement of Art 7 para. 1 B-VG becomes obvious. As shown in chapter A section II.3.c there is no room for applying Sec. 2 para. 2a EStG to losses attributed between financially integrated companies within a fiscal group according to Sec. 9 KStG.

Sections III and IV then deal with the loss carryforward and its effect as inter-periodical loss set-off, with special emphasis being placed on the 75% loss carryforward limitation as defined in Sec. 2 para. 2b no. 2 EStG. This rule, which is of paramount importance in practice, is often referred to as “minimum taxation” as it restricts the loss carryforward to 75% of the regular annual income received in the year the losses are to be used. Thus, at least 25% of the annual regular income has to be taxed without being available for a loss deduction. Here the author elaborates on the obligations imposed by constitutional law on the availability of a loss carryforward in general and on Sec. 2 para. 2b no. 2 EStG in particular. Also in this context the starting point is that the 75% carryforward limitation does not result in any final rejection of the losses to be used but only in a (temporal) protraction of the carryforward. Consequently, unclaimed losses may be carried forward to subsequent years in which they may be compensated (again by applying the 75% threshold). Taking into account the total period, the objective-net-principle is not violated. Furthermore, the rule does not have any confiscatory characteristics on the whole, which leads to the result that the freedom of ownership according to Art. 5 StGG is not violated. Nevertheless, the author demonstrates that the rules can - above all - be tested for its conformity with the principle of equality as provided for by Art. 7 para. 1 B-VG. Concerns arise if one draws a parallel with the case law of the VfGH on the minimum corporation tax pursuant to Sec. 24 para. 4 KStG which the Court has declared to be unconstitutional because it required companies to generate an unrealistically high minimum rate of return in order to be able to fully use the minimum tax as a prepayment of mainstream corporation tax. Thereby companies, the income of which was permanently lower then this minimum rate of return, were - relatively speaking - taxed at a higher level than companies the income of which exceeded this minimum rate of return. For the purpose of this thesis the question was whether the results derived by the VfGH in the context of Sec. 24 para. 4 KStG can also be transposed to the loss carryforward limitation as provided for by Sec. 2 para. 2b no. 2 EStG. Here it is ultimately illustrated that any infringement of Art 7 para. 1 B-VG provoked by this loss carryforward restriction depends on the actual pair of comparison that is used for the discrimination analysis and the time period under review. Since discrimination can only be demonstrated if one compares companies with less

\[23\] Part 3 chapter A.II, pp. 148 et seq.
\[24\] Part 3 chapter A.II, pp. 150 et seq.
\[25\] Part 3 chapter A.III, pp. 153 et seq.
\[26\] Part 3 chapter A.IV, pp. 157 et seq.
pronounced fluctuations in income to companies with strong income fluctuations, the question arises whether such companies are actually comparable. Moreover, the longer the period under review, the smaller are the differences in treatment. However, as the selection of the pair of comparison is to a certain extent also based on a value judgment, it is difficult to anticipate whether the VfGH would regard those situations as comparable. If one proceeds on the assumption of comparability it is indeed difficult to find a valid justification for the differentiations caused by section 2 para. 2b no. 2 EStG. This loss carryforward restriction is primarily the result of tax policy and budgetary considerations which per se are only valid as justification in exceptional situations.  

### 4.2. Compensation of domestic losses and limited tax liability

Chapter A is then followed by a detailed analysis of Sec. 102 para. 2 no. 2 EStG which deals with the compensation of domestic losses incurred by taxpayers subject to limited tax liability in Austria. According to Sec. 102 para. 2 no. 2 EStG only those losses that are incurred in a domestic PE or that are attributable to immovable property situated in Austria and only to the extent they exceed the income which is not subject to limited tax liability in Austria are eligible for a loss carryforward within the meaning of Sec. 18 para. 6 and 7 EStG. Thus from the Austrian point of view, the loss carryforward is forfeited if the income not subject to limited tax liability in Austria (i.e. the remaining worldwide income) exceeds the Austrian losses. Although this restriction does not violate constitutional law, it raises serious concerns from the perspective of Community law (Art. 43 and/or Art. 56 EC) and the PE-non-discrimination principle enshrined in almost all tax treaties concluded by Austria (Art. 24 para. 3 OECD-MC). However, according to the case law of the VwGH as well as the UFS (i.e. lower tax court) which is followed by the tax administration this rule does not apply with regard to qualifying losses of taxpayers resident in countries with which Austria has concluded a tax treaty providing for a non-discrimination clause similar to Art. 24 para. 3 OECD-MC or taxpayers which are protected by the fundamental freedoms of Community law, unless the losses can be utilized in the residence state and thus would be subject to a double dip. The question that inevitably arises therefore is whether this partial non-application of Sec. 102 para. 2 no. 2 EStG is enough to comply with the obligations imposed by tax treaty law and/or Community law, both from a substantive and formal point of view.

With regard to the obligations imposed by tax treaty law the author comes to the conclusion that the case law of the VwGH and its transposition by the tax administration is in conformity with the requirements of Art. 24 para. 3 OECD-MC. Although the wording of the non-discrimination clauses contained in Art. 24 OECD-MC suggests that they are absolute non-discrimination clauses which are

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27 Part 3 chapter A.IV, pp. 163 et seq.
28 Part 3 chapter B.I and II, pp. 167 et seq.
30 Part 3 chapter B.IV, pp. 175 et seq.
not amenable to justification, a closer look at the case law of various national courts as well as the OECD commentary on Art. 24 reveals that also tax treaty non-discrimination clauses - including above all Art. 24 para. 3 OECD-MC - are accessible to the three-tier discrimination analysis\(^{31}\) as known by Community law or constitutional law. Here the author demonstrates that the only difference between the above-named discrimination principles seems to be the stage at which the justification arguments are taken into account. For example: in the case of tax treaty non-discrimination clauses several grounds which are accepted as justification for the different treatment of comparable situations by the ECJ are already taken into account at the level of the comparability analysis in order to deny the comparability of the situations. This only confirms the exchangeability of arguments as well as the transmissibility of the various stages of the discrimination analysis.\(^{32}\) Against this dogmatic background it can further be established that the avoidance of double non-taxation is a valid justification within the scope of application of Art. 24 para. 3 OECD-MC; both from the perspective of the host or source state. Consequently, the prevailing hypothesis of the absolute irrelevance of the losses’ treatment in the taxpayer’s state of residence for their treatment in the source state is not followed for the purpose of this thesis. Nevertheless, a consistent teleological interpretation of Art. 24 para. 3 OECD shows that it is the source state that bears the prior obligation to take into account the losses attributable to a PE situated therein. Consequently, the loss carryforward may legitimately only be denied in exceptional situations, e.g. when the residence state takes into account foreign losses without recapturing them upon subsequent utilization in the source state.\(^{33}\) Section IV.2.ab to ad then deals with the procedural law aspects of implementing this prior loss compensation in Sec. 102 para. 2 no. 2 EStG by using the instruments provided for by the Austrian Federal Fiscal Code (BAO).\(^{34}\)

Whether the same conclusions can also be drawn with regard to the imperatives of the fundamental freedoms of Community law is, however, disputable. This is due to the differing tendencies which can be deduced from the existing jurisprudence of the ECJ. Given the verdicts in the *Futura Participations* and *AMID* cases there should be no doubt that Sec. 102 para. 2 no. 2 EStG as such (i.e. disregarding the restricted application mentioned above) is violating EC law, first and foremost the freedom of establishment according to Art. 43 EC.\(^{35}\) From *Futura Participations* it follows that Member States in their capacity as host states have to take into account (only) those losses which have a sufficient territorial nexus with their taxing jurisdiction in a non-discriminatory manner whereas in *AMID* the Court held with respect to the compensation of domestic losses that

\(^{31}\) Comparability - Justification - Proportionality.
\(^{32}\) Part 3 chapter B.IV, pp. 180 et seq.
\(^{33}\) Part 3 chapter B.IV, pp. 178 et seq. and pp. 182 et seq.
\(^{34}\) Part 3 chapter B.IV, pp. 184 et seq.
\(^{35}\) Third country implications are dealt with in part 3 chapter B.IV.2.e, pp. 212 et seq. The author is well aware of the fact the *AMID* case concerned the taxation of resident taxpayers in the state of origin. Nevertheless an accurate analysis of the case reveals the parallels between *AMID* and the taxation of non-residents according to the principle of territoriality. See part 3 chapter B.V, pp. 190 et seq.
such losses must not be set off against treaty exempt (foreign) PE-profits provided these losses, although set-off, cannot be deducted from taxable income in either of the Member States concerned.\textsuperscript{36} Summarized it becomes clear that Sec. 102 para. 2 no. 2 EStG as its stands in the law is indefensible.\textsuperscript{37} Nevertheless, it is highly questionable whether the partial non-application of that rule as provided for by the income tax directives of the Ministry of Finance is able to refute these concerns. From a formal point of view this has to be denied as the ECJ has consistently held that the incompatibility of provisions of national law with provisions of the EC-Treaty, even those directly applicable, can be definitely eliminated only by means of binding domestic provision having the same legal force as those which require to be amended. Mere administrative practices, which are alterable at will by the authorities and are not given appropriate publicity, cannot be regarded as constituting the proper fulfillment of a Member States’ obligations under the treaty, since they maintain, for the persons concerned, a state of uncertainty as regards the extent of their right guaranteed by the EC-Treaty. The crux of the matter is however the question whether a statutory implementation of the current legal practice and case law would substantively meet the obligations imposed by Community law.

Looking at the basic structure of the principle of territoriality and the Marks & Spencer and Lidl Belgium cases it is beyond doubt that the prevention of double loss utilization is accepted as justification if it is applied together with a symmetrical allocation of taxing powers between the Member States. Further developed, this approach strongly suggests that the avoidance of double loss utilization can only be relied on as justification if the compensation of the losses concerned would result in an asymmetry between the obligation to take into account the losses and the right to tax corresponding profits but not if the loss-compensating state has the right to tax these profits anyway. Transposed to the complex of problems related to Sec. 102 para. 2 no. 2 EStG this would mean that the carryforward of domestic losses incurred by non-resident taxpayers must not be made dependent on the losses’ treatment in the residence state; even if this results in a double dip.\textsuperscript{38} Nevertheless, as the cases Eckelkamp and Amurta suggest, an exception from this maxim should apply if the avoidance of double loss utilization in such a way is provided for in a tax treaty. If a Member State in its capacity as host state has assumed joint responsibility for the prevention of double taxation by concluding a tax treaty, it should be also at liberty to provide for a rule which ensures that losses are deducted only once. Consequently, a treaty provision that ties the loss-carryforward in the source state to the non-consideration of the respective losses in the state of residence should be in line with the requirements of Community law.\textsuperscript{39} Even though the ECJ seems to support this line of reasoning, the author is skeptical as far as the treaty foundation of such a rule is

\textsuperscript{36} ECJ 14.12.2000, C-141/99, AMID [2000] ECR I-11619, para. 33. Presumably the Court would have reached another conclusion if the losses - for whatever reason - had already been deducted in the PE-state.

\textsuperscript{37} Part 3 chapter B.IV, p. 193 et seq.

\textsuperscript{38} Part 3 chapter B.V, pp. 194 et seq.

\textsuperscript{39} Part 3 chapter B.V, pp. 196 et seq.
concerned. Videlicet, in the end it makes no difference in terms of legal certainty and in terms of the economic result whether the carryforward of already compensated losses is denied in the source state because of a treaty provision or a national law provision. In both cases a tax benefit is denied in the source state because a functionally equivalent benefit has already been granted in the residence state. Moreover, such a “treaty-proviso” would also conflict with the N judgment and to a certain extent also with the Centro Equestre da Lezíria Grande case.\textsuperscript{40} Provided that one accepts the avoidance of double loss utilization as legitimate objective compatible with the EC-Treaty which constitutes an imperative reason in the public interest,\textsuperscript{41} it does not seem to be fallacious to allow the Member States to take measures against double loss utilization even in their position as (income) source state; at least in cases of a final double dip. However, this conclusion as a rule does not hold true in bilateral situations governed by a tax treaty providing for the credit method. Under these circumstances the avoidance of double non-taxation caused by a double dip of the PE-losses is not capable of justifying any restriction on the loss compensation in the source state. Moreover, it must be borne in mind that it is the source state of the income that bears the prior-ranking obligation to compensate the losses. This obligation cannot be shifted to another Member State by using this state as a kind of surety.\textsuperscript{42} Summarizing it is therefore fair to say that the issue of preventing double loss utilization by the source state is not only complex but also highly controversial as the existing case law of the ECJ is ambiguous in this respect.\textsuperscript{43}

Apart from the issue of preventing double loss utilization, Sec. 102 para. 2 no. 2 EStG also raises concerns with respect to other aspects. One of these aspects is the PE-requirement of Sec. 102 para. 2 no. 2 1st sentence EStG according to which the losses must be attributable to a domestic PE in order for them to qualify for a loss carryforward. At least as far as losses are concerned which were incurred in a source of income that is taxable in Austria also under a tax treaty, this requirement runs the risk of violating the freedom to provide services within the meaning of Art. 49 EC and exceptionally also the free movement of capital within the meaning of Art. 56 EC.\textsuperscript{44} With regard to corporations subject to limited tax liability these concerns apply to corporate bodies which are comparable to those bodies referred to in Sec. 7 para. 3 KStG and which neither maintain a PE nor immovable property in Austria or to corporate bodies which are not covered by Sec. 21 para. 1 no. 2 lit. b KStG.\textsuperscript{45}

\textsuperscript{40} As to the line of reasoning see Part 3 chapter B.V, p. 186 et seq.
\textsuperscript{41} The Marks & Spencer, N as well as Rewe Zentralfinanz cases point in this direction; see p. 199. For the implications of the Papillon case in this respect see pp. 586 et seq. as well as point 10 of this summary.
\textsuperscript{42} Part 3 chapter B.V, p. 200 et seq.
\textsuperscript{43} A potential case - provided it is referred to the ECJ in a later stage of the appeal proceedings - in which this issue could be solved is the Philips Electronics UK Ltd v Revenue and Customs Case decided by the UK First-Tier Tribunal on 19 August 2009.
\textsuperscript{44} Part 3 chapter B.V, pp. 202 et seq.
\textsuperscript{45} Part 3 chapter B.V, p. 205 et seq.
Further issues are raised by the differences in treatment between taxpayers subject to limited tax liability and taxpayers subject to unlimited tax liability due to the theory of isolation. The theory of isolation combined with the plain exclusion from balance-sheet profit determination (Sec. 4 para. 1 or Sec. 5 para. 1 EStG) is violating EC law if the losses concerned would be classified as “business losses” in the case of a comparable corporation subject to unlimited tax liability and Austria being entitled to tax the income stemming from this source also according to a tax treaty. This conclusion is drawn from the Gilly-doctrine which also finds support in the Futura Participations judgment. If, however, one transposes in the light of the recent Renneberg decision the Marks & Spencer-doctrine also to the source state, this results in an obligation to take into account also “treaty-exempt” (domestic) losses, provided these losses fulfill the conditions as set out by the ECJ in paragraph 55 of the Marks & Spencer-decision.

Section II.2.e of this chapter is then devoted to third country issues with respect to Sec. 102 para. 2 no. 2 EStG. Given the current interpretation and application of Sec. 102 para. 2 no. 2 EStG, the limitation to losses which exceed the worldwide income has full effect in relation to third countries with which Austria has not concluded a tax treaty or with which the concluded tax treaty lacks a non-discrimination clause only. In all other cases the loss carry-forward is granted on condition that the losses are not used twice. This naturally raises the question whether Art. 56 EC is applicable under these circumstances. Following the approach of determining the substantive scope of application and the order of priority between Art. 43 and Art. 56 EC by reference to the actual facts of the case (Theorie der Maßgeblichkeit des Sachverhalts) one has to differentiate:

With regard to PEs in the narrower sense of the word Art 56 EC is not applicable as Art. 43 EC is taking precedence over Art. 56 EC under these circumstances. In the absence of a qualifying community nexus Art. 43 EC cannot be invoked, however. But even if a company incorporated under the laws of a non-member country which maintains a permanent establishment in a Member State were justified in invoking Art. 56 EC when challenging the restrictions caused by Sec. 102 para. 2 no. 2 EStG, it has to be noted that Sec. 102 para. 2 no. 2 EStG is caught by the exception laid down in Art. 57 para. 1 EC as it has already existed on 31 December 1993. Thus, even the full exclusion of the loss carry-forward would not be in breach with Community law; arguably this should be true even less for subjecting the carry-forward to the condition that the losses concerned are not deducted twice.

Difficulties arise, however, in connection with participations in partnerships whose domestic permanent establishments and undertakings are proportionately attributed to the shareholders. Since every shareholder in an entrepreneurial partnership maintains a PE in Austria it may be questioned in a first step whether this automatically leads to the conclusion that the restriction to

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46 Part 3 chapter B.V, pp. 208 et seq.
47 Part 3 chapter B.V, p. 211.
48 E.g. the treaty between Austria and Australia.
carry forward only those domestic losses which exceed the amount of income not subject to limited tax liability primarily affects the freedom of establishment within the meaning of Art. 43 EC as it requires the existence of a PE in Austria. In the case of affirmation this would mean that restrictive effects on the free movement of capital must be seen as an unavoidable consequence of the restriction on the freedom of establishment and do not justify an examination of the underlying national measure in the light of Arts. 56 EC to 58 EC. In order to answer this question, the relevant ECJ case law on partnerships (Conijn, Columbus Container Services, Stahlwerk Ergste Westig and Heinrich Bauer Verlag) is analyzed and the difficulties the Court has in classifying these investments for the purpose of determining the applicable treaty freedom are expounded. Despite the inconsistencies in the case law of the ECJ in this respect the author comes to the conclusion that in conformity with the Burda, KBC Bank and Aberdeen cases it is not the (domestic)\textsuperscript{49} tax law which refers to an idealistic\textsuperscript{50} type of partnership which is decisive for determining whether Art. 43 or Art. 56 EC is applicable but the individual facts of the case. Following this approach not only the company law of the host state but also the respective articles of partnership have to be taken into account in order to be able to establish whether a certain participation in a partnership allows its holder a definite influence over the company’s decisions and the determination of its activities. If these criteria are not fulfilled, there might still be a case which is caught by the grandfathering clause of Art. 57 para. 1 EC. However, even if one stops short of classifying a participation that is below the limit of control within the meaning of Art. 43 EC as direct investment according to the Directive 88/361/EEC that comes under Art. 57 para. 1 EC,\textsuperscript{51} the denial of the loss carryforward in the case of an actual double dip should be justified.\textsuperscript{52}

Losses from real estate fall under the protective scope of Art 56 EC without restrictions; also in relation to third countries. Due to the fundamental changes in the taxation of income from real estate enacted by the structural adjustment act 2006 (Strukturanpassungsgesetz 2006), the restrictions caused by Sec. 102 para. 2 no. 2 EStG cannot be regarded as restrictions which already existed on 31 December 1993 after all. Thus, the restrictions caused by Sec 102 para. 2 no. 2 EStG

\textsuperscript{49} In the case of Stahlwerk Ergste Westig it was the provisions contained in a tax treaty.

\textsuperscript{50} From the perspective of company law.

\textsuperscript{51} This is due to the fact that the Directive 88/361/EEC defines direct investment among others as participation in a company limited by shares which "enables the shareholder, either pursuant to the provisions of national laws relating to companies limited by shares or otherwise, to participate effectively in the management of the company or in its control", whereas Art. 43 EC requires the existence of a participation which gives its holder a "definite influence on the company’s decisions and [allows him] to determine its activities". If one transposes these principles to partnerships (which also seems to be the approach followed by the ECJ) it becomes clear that with respect to partnerships established under Austrian law also partners with tiny shares can have a right to participate in the partnership’s control similar to that of substantial shareholders in companies limited by shares, even though they are not able to participate effectively in the management of the company. If the conjunction "or" is understood in such a way that connects two independent criteria, there is some reason to believe that also minor participations in entrepreneurial partnerships can be covered by Art. 57 para. 1 EC. See pp. 218 et seq.

\textsuperscript{52} Part 3 chapter B.V, p. 225 et seq.
need to be justified; an endeavor which, in the light of the A case, could only (if at all) succeed in relation to third countries which do not exchange information on the basis of a treaty.\textsuperscript{53}

As far as the PE-requirement combined with the theory of isolation is concerned, Sec. 102 para. 2. no. 2 EStG raises concerns as regards losses from portfolio investments which may be also “taxed” in Austria under a tax treaty. Whether the disadvantage of the restricted loss carryforward may be offset by other advantages which are connected to the application of the theory of isolation, seems questionable. So far the ECJ has only held that it may be that a Member State is able to demonstrate that a restriction of capital movements to or from non-member countries is justified for a particular reason in circumstances where that reason would not constitute a valid justification for a restriction on capital movements between Member States but it has not specified these circumstances. Thus, in this respect further clarification from the court has to be awaited.\textsuperscript{54}

5. The compensation of domestic losses within groups of companies according to Sec. 9 of the Austrian Corporate Income Tax Act (KStG)

Part 4 then examines the compensation of losses in the context of the Austrian group taxation regime according to Sec. 9 KStG - thus the compensation of losses from legally independent sources of income. After a short overview of the historic development of the old “Organschaft”-regime and the systematic classification of the current Austrian group taxation regime,\textsuperscript{55} the objective justification for the group taxation’s deviation from the principle of individual taxation otherwise prevailing in Austrian tax law is analyzed. Supporting the prevailing legal doctrine, the author is of the opinion that the justification lies in the fact that the group parent controls the group members which - as a result - also permits the exception from the single-taxpayer principle. Moreover, the Austrian group taxation regime treat losses and profits of group members - with the exception of foreign group members - symmetrically. The shifting of assets which could potentially occur since only the group parent is paying taxes is avoided by balancing payments. Similarly also the 100% income allocation irrespective of the actual participation is justified as simplification measure.\textsuperscript{56} Thus, on the whole, there is no evidence of a violation of the principle of equality. On the contrary, it has to be emphasized that the current state of constitutional law does not require the ordinary tax legislator to provide for a group taxation regime.\textsuperscript{57}

In the last chapter of part 4 attention is paid to several other elements relating to the compensation of (domestic) losses within groups of companies from a systematic and constitutional law point of view. This is true not only for the exceptional treatment of pre-group and extra group

\textsuperscript{53} Part 3 chapter B.V, p. 226 et seq.
\textsuperscript{54} Part 3 chapter B.V, p. 227 et seq.
\textsuperscript{55} Part 4 chapters A, B and C, pp. 231 et seq.
\textsuperscript{56} Part 4 chapter E.II; pp. 240 et seq.
\textsuperscript{57} Part 4 chapter D.II, pp. 235 et seq.
losses but also for the application of the loss set-off and loss carryforward limitations within the scope of Sec. 9 KStG. With regard to the ring fencing of pre-group and extra-group losses at the level of the respective group member it can be stated that this exception from group taxation is objectively justified and corresponds to the international legal practice. Problems arise however due to the fact that no comparable exception is provided for at the level of group parents (Sec. 9 para. 6 no. 4 KStG is only applicable to group members). At the level of group parents it is consequently possible to deduct pre-group or extra-group losses from attributed group profits whereas such losses remain isolated at the level of group members without being available for a loss relief within the fiscal group. Since no convincing justification can be found for this difference in treatment, Sec. 9 para. 6 no. 4 KStG should also be extended to group parents de lege ferenda.58

After all, no convincing justification from a systematic point of view can be found for the inapplicability of the 75% loss carry-forward limitation pursuant to Sec. 2 para. 2b no. 2 EStG at the level of group members. However, the origin of the mentioned problem does not lie so much in the exemption according to Sec. 9 para. 6 no. 4 KStG but in the 75% threshold as such. Videlicet, applying this threshold to group members could result in a cascade effect, which prima vista seems to contravene the object and purpose of group taxation. Taking however a closer look at the structure of Sec. 9 KStG it becomes obvious that this cascade effect, which would be limited to one cascade anyhow, was the result of the principle of individual taxation which is diluted but definitely not given up by Sec. 9 KStG. On the contrary, the income attribution principle as provided for by Sec. 9 para. 6 KStG would suggest the application of Sec. 2 para. 2b no. 2 EStG to group members as well.59

6. The compensation of foreign losses in the case law of the Austrian Supreme Administrative Court (VwGH) and the ECJ

The starting point for this part of the thesis is the famous “loss-judgment” of the VwGH concerning the treatment of foreign PE-losses incurred by resident taxpayers under a tax treaty that provided for the exemption method.60 In this ruling which was also the trigger for implementing Sec. 2 para. 8 no. 3 - the Court for the first time rejected the symmetry principle of tax treaties61 and came to the conclusion - independently from Community law and only on the basis of the tax treaty in question - that foreign losses have to be offset against the taxable profits of the head office in the year the losses arise as tax treaties may only limit the right to tax under domestic tax law, but may neither generate a tax claim that did not otherwise exist under domestic tax law nor extend the scope of an existing tax claim. The second line of reasoning was based on the object and purpose of the tax treaty in question which according to the Court was the avoidance of double taxation or

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58 Part 4 chapter E.III; pp. 242 et seq.
59 Part 4 chapter E.IV; pp. 246 et seq.
61 See part 5 chapter A.I, p. 249 et seq.
double non-taxation. Since in the case of losses no double taxation occurs in the year the losses arise they have to be deducted in Austria. Based on a teleological interpretation the Court further ruled that if the taxpayer is able to set off these losses against subsequent profits in the PE-state, these profits may only be exempt in the residence state to the extent that they are reduced by the loss carryforward granted in the PE-state.\textsuperscript{62} Thus, in order to avoid situations of double non-taxation the VwGH deduced a recapture mechanism from tax treaty law by means of interpretation, which is criticized by the author for dogmatic reasons.\textsuperscript{63}

Whether this result can also be deduced from the requirements of primary Community law was the main question asked in chapter B. For this purpose an in-depth analysis of the existing case law on losses of the ECJ was carried out, both with respect to the direct compensation of losses from legally independent sources of income (\textit{Marks & Spencer} and \textit{Oy AA}) and with respect to the direct compensation of losses from legally dependent sources of income (\textit{Stahlwerk Ergste Westig}, \textit{Deutsche Shell}, \textit{Lidl Belgium} and \textit{Krankenheim Wannsee}).\textsuperscript{64} The condensed conclusions of this analysis can be summarized as follows.\textsuperscript{65}

As far as the issue of cross-border loss compensation is concerned, the ECJ - after all - rightly does not differentiate between the compensation of losses from legally independent sources of income and the compensation of (treaty exempt) losses from legally dependent sources of income.\textsuperscript{66} Not convincing, both from an economic and dogmatic point of view, are, however, the proportionality conditions developed by the ECJ in \textit{Marks & Spencer}\textsuperscript{67} and confirmed in \textit{Lidl Belgium}.\textsuperscript{68} As to the justification in the narrower sense, the need to maintain a balanced allocation of taxing powers and the prevention of double loss utilization are to be regarded as sound

\textsuperscript{62} Part 5 chapter A.II, pp. 250 et seq.
\textsuperscript{63} Part 5 chapter A.III, pp. 252 et seq.
\textsuperscript{64} Part 5 chapter B.I and II, pp. 255 et seq.
\textsuperscript{65} See also Part 5 chapter B.III, pp. 332 et seq.
\textsuperscript{66} Part 5 chapter B.II, pp. 293 et seq. This result from a systematical comparison of the cases \textit{Marks & Spencer} and \textit{Lidl Belgium} with simultaneous consideration of the \textit{Deutsche Shell} case. In this context the author also demonstrates that the \textit{Deutsche Shell} case does not contradict the \textit{Marks & Spencer}-doctrine since the losses concerned in \textit{Deutsche Shell} may be classified as “final” losses within the meaning of \textit{Marks & Spencer} and cannot be traced back to mere disparities (pp. 290 et seq).
\textsuperscript{67} Part 5 chapter B.I, pp. 255 et seq. in particular p. 267.
\textsuperscript{68} Part 5 chapter B.II, pp. 293 et seq. in particular p. 310 et seq.
justifications,\textsuperscript{69} with the need to maintain a balanced allocation of taxing powers being the decisive factor in this context.\textsuperscript{70}

If a Member State - following the principle of symmetry\textsuperscript{71} - does not take into account foreign losses incurred in a non-resident subsidiary or foreign PE on a current basis, the cross-border compensation of such losses is only required where they are “final”; thus, the non-resident subsidiary has exhausted the possibilities available under foreign law of having the losses taken into account for the accounting period concerned by the claim for relief as well as for previous accounting periods and where there is no possibility for the losses to be taken into account abroad for future periods).\textsuperscript{72} Interest and liquidity disadvantages associated with this approach are irrelevant. By contrast, if a Member State follows an asymmetrical system of compensating foreign losses according to which losses may be deducted although that Member State is prevented from taxing corresponding profits, these losses may be recaptured - in a logical symmetry to purely domestic cases - if and to the extent that profits are generated by the former loss producing assets abroad. This conclusion also holds true if the losses - seen from an overall perspective - are not deductible at all since under these circumstances the non-deductibility can be (exclusively) traced back to more restrictive loss compensation rules in the source state of the loss (which may be regarded as a disparity after all).\textsuperscript{73}

At this point the author tries to reconcile the ECJ’s \textit{Marks & Spencer}-jurisprudence with the ruling in the \textit{Krankenheim Wannsee} case. In this case the ECJ accepted the recapture of (foreign) losses although the losses concerned (presumably)\textsuperscript{75} were “final” and therefore should have prevented a recapture according to the \textit{Marks & Spencer} doctrine.\textsuperscript{76} The tension thereby created may be

\textsuperscript{69} In the analysis of the \textit{Marks & Spencer} case the author argues that these justifications are not novel but can be traced back to already known justifications such as the principle of coherence or the principle of fiscal territoriality. See part 5 chapter B.II, pp. 261 et seq.

\textsuperscript{70} As to the prevention of tax avoidance, it has to be noted that this justification is a mere lip service when it is taken into account together with another justification. This conclusion was confirmed in the \textit{Oy AA} case. See Part 7 chapter B.I, pp. 269 et seq., in particular p. 273 et seq.

\textsuperscript{71} This is mainly due to the fact the double loss utilization is in this context a reflex to the symmetrical allocation of taxing powers. See also p. 273.

\textsuperscript{72} The question whether the principle of symmetry as confirmed by the ECJ in \textit{Lidl Belgium} is contradicting prior case law (the cases \textit{Deutsche Shell, Lakebrink and Rewe Zentralfinanz} to be precise) has been addressed and finally answered in the negative in section II.3.d, pp. 307 et seq.

\textsuperscript{73} This “finality-test” is elaborated in detail in part 7 chapter C.VI, pp. 517 et seq.; see also point 8.2 of this summary.

\textsuperscript{74} As to that effect see chapter B.II, pp. 324 et seq.

\textsuperscript{75} In this respect it has to be noted that the author agrees with the result of the judgment in the \textit{Krankenheim Wannsee} case but does not agree with the ECJ’s line of reasoning. In \textit{Krankenheim Wannsee} the ECJ softened one of the major point of criticism related to \textit{Marks & Spencer}: the fact that the source state of the losses is able to burden the residence state of the parent company or the head office with the obligation to take into account the losses simply by restricting its domestic loss relief rules. Part 5 chapter B.II, pp. 312 et seq.

\textsuperscript{76} Presumably because it was argued that the subsequent alienation profits related to the Austrian PE were not taxed.

\textsuperscript{77} For a detailed reasoning see p. 316 et seq and pp. 329 et seq.
dissolved as follows: Accordingly, *Marks & Spencer* primarily specifies the date on which the residence state of the parent company or the head office has to take into account final foreign losses in a symmetrical system. However, in the light of the *Krankenheim Wannsee* case, this does not prevent it from recapturing these losses if and insofar as the foreign income source generates profits again in order to counteract the asymmetry in the allocation of taxing powers between the Member States thereby created. As soon as final losses have to be taken into account in the state of residence of the parent company the loss compensation system operated by that state changes from a symmetrical system to an asymmetrical system which in turn makes the *Krankenheim Wannsee* reasoning applicable.\(^\text{77}\)

Finally the question of cross-border loss compensation in the case of limited tax liability is dealt with. For this purpose the recent *Renneberg* decision is analyzed. Here the author demonstrates that the ECJ completely neglected the limits of the *Schumacker*-doctrine and furthermore also failed to consider its own previous case law on the compensation of foreign losses (above all the *Futura Participations* case). As far as the dogmatics of the fundamental freedoms is concerned, the approach followed by the ECJ in this ruling is not convincing at all. Based on this conclusion, the author presents potential ways of the dilemma caused by *Renneberg*. Videlicet, at this stage there are good reasons to believe that it is not compelling to apply the Renneberg decision to corporations under limited tax liability in order to force Member States to take into account losses which lack both a personal and a substantive nexus to the respective Member State.\(^\text{78}\)

### 7. The compensation of foreign losses according to Sec. 2 para. 8 no. 3 of the Austrian Income Tax Act (EStG)

The results found in part 5 of the thesis are then transposed to cross-border loss compensation rules provided for under Austrian tax law, starting with Sec. 2 para. 8 no. 3 EStG which allows the cross-border set-off of foreign losses in the year they accrue and provides for a later recapture of these losses on the condition that they are used or could be used abroad. Before addressing Community law issues raised by this provision, the scope of application and the legal consequences of this rule are examined in detail. Main results are:

Sec. 2 para. 8 no. 3 EStG is not only applicable to taxpayers subject to unlimited tax liability but also to taxpayers subject to limited tax liability. However, due to the fact that the latter are taxed according to the principle of territoriality, the compensation of foreign losses is restricted to exceptional cases, e.g. the compensation of foreign losses which are attributable to a domestic PE\(^\text{79}\).

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\(^{77}\) Part 5 chapter B.III, pp. 332 et seq.

\(^{78}\) Part 5 chapter B.IV, pp. 335 et seq.

\(^{79}\) Part 6 chapter B, p. 356.
According to Sec. 2 para. 8 no. 3 EStG only such foreign losses are deductible for the purpose of determining the Austrian taxable base, which have not been taken into account abroad. Based on a grammatical and teleological interpretation of the provision it can be concluded that the state in which the losses are compensated “abroad” need not be identical with the source state of the losses, as it may be the case in triangular situations.\(^\text{80}\)

In order to be deductible, the foreign losses have to be determined according to Austrian law which requires a translation or adaptation of the foreign results. This approach is not only systematically correct but is also in conformity with the requirements of Community law as the Marks & Spencer and Lidl Belgium cases suggest. Based on a vertical pair of comparison Art. 43 EC requires equal treatment between the cross-border case and the comparable domestic case. Consequently, only the domestic income determination provisions can be relevant.\(^\text{81}\) Nevertheless, for answering the question whether and to which extent the losses are or could be used abroad foreign law is decisive. As similar issues also arise in connection with the recapture of the losses in subsequent years, the problems arising from this mélange of domestic and foreign law are dealt with in chapter D.\(^\text{82}\)

According to the prevailing opinion, the deduction of the losses has to be carried out on the basis of looking at the individual source of income. However, as pointed out in chapter IV, the term “source of income” in the context of Sec. 2 para. 8 no. 3 EStG (losses of a foreign source of income) must not be given the meaning it has according to domestic profit determination rules but has to be determined by referring to the distributive rules in the respective tax treaty to be applied or similar (unilateral) rules under domestic law (such as Sec. 1 para 1 lit a to f of the ordinance on Sec. 48 BAO). Consequently, the term “loss” within the meaning of Sec. 2 para 8 no. 3 1st sentence EStG is to be understood as negative income which in a cross border case is referred to by a distributive rule in a tax treaty or by a similar unilateral provision and which may be taxed by the source state. Only for determining the respective income category and the method of income determination, the general meaning of the term “source of income” under Austrian income tax law is to be relied upon.\(^\text{83}\)

\textit{Prima facie} Sec. 2 para. 8 no. 3 EStG does not differentiate between losses sourced in states with which Austria has not concluded a tax treaty or has concluded a tax treaty providing for the credit method and losses which are covered by tax treaties providing for the exemption method. However, due to systematic and teleological reasons, the deduction of losses (in the meaning of negative income) which may also be “taxed” in Austria must not be denied if they are set off abroad against profits of the same taxpayer which after the application of the respective tax treaty and the methods

\(^{80}\) Part 6 chapter C.III, p. 362 et seq.

\(^{81}\) Part 6 chapter C.II, pp. 357 et seq. which also expounds on details of the loss determination process.

\(^{82}\) For an example see also Part 6 chapter C.III, pp. 360 et seq.

\(^{83}\) Part 6 chapter C.IV, pp. 364 et seq.
to avoid double taxation contained therein may also be taxed in Austria. In other words, if (foreign) losses from sources which fall under the credit method are set off against (foreign) profits (of the same taxpayer) to which also the credit method applies, these losses have to be regarded as “losses which have not been taken into account abroad” and therefore have to be deducted according to Sec. 2 para. 8 no. 3 EStG. The same is also true for treaty-exempt losses which are set off against (foreign) profits of the same taxpayer to which the credit method applies. Such losses have to be deducted in Austria on the basis of Sec. 2 para. 8 no. 3 EStG. Whether the obligations imposed by the fundamental freedoms of Community law would have led to a similar conclusion is doubtful, however.

By contrast, if foreign losses which fall under the credit method are set off against treaty exempt profits of the same taxpayer, this compensation abroad leads to a denial of the loss deduction according to Sec. 2 para. 8 no. 3 EStG. Since these losses are taken into account abroad, they must not be deducted for a second time in the residence state of the taxpayer. Although this approach could possibly be understood as partial non-application of the exemption method as far as the foreign profits are concerned, the author establishes that the object and purpose of Sec. 2 para. 8 no. 3 as well as its systematic positioning suggest that this provision has to be seen as legal basis for the exclusion from the taxable base of such losses (deductible in Austria according to the principle of worldwide income) which after a hypothetical application of the respective treaty are already taken into account in their source state. Thereby, the requirements of treaty law should be fulfilled as the profits are fully exempt and Art. 238 para. 1 lit a OECD does not seem to oblige the residence state to take into account foreign income, even if it is negative. This result should also be in conformity with the requirements of Community law as a synopsis of the cases AMID, Lidl Belgium, Krankenheim Wannsee and Kerckhaert-Morres show.

Losses are not only taken into account abroad when they are set off against other profits of the same taxpayer but also if they are eligible for loss carryback or can be transferred to another taxable person (e.g. by means of a foreign group relief). However, with respect to losses from sources to which the credit method applies, this inter-taxpayer loss compensation is subject to a reservation. If the foreign losses are set off against (foreign) profits of another taxpayer, the deduction according to Sec. 2 para. 8 no. 3 EStG may only be denied when the loss compensation is of a permanent nature and adequate measures to effectively avoid double taxation of subsequent profits stemming from the respective source of income are provided for. This primarily concerns the admissibility of a tax

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84 This conclusion is also supported by a case study. Part 6 chapter C.V.1, pp. 369 et seq.
85 Part 6 chapter C.VI, pp. 381 et seq. with supporting these findings by a case study.
86 As to the argumentation see FN 1912.
87 Part 6 chapter C.V, pp. 376 et seq.
88 FN 1883.
89 Part 6 chapter C.VI, p. 380 et seq.
credit regarding those later profits even in the absence of taxpayer identity. Triangular situations involving dual resident companies are then addressed in section VII of chapter C.

These findings are finally completed by an analysis of the type and extent of the obligation to prove the accuracy of the loss deduction claimed. Behind the background of the recent case law of the ECJ (especially the *Twoh International* and *Persche* cases) the author argues for a differentiating approach. The smaller the (legal) possibilities for an exchange of information with the loss compensating state are the higher the requirements legitimately imposed on the taxpayer for proving the accuracy of the loss deduction claimed may be. However, generally higher requirements or a reversal of the burden of proof have to be dismissed on the basis of Austrian procedural law.

While chapter C is devoted to the deduction of foreign losses in the year they are incurred, chapter D focuses on the recapture mechanism as provided for by Sec. 2 para. 8 no. 3 3rd sentence EStG in order to avoid situations of double loss utilization. Contrary to the recapture mechanism established by the VwGH in its loss-judgment of 25 September 2001, the recapture mechanism implemented in Sec. 2 para. 8 no. 3 3rd sentence EStG can be described as subsequent taxation of the domestic income against which the losses have been set off in the year of their incurrence. Thus, the recapture is simply the reversal of the previous loss deduction and therefore cannot be regarded as taxation of those (exempt) foreign profits against which the losses are set off abroad later on. Behind that background the functioning and application of the recapture mechanism within the scope of tax treaties providing for the credit method is expounded. Although foreign losses from income sources to which the credit method applies represent "*losses that have not been taken into account abroad*" within the meaning of Sec. 2 para. 8 no. 3 1st sentence EStG no recapture according to Sec. 2 para. 8 no. 3 3rd sentence EStG must be carried out in the event of their compensation abroad provided the items of income used for this compensation are also taxable in Austria. As a result of the taxation of the subsequent profits an “automatic” recapture of the previously deducted (foreign) losses takes place which in turn prevents situations of double loss utilization. This is due to the fact that in the year the losses are compensated abroad, the profits are fully taxed in Austria but only partially (to the extent they are not offset against the losses) abroad. Thereby, the loss compensation abroad leads to a lower tax credit in Austria which again has the effect of an automatic recapture. For this reason a simultaneous application of Sec. 2 para. 8 no. 3 3rd sentence EStG has to be refrained from on systematic and teleological grounds. This justifies a

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91 Part 6 chapter C.VII, pp. 385 et seq.
92 Part 6 chapter C.VIII, pp. 390 et seq.
93 This conclusion is also underlined by a comparative law analysis between Sec. 2 para. 8 no. 3 EStG and the former provision of Sec. 2a para. 3 no. 3 of the German Income Tax Act (dEStG). Part 6 chapter D.I, pp. 396 et seq.
94 "Im Ausland nicht berücksichtigte Verluste sind bei der Ermittlung des Einkommens anzusetzen."
teleological interpretation (or even reduction) of Sec. 2 para. 8 no. 3 3rd sentence to the effect that the recapture mechanism contained therein is only applicable to such foreign losses which have lowered the domestic taxable base in the year of their incurrence but which are - in spite of their compensation abroad - not subject to an “automatic” recapture. This primarily concerns losses which are set off against treaty exempt income or against (foreign) income which is otherwise not subject to tax in Austria.

According to Sec. 2 para. 8 no. 3 3rd sentence EStG foreign losses which have been taken into account in determining the taxable income shall partly or fully increase the total amount of income in that year in which these losses have been fully or partly allowed for or could have been allowed for abroad. Following the prevailing opinion in legal literature as well as the administrative practice Sec. 2 para. 8 no. 3 3rd sentence EStG provides for a double cap as regards the amount of losses to be recaptured. This implies that the amount reinstated must not be higher than the amount actually set off and, in addition, not higher than the amount of losses compensated abroad according to foreign law. With respect to the second cap it is argued that only the actual Euro-amount of the foreign losses compensated is decisive. Consequently, differences which are caused by deviations in the respective national laws always impinge upon the Austria tax jurisdiction. This result is not only unsatisfactory but also not necessarily provided for by Sec. 2 para. 8 no. 3 3rd sentence EStG as an interpretation which attaches more importance to structural and teleological arguments shows. According to this interpretation it would be possible to adapt the amount of losses compensated abroad to Austrian law. However, this adaptation does not imply that the subsequent foreign profits have to be determined on the basis of Austrian law but only the loss actually used. The wording of Sec. 2 para. 8 no. 3 3rd sentence EStG as well as the slightly different wording of Sec. 9 para. 6 no. 6 KStG is no obstacle to that interpretation. Moreover, there is not dogmatic imperative for interpreting the recapture rules in Sec. 2 para. 8 no. 3 EStG and Sec. 9 para. 6 no. 6 KStG identically. Since this approach also ensures that the losses are used only once, it is also in conformity with the obligations imposed by Community law, which after all cannot be understood as an obligation to level out non-harmonized income determination rules.

De lege lata the amount of losses to be recaptured on the basis of Sec. 2 para. 8 no. 3 EStG in the event of their compensation abroad is not to be limited by the amount of the subsequent (foreign) profits as determined according to Austrian law. Although this approach could be taken into consideration for future tax reforms, on the basis of the current law it would cause situations of

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95 Part 6 chapter D.I, p. 396 et seq.
96 Part 6 chapter D.II, pp. 399 et seq. with a numerical example.
97 Part 6 chapter D.III, p. 401 et seq.
98 Part 6 chapter D.III, pp. 402 et seq. with a numerical example.
99 Part 6 chapter D. III, p. 405 et seq.
100 Part 6 chapter D.III, p. 404.
double loss utilization which is against the object and purpose of Sec. 2 para. 8 no. 3 EStG. Even after the Krankenheim Wannsee decision, this interpretation should be in conformity with the fundamental freedoms. This is due to the fact that Sec. 2 para. 8. no. 3 EStG - unlike the rule at stake in Krankenheim Wannsee - provides for an effective (single) loss utilization that is temporally and heightwise tied to the actual (possible) compensation according to foreign law.\footnote{Part 6 chapter D.IV, pp. 406 et seq.}

Section V is then devoted to open flanks and other issues concerning the recapture mechanism as provided for in Sec. 2 para. 8 no. 3 EStG. Thereby special emphasis is placed on the treatment of losses according to Sec. 2 para. 8 no. 3 EStG in connection with reorganizations, including domestic mergers and cross-border mergers within the meaning of Art. I UmgrStG as well as the transfer of assets within the meaning of Art. III UmgrStG. In this context not only domestic law implications of such reorganizations are analyzed but also the conformity Community law of potential restrictions on the loss utilization caused by the reorganization with is highlighted: e.g. the question whether it would be possible to recapture the losses if the right to use these losses is forfeited under foreign law as a result of the (tax neutral) reorganization. In the light of the Krankenheim Wannsee case it could be argued that a recapture may take place as soon as and to the extent that the legal successor of the loss producing assets - although not being able to actually use the losses - generates profits out of these assets again. Nevertheless, Sec. 2 para. 8 no. 3 EStG does not provide for such an approach \textit{de lege lata}.\footnote{Part 6 chapter D.IV, p. 415 et seq.} With respect to cross-border mergers also Art. 10 para. 1 of the Merger Directive and the opinion of AG Sharpston in the Lidl Belgium case are taken into account. Here the author comes to the conclusion than an immediate recapture at the time the reorganization takes place is at least in intra-Community situations not in conformity with the imperatives of the fundamental freedoms.\footnote{Part 6 chapter D.IV, pp. 423 et seq.} Similarly, the transfer of a foreign PE the losses of which have been previously deducted in Austria to a corporation pursuant to Art. III UmgrStG or comparable foreign law does not result in an immediate recapture of losses (unless the losses are used in the course of the reorganization). Since Sec. 2 para. 8 no. 3 EStG does not require personal identity between the taxpayer who deducted the losses according to Sec. 2 para. 8 no. 3 EStG in a first step and the taxpayer who subsequently uses them abroad, the domestic recapture can only take place insofar as the legal successor uses or could use the losses according to foreign law.\footnote{Part 6 chapter D.IV, pp. 424 et seq.} In practice this rule may be difficult to enforce. That is why the recapture mechanism as provided for by Sec. 2 para. 8 no. 3 EStG runs the risk of factually staring into space when it comes to cross-border reorganizations.
After analyzing the application of the 75%-limitation of Sec. 2 para. 2b no. 2 EStG to the amount added to the total amount of income as a result of the recapture rule, part 6 is concluded by some thoughts on possible alternatives to the current version of Sec. 2 para. 8 no. 3 EStG.

8. The compensation of foreign losses within groups of companies according to Sec. 9 para. 6 no. 6 KStG

The compensation of foreign losses within groups of companies pursuant to Sec. 9 para. 6 no. 6 KStG is of course also subject of an in-depth analysis. This is due to the fact that the compensation of foreign losses within groups of companies was one of the main political objectives for introducing the group taxation regime by the Tax Reform Act 2005. For that reason also certain non-resident foreign corporations which are financially controlled (within the meaning of Sec. 9 para. 4 KStG) by resident group members or the group parent can participate as “foreign” group members according to Sec. 9 para. 2 indent 2 KStG in the group taxation regime. However, foreign group members do not fully participate in the group taxation regime as only their losses are taken into account for the purpose of determining the overall income of the group that is taxed in the hand of the group parent. In this respect it has to be noted that the Austrian group taxation regime does not provide for a consolidation but is based on an income attribution system according to which the individual income of each group member - and in the case of foreign group members the losses of the respective corporation - is attributed to the next higher group member in a stepwise manner until all results are pooled and taxed at the level of the group parent. With respect to foreign group members Sec. 9 para. 6 no. 6 KStG provides that only losses which are determined according to Austrian tax rules may be attributed to the next higher controlling group member or the group parent in proportion to all shares held by group members in that corporation. In other words, Sec. 9 para. 6 no. 6 KStG provides for a pro-rata allocation of losses. Since is it an explicit objective of the group taxation regime to eliminate the possibility of utilizing a particular loss more than once, also Sec. 9 para. 6 no. 6 KStG provides for a recapture mechanism. Accordingly, losses must be recaptured if and insofar as the foreign loss is or could be taken into account abroad by means of an offset against foreign income. As long as a foreign group member continues to generate losses and lacks other loss compensating possibilities abroad, the recapture mechanism - as a rule - will not be triggered under the Austrian system. Thereby, the recapture mechanism ensures that losses are taken into account only once by means of a temporary compensation. However, the final responsibility to allow for such

105 Here the author is of the opinion that the 75%-limitation has to be applied to the amount recaptured according to Sec. 2 para. 8 no. 3 3rd sentence EStG since an interpretation similar to the one applied in the context of Sec. 2a para. 3 dESTG fails with respect to the wording of Sec. 2 para. 8 no. 3 3rd sentence EStG in conjunction with Sec. 2 para. 2b para. 2 EStG. Although this result is unsatisfactory, it neither violates tax treaty law nor Community law, at least as long as the loss carryforward that is “created” by the application of Sec. 2 para. 2b no. 2 EStG can still be used under domestic (i.e. Austrian) law in subsequent periods. Part 6 chapter D.IV, pp. 430 et seq.

106 Part 6 chapter E, pp. 434 et seq.
foreign losses remains with the source state of the losses as Sec. 9 para. 6 no. 6 3rd sentence KStG provides for a final recapture if the foreign group member leaves the group. As of 2009, this final recapture was tightened. Henceforth not only the actual exit of a foreign group member triggers the recapture of compensated losses but also its “economic” exit. An economic exist is deemed to occur if the comparability of the loss producing assets is forfeited within the meaning of Sec. 4 no. 1 lit. c UmgrStG. However, if the “asset loss” is definite due to a liquidation of the corporation or due to insolvency, the amount to be recaptured will be reduced by (tax neutral) depreciations of the share value that has taken place during the period the foreign corporation has belonged to the group. *Prima facie*, the amount to be recaptured can only be reduced and therefore any depreciation exceeding the foreign loss-balance will be disregarded. Any remaining loss compensated under Sec. 9 para. 6 no. 6 KStG must be recaptured and consequently increases the taxable income of the fiscal group in the year of exit. In other words this means that a foreign loss will be permanently acknowledged under the Austrian loss compensation system insofar and to the extent that it does not exceed the respective decrease in share value. From the above it becomes clear that Sec. 9 para. 6 no. 6 KStG resembles the compensation of foreign losses under Sec. 2 para. 8 no. 3 KStG. However, taking a closer look at the provisions and their legal consequences, major differences can be identified.\textsuperscript{107} These differences as well as the specifics of Sec. 9 para. 6 no. 6 KStG are analyzed in part 7. Thereby, special emphasis is put on the recapture mechanism and its shortcomings from the perspective of Community law. In the beginning, however, the loss determination principles as well as the attribution mechanism are analyzed.

8.1. Determination of the losses of foreign group members and attribution to the controlling group member or to the group parent

As a result of the imperative application of the Austrian income determination rules the foreign group member is treated like a resident corporation subject to unlimited tax liability in Austria. Thus, the determination of the losses within the meaning of Sec. 9 para. 6 no. 6 1st sentence KStG is indirectly based on the fiction of the foreign group member being resident and therefore subject to unlimited tax liability in Austria.\textsuperscript{108} The scope of this fiction is unclear, however. This is particularly true as regards the application of the participation exemption within the meaning of Sec. 10 KStG and related provisions such as Sec. 12 para. 3 KStG to shares held by foreign group members. Based on the principle of equality, which is also enshrined in Sec. 9 para. 6 no. 6 KStG, the author criticizes the current administrative practice according to which - for the purpose of applying Sec. 10 and Sec. 12 para. 3 KStG - shares held in Austrian corporations are treated like shares held in a foreign corporation.\textsuperscript{109}

\textsuperscript{107} Part 7 chapter A and B.I, pp. 439 et seq.
\textsuperscript{108} As to the details concerning the determination of the losses see part 7 chapter B.II, pp. 444 et seq.
\textsuperscript{109} Part 7 chapter A and B.I, pp. 449 et seq.
In a next step the treatment of income attributable to domestic PEs maintained by foreign group members in Austria is analyzed. De lege lata this income is not directly attributable to the next higher (domestic) group member which is subject to unlimited tax liability for the purpose of group taxation. On the contrary, such income has to be taxed separately according to the rules applicable to taxpayers which are subject to limited tax liability in Austria. However, if the domestic PE incurs a loss, this PE-loss may be taken into account for the purpose of calculating the attributable losses of the foreign group member as such. In this context the author demonstrates that for the purpose of calculating this overall loss a fictitious application of the respective tax treaty between Austria and the residence state of the group member has to be refrained from. A similar conclusion also holds true for the treatment of income that is attributable to PEs and separate business undertakings which the foreign group members maintains in its residence state. Such PEs or businesses have to be treated - for the purpose of loss determination according to Sec. 9 para. 6 no. 6 1st sentence KStG - as domestic PEs and business undertakings. Seen from that perspective, the fact pattern realized by the foreign group members corresponds to a purely domestic case. Consequently, there is no need to (fictitiously) apply a tax treaty in the course of determining a group member’s income. Furthermore, the mutatis mutandis application of Sec. 2 para. 8 no. 3 EStG becomes superfluous as there is simply no “foreign” income at hand that would justify such an approach. The same is also true for income received by the foreign group member from other activities carried out in its residence state which do not qualify as a PE or independent business undertaking. Consequently, profits and losses from income producing activities carried out by the foreign group member in its residence state have to be (directly) taken into account according to Sec. 7 para. 2 KStG in conjunction with Sec. 2 para. 2 EStG when it comes to determining the attributable losses pursuant to Sec. 9 para. 6 no. 6 1st sentence KStG. By contrast, if the foreign group members maintains a PE in a third state (other than Austria or its state of residence) the loss determination within the meaning of Sec. 9 para. 6 no. 6 1st sentence KStG requires not only the mutatis mutandis application of Sec. 2 para. 8 no. 3 1st sentence EStG but also the fictitious application of the respective tax treaty between Austria and the PE-state.

Even though Sec. 9 para. 6 no. 6 1st sentence KStG does not contain a clause similar to Sec. 2 para. 8 no. 3 1st sentence EStG according to which only losses that have not been taken into account abroad may be deducted for the purpose of determining the taxable income in Austria, also Sec. 9 para. 6 no. 6 KStG prevents the attribution of losses which have already been compensated elsewhere. This result cannot only be deduced from the recapture rules as contain in the 2nd sentence of Sec. 9 para. 6 no. 6 KStG but it is also supported by an interpretation in conformity with

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110 The Community law issues caused by this exclusion from group taxation are dealt with in part 9 chapter B, pp. 614 et seq. and point 10 of this summary.
111 Part 7 chapter B.II, pp. 455 et seq.
112 Part 7 chapter B.II, pp. 459 et seq.
113 Part 7 chapter B.II, pp. 461 et seq. with the findings being demonstrated on the basis of a case study.
constitutional law. By means of a teleological extension of Sec. 9 para. 6 no. 6 KStG also situations of double loss utilization which otherwise might arise in the case of expenses that are spread over a certain period of time can be avoided. For this purpose the temporal coincidence of the losses’ incurrence and their compensation is feigned. As demonstrated in section III.2 an attribution of losses according to Sec. 9 para. 6 no. 6 1st sentence KStG is also out of the question if the (foreign) losses can be taken into account in a third state, as it might be the case in multilateral situations. This conclusion generally also holds true if the loss-compensation in the third state is of a temporary nature only.

Section IV of chapter B is then devoted to the proportional attribution of losses from foreign group members. Whereas in the case of domestic group members 100% of each group member’s income finds its way to the combined income which is then taxed at the level of the group parent, losses of foreign group members are only attributed according to the participation quota. This vertical difference in treatment, of course, runs the risk of violating Art. 43 EC on the freedom of establishment. However, with respect to losses from third country corporations, the proportional loss compensation does not infringe Community law, as (according to the case law of the ECJ) any restrictive effects on the free movement of capital must be seen as an unavoidable consequence of the restriction on the freedom of establishment which does not justify an examination in the light of Arts. 56 EC to 58 EC. Nevertheless, with respect to EU or EEA-Member States the proportional loss attribution constitutes an infringement of Art. 43 EC, as soon as the losses concerned qualify as final losses within the meaning of Marks & Spencer. As far as those losses which cannot be deducted because of the pro-rata limitation are concerned, their non-deductibility seems to be in conformity with the Marks & Spencer-doctrine; at least as long as they are still eligible for a relief abroad. However, as soon as these losses turn into final losses and thereby fulfill the Marks & Spencer-condition (para. 55) they have to be taken into account in Austria as well.

8.2. Recapture of foreign losses

Chapter C is subsequently devoted to the recapture mechanism as provided for by Sec. 9 para. 6 no. 6 KStG. Although the wording of Sec. 9 para. 6 no. 6 2nd sentence KStG differs from Sec. 2 para. 8 no. 3 3rd sentence EStG in such a way that it would - at least prima facie - provide for a recapture whose amount is determined by the Euro-amount of the losses compensated abroad according to foreign law, the author demonstrates that also in the context of group taxation an adaptation of the loss-amount allowed for abroad to Austrian law is possible.

114 Part 7 chapter B.III, p. 464 et seq.  
115 Part 7 chapter B.III, pp. 465 et seq.  
116 Part 7 chapter B.III, pp. 567 et seq.  
117 Part 7 chapter B.VI, pp. 472 et seq.  
118 Part 7 chapter C.II, pp. 475 et seq.
Apart from that, problems arise in connection with the recapture of losses which can be traced back to a domestic PE the foreign group member maintains in Austria. According to the wording of Sec. 9 para. 6 no. 6 KStG the recapture is triggered when the losses are subsequently set off against “foreign” income abroad. In the case of losses attributable to domestic PEs of the foreign group member the subsequent loss compensation is, however, effected by a set-off against domestic income in Austria. Double loss utilization would be the result. Here the author establishes the existence of a genuine gap that has to be filled by means of analogy. Consequently, the compensation or possible compensation of the losses under Austrian law (on the occasion of taxing the foreign group member within its limited tax liability) may be regarded as trigger for the recapture according to Sec. 9 para. 6 no. 6 2nd sentence KStG.\(^1\) With respect to losses which result from PEs maintained by the foreign group member in a third state (other than its state of residence or Austria), the recapture upon actual or possible loss utilization abroad has to be conducted exclusively on the basis of Sec. 9 para. 6 no. 6 2nd sentence KStG. A simultaneous application of the recapture mechanism according to Sec. 2 para. 8 no. 3 3rd sentence EStG - which is basically applicable under these circumstances - has to be omitted as it would lead to a “double recapture”.\(^2\)

Section V then contains a comprehensive analysis of the legal consequences of a discontinuity of or changes in the financial integration of foreign group members, including the following scenarios: the recapture of losses on the occasion of the foreign group member leaving the fiscal group through withdrawal;\(^3\) the (partial) recapture of losses upon alienation of the participation in the foreign group member;\(^4\) the omission of an immediate recapture on the occasion of a reorganization that leads to a shift in the participation quotas (provided the financial integration remains intact as a whole);\(^5\) the treatment of foreign group members leaving the group as a result of reorganizations (including the exit of foreign group members due to the discontinuity of the whole group, the exit of foreign group members due to their dissolution after a reorganization and the exit of a foreign group member due to the termination of the financial integration);\(^6\) the recapture upon a reorganization-induced elimination or reduction of future loss utilization possibilities within the fiscal group (due to a transfer of the losses to another person outside the group);\(^7\) and the issues raised by the “economic” exit of foreign group members according to Sec. 9 para. 6 no. 6 sentence 4 KStG.\(^8\) Section V.5 is then devoted to the consequences of a dissolution of foreign group members as a result of liquidation or insolvency. In this context not only the insufficiencies of Sec. 9 para. 6 no. 6

\(^1\) Part 7 chapter C.III, pp. 477 et seq. with examples.  
\(^2\) Part 7 chapter C.IV, p. 480 et seq.  
\(^3\) Part 7 chapter C.V, p. 481 et seq.  
\(^4\) Part 7 chapter C.V, pp. 482 et seq.  
\(^5\) Part 7 chapter C.V, pp. 485 et seq.  
\(^6\) Part 7 chapter C.V, pp. 487 et seq.  
\(^7\) Part 7 chapter C.V, p. 496 et seq. In this context the author is of the opinion that the losses must not be recaptured immediately but only as the losses are used by the legal successor.  
\(^8\) Part 7 chapter C.V, pp. 497 et seq.
last sentence KStG as such (e.g. the fact that losses which arise during the liquidation procedure are not properly allowed for or the discrepancies which arise from the fact that Sec. 9 para. 6 no. 6 KStG only provides for a reduction in the amount to be recaptured but not more) but also its systematic interaction with the prohibition to use impairment losses according to Sec. 12 para. 3 no. 3 KStG are examined.\textsuperscript{127}

All in all it can be held that the recapture of foreign losses according to Sec. 9 para. 6 no. 6 KStG is characterized by an enormous complexity. This is particularly true when the foreign group member is liquidated or dissolved due to its insolvency. The complexity is even intensified if one further takes into account the requirements imposed by Community law. Although the Austrian group taxation regime is often referred to as role model for Europe since it allows the immediate deduction of foreign losses, it must not be forgotten that Sec. 9 para. 6 no. 6 KStG in many cases provides for a recapture of these losses without them being taken into account abroad. This, of courses, raises concerns from the perspective of Community law; even after the restrictive verdict in \textit{Marks & Spencer}. Section V.VI examines this legal status in the light of the requirements imposed by Community law as interpreted by the ECJ.

First of all the author demonstrates that the \textit{Marks & Spencer}-doctrine - potentially modified by the ECJ’s considerations in the \textit{Krankenheim Wannsee} case - can be transposed \textit{mutatis mutandis} to the Austrian group taxation regime. More precisely, the restrictions provoked by Sec. 9 para. 6 no. 6 KStG (i.e. those cases in which no in-phase loss compensation is possible at all or in which the loss compensation is reversed by an early recapture, although no corresponding profits have been generated so far) can be justified by the need to maintain a balanced allocation of taxing powers between the Member States, the, the avoidance of double loss utilization and to a certain extent also by the prevention of tax avoidance. On the one hand, this is due to the fact that in the mentioned cases the Austrian group taxation system resembles an asymmetrical loss compensation system. On the other hand, there are good reasons to believe that the \textit{Marks & Spencer} and \textit{Lidl Belgium} condition is to be understood as a limit up to which the Members States are free to fully deny the deductibility of foreign losses.\textsuperscript{128} Nevertheless, Member States (including Austria) have to adapt their national laws to that effect that the inclusion of foreign losses is permitted provided they are “final” abroad.

This approach obviously places a lot of importance on the criterion of “definitiveness”, which the author tried to flesh out - also by analyzing the subsequent UK case law in the \textit{Marks & Spencer} case\textsuperscript{129} - in chapter C.VI. The decisive question therefore is which conditions need to prevail in order for such “definitiveness or finality” to exist, particularly with regard to possible (tax planning) efforts

\textsuperscript{127} Part 7 chapter C.V, pp. 500 et seq.
\textsuperscript{128} Part 7 chapter C.VI, pp. 525 et seq.
\textsuperscript{129} Part 7 chapter C.VI, pp. 518 et seq.
which can be reasonably expected from the group in order to utilize existing foreign losses and thus not making them “final”. In other words: What are the substantive requirements for losses to qualify as “final” losses? Generally speaking the author reaches the conclusion that the “due care and diligence of a prudent businessman” must decide whether or which loss compensation strategies should be implemented or not, as the case may be, in order to render the foreign losses “definitive”.

In the first instance all fiscally and economically reasonable of loss relief legally available in the subsidiary’s state of residence or in a third state (including the use of foreign group taxation regimes or to a certain extent also restructuring measures) must be exhausted and secondly there must not be a real possibility for the losses to be taken into account in future accounting periods. The assessment whether all reasonable loss compensation possibilities under foreign law have been exhausted has to be carried out without reference to the potential loss relief at the level of the domestic parent company or head office. Thus, the subsidiary loss relief in the residence state of the parent company must not be the reason for renouncing loss compensation abroad. Furthermore, the author demonstrates that it is generally speaking the “legal impossibility” that is decisive for rendering the losses “definitive” and not the “economic impossibility” based on profit forecasts. The decisive time period for demonstrating the finality of the foreign losses is the time when the taxpayer files for the loss relief.

Summarizing it may be held: Whether losses qualify as final losses has to be established according to foreign law; whether these losses then must be deducted at the level of the domestic parent company has to be determined on the basis of a hypothetical comparison which takes into account the requirements of national law. As for the Austrian group taxation under Sec. 9 KStG, the author comes to the conclusion that the adequate comparator for this hypothetical comparison is the corresponding treatment of losses at the level of group parents [sic].

If, therefore, the losses become final before the foreign group member leaves the group the recapture must remain undone at the time of exit; at least insofar as and to the extent that the foreign group member has not generated corresponding profits up to this point in time. This stringent view may be deducted from the ECJ’s ruling in the Krankenheim Wannsee case, which seems to be relevant in this context. De lege lata Sec. 9 para. 6 no. 6 KStG does not, however, provide a legal basis for recapturing losses on a current basis if and insofar as the (former) foreign group member generates profits after it has left the fiscal group. If the losses become final after the respective group member has left the

130 Part 7 chapter C.VI, p. 521 et seq.
131 Part 7 chapter C.VI, pp. 523 et seq.
132 Part 7 chapter C.VI, p. 517 et seq.
133 Part 7 chapter C.VI, pp. 529 et seq.
134 Even if these profits - due to more restrictive loss relief rules - have not led to an actual compensation of the foreign losses abroad.
135 Part 7 chapter C.VI, p. 531.
group and therefore all attributed losses have been recaptured, the foreign losses must be re-included.

This leaves the final question to be answered: the period in which the “final” losses have to be taken into account - ex tunc in the year of incurrence or ex nunc in the year of finality? The Marks & Spencer case is silent on this question, whereas the final judgment of the BFH in the Lidl Belgium case could be interpreted as favoring a retroactive inclusion of the losses in the fiscal year in which they were incurred. From an economic perspective this approach has to be preferred, it raises complex procedural law issues, however. These issues - e.g. the application of Sec. 295a BAO for achieving an ex tunc deduction of the losses or the Community law issues resulting from the Austrian rules on limitation - are addressed in the final subsections of chapter C.VI.136

8.3. Exclusion of (foreign) companies controlled by foreign group members from group taxation

As a result of Sec. 9 para. 2 in conjunction with Sec. 9 para. 4 KStG, (foreign) subsidiaries of foreign group members cannot be included in the group taxation regime. This clearly represents a discriminating restriction within the meaning of Art. 43 EC. Since the non-deductibility of losses of foreign sub-subsidiaries can be classified as a symmetrical loss-compensation system within the meaning of Marks & Spencer, the exclusion from group taxation may only be considered as infringement of Community law if and insofar as the foreign subsidiary has exhausted the possibilities available for having the losses taken into account for the accounting period concerned as well as for previous accounting periods and there is not possibility for the foreign subsidiary’s losses to be taken into account for future periods (i.e. when the losses become final losses) in its residence state or in another state. In this context the author demonstrates that the Marks & Spencer-justification can also be transposed to the Austrian group taxation regime. Questionable is, however, the extent to which the ruling in the Krankenheim Wannsee case influences these findings. Whether this ruling allows Member States - at least when they provide for an asymmetrical loss compensation regime - to introduce further restrictions in connection with the recapture of deducted losses remains to be seen.137 Chapter D.III then asks the question of how the ECJ’s case law on losses could be implemented in Sec. 9 para. 2 in conjunction with para. 6 no. 6 KStG. In a first step the author demonstrates that a mere extension of the group taxation regime as it stands for domestic group members to sub-subsidiaries does not represent an adequate solution. On the one hand such an approach could lead to the result that even final losses within the meaning of Marks & Spencer are not taken into account (which de lege lata seems to be problematic from the point of view of

136 Part 7 chapter C.VI, pp. 532 et seq.
137 Part 7 chapter D.I and II, pp. 539 et seq.
Community law) and on the other hand it would also contradict the current loss compensation system according to Sec. 9 para. 6 no. 6 KStG. In order to achieve a result that is in conformity with community law, it is therefore necessary to attribute any sub-subsidiary’s final losses directly to the next higher domestic group member subject to unlimited tax liability or to the group parent. This, however, requires a modification of Sec. 9 para. 2 KStG in conjunction with Sec. 9 para. 6 no. 6 KStG de lege ferenda, as an interpretation in conformity with Community law of the respective provisions to that effect would arguably go beyond the limits of interpretation. Finally, based on the findings of the court in the Oy AA case, the question of order of loss compensation in a multinational scenario is dealt with. In this context the author argues in favour of a qualified primacy of compensating losses up-stream along the chain of holdings.

9. The compensation of foreign losses and neutrality of legal forms

Based on the conclusions in part 2 of the thesis, part 8 provides an in-depth analysis of the issue of neutrality of legal form in the context of cross-border loss compensation. This issue is of particular relevance for Austria since the compensation of losses from legally dependent sources of income according to Sec. 2 para. 8. no. 3 EStG differs from the compensation of losses from legally independent sources of income within the group taxation regime according to Sec. 9 para. 6 no. 6 KStG. However, as demonstrated, neither constitutional nor Community law requires the identical treatment of cross-border losses stemming from PEs or from subsidiaries. With respect to Community law this conclusion is reached by a systematic analysis of the Marks & Spencer and Columbus Container Services case.

The fundamental freedoms of Community law prohibit the vertical discrimination of cross-border economic activities compared to activities which are restricted to the domestic market. Nevertheless, in view of the Marks & Spencer and Lidl Belgium cases Member States are only required to provide for a cross-border compensation of final losses. Consequently, a national law provision only infringes Community law if it denies the deductibility of final foreign losses. If, however, one accepts the Marks & Spencer and Lidl Belgium condition as a limit up to which the Member States are free to deny the deductibility of foreign losses, also an over-compliance with these conditions cannot be regarded as discrimination prohibited by Art. 43 EC. Looking at the ECJ’s convincing argumentation in

\[138\] In this context it has to be held that the Krankenheim Wannsee decision was based on an asymmetrical loss compensation system. Therefore the arguments contained therein cannot be transposed without modifications to symmetrical systems.
\[139\] Part 7 chapter D.III, pp. 543 et seq.
\[140\] Part 7 chapter D.III, pp. 545 et seq. As to the direct application of Community law (primacy in application) within the meaning of a “geltungserhaltende Reduktion” see part 7 chapter D.III, p. 549 et seq.
\[141\] Part 7 chapter D.III, pp. 551 et seq.
\[142\] Part 8 chapter A, p. 555 et seq.
\[143\] Part 8 chapter B, pp. 557 et seq.
\[144\] Part 8 chapter C.II, pp. 576 et seq.
the *Columbus Container Services* and *KBC Bank* cases, this conclusion must also be true for cases in which the over-compliance differs with respect to the legal form concerned. Therefore, the differentiations between Sec. 2 para. 8 no. 3 EStG and Sec. 9 para. 6 no. 6 KStG cannot be objected to on a horizontal basis. An infringement only exists if foreign losses in spite of their finality within the meaning of *Marks & Spencer* are not taken into account although comparable domestic losses would have been eligible for a set-off. As to the result, this conclusion has recently also been confirmed by Advocate General *Kokott* in her opinion on the *X-Holding* case.

10. The compensation of domestic losses incurred by foreign group members

After analyzing the cross-border compensation of losses within groups of companies Part 9 and 10 both deal with issues relating to the compensation of losses within corporate groups from the perspective of Austria being the source state of the losses concerned. This examination starts with the compensation of domestic losses incurred by foreign group members within the meaning of Sec. 9 para. 2 2nd indent KStG.

In chapter A the exclusion of foreign group members as intermediary companies in “sandwich-constellations” (i.e. when a domestic company indirectly controls another domestic subsidiary through a non-resident intermediary company) is dealt with. In this context the author is of the opinion that this exclusion may not only be contested on grounds of constitutional law but most notably also from the perspective of Community law, as the verdict in the *Papillon case* reveals. The “unbroken chain”-requirement as provided for by Sec. 9 para. 2 in conjunction with para. 4 KStG leads to a “de facto” discrimination of resident parent companies which - in the exercise of the rights guaranteed by Art. 43 EC - establish a subsidiary in another Member State through which it exercises an economic activity, among others in the form of holding a controlling participation in a domestic (sub)subsidiary.

However, according to the ECJ, the avoidance of indirect double loss utilization may serve as justification for this restriction in order to maintain the coherence of the tax system. Whether the ECJ in this context only addresses the avoidance of double loss utilization within the fiscal jurisdiction of the parent company’s state of residence or also refers to the avoidance of cross-border double loss utilization (i.e. the utilization of the losses in the state of residence of the parent company and in the residence state of the intermediary company under its domestic tax law) remains doubtful. This is due to the fact that the ECJ’s diction in paras. 47 to 49 of the *Papillon* case would also allow for the

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145 Part 8 chapter C.III, p. 580 et seq.
146 Opinion of AG *Kokott* 19.11.2009, C-337/08 *X-Holding*, paras. 48 et seq.
147 For an illustration see pp. 583 et seq.
148 Part 9 chapter A.II, p. 584 et seq.
149 Part 9 chapter A.III, pp. 585 et seq.
150 Part 9 chapter A.III, p. 592 in conjunction with p. 589 et seq.
latter interpretation. The latter view is supported by the Papillon case to the effect that it also supports the legitimacy of avoiding cross-border double dips, the exclusion of sandwich groups under the Austrian group taxation regime cannot be justified; simply because indirect double dips are - to a certain extent - also possible in purely domestic (group) situations. The crux of the Papillon case is, however, whether the deliberations of the ECJ on the principle of coherence also apply to cross-border double dips. Proceeding on the assumption that this is the case, the same reasoning must also hold true for direct double dips. If one seriously follows this thought, it would mean that even the source state of the losses may take measures to avoid (direct) double loss utilization that could arise from the losses also being taken into account in the intermediary’s state of residence. Based on a systematic interpretation of the Austrian group taxation regime in the light of the dogmatics of the fundamental freedoms, this reasoning may, however, only be taken into account in the case of final losses. Also in this context a recapture mechanism could be a solution. All in all it is safe to say that Sec. 9 para. 2 EStG needs to be adjusted. Proposals to that effect are given in the end of section III.

Subsequently, the concerns stemming from the exclusion of foreign group members as intermediary companies for the purpose of including domestic sub-subsidiaries in the group taxation regime are analyzed from the perspective of tax treaty law and from the perspective of the ownership non-discrimination clause pursuant to Art. 24 para. 5 OECD-MC. Following the 2008 update on the OECD Commentary one could come to the conclusion that group taxation regimes as such are beyond the scope of application and protection of Art. 24 para. 5 OECD-MC. As the author demonstrates in Chapter B.IV, this approach is too blunt and not convincing after all. In fact, Art. 24 para. 5 OECD-MC calls for a much more differentiating approach depending on whether a foreign intermediary company or a foreign parent company is concerned. Transposed to the Austrian group taxation regime this leads to the following conclusion: Since the inclusion of cross-border sandwich-groups in the Austrian group taxation system together with a simultaneous attribution of the income of the domestic sub-subsidiaries to the next higher domestic group member or the group parent (thus skipping the foreign intermediary company) would not encroach upon the integrity of the Austrian attribution system, the overall exclusion of sandwich-groups from group taxation

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151 See Part 9 chapter A.III, pp. 593 et seq.
152 Part 9 chapter A.III, p. 595 et seq.
153 Part 9 chapter A.III, p. 596 et seq.
154 Part 9 chapter A.III, p. 598.
155 Part 9 chapter A.III, pp. 599 et seq.
156 Part 9 chapter A.IV, pp. 604 et seq., also taking into account the decision in Boake Allen Ltd and others v HMRC and other national court decisions.
157 Part 9 chapter A.IV, pp. 609 et seq.
158 Part 9 chapter A.IV, p. 610 et seq.
159 This would require a teleological reduction of the attribution rules contained in Sec. 9 para. 6 KStG.
violates Art. 24 para. 5 OECD-MC. Situations of double loss deductions have to be avoided, however.\textsuperscript{160}

Similar questions as to the treatment of domestic losses from foreign group members in sandwich constellations also arise with respect to domestic PE-income of group members subject to limited tax liability in Austria.\textsuperscript{161} The overall exclusion of such income from group taxation (thus the exclusion from offsetting PE-losses from group profits or vice versa) leads to a violation of Art. 43 EC.\textsuperscript{162} What causes problems in this context is, however, the avoidance of double dips. Whereas situations of (direct) double loss utilization within the Austrian tax jurisdiction can be avoided by a teleological reduction of the loss attribution rule contained in Sec. 9 para. 6 no. 6 KStG, this is not possible as far as cross-border double dips are concerned. At the same time these constellations are also prone to juridical/economic double taxation. \textit{De lege ferenda}, the implementation of an opting-out-model combined with a general recapture rule seems to be worth consideration as a result.\textsuperscript{163}

Apart from that also the implications of PE-non-discrimination clauses contained in bilateral tax treaties similar to Art. 24 para. 3 OECD-MC are taken into consideration. Surprisingly, Art. 24 para. 3 OECD-MC (leaving aside the restrictive approach adopted by the OECD in its 2008 update to the Commentary) does not require the full integration of the income attributable to domestic PEs of non-resident group members into the group taxation system. Strictly speaking such an inclusion may only be argued for profits but not for losses. Nevertheless, the overall exclusion from group taxation is also problematic from the viewpoint of tax treaty law.\textsuperscript{164} The exclusion of other income than PE-income incurred by non-resident group members from group taxation, however, is unproblematic from the treaty perspective unproblematic is.\textsuperscript{165} Since such an exclusion according to Sec. 9 para. 2 in conjunction with para. 4 KStG primarily restricts the freedom of establishment of resident (parent) companies any restrictive effects on the free movement of capital must be seen as an unavoidable consequence of the restriction on the freedom of establishment which rules out the invocation of Art. 56 EC. Within the EU or the EEA this result is to be contested, however.\textsuperscript{166}

11. The compensation of losses in groups of companies with foreign parent companies

Part 10 finally deals with the compensation of losses in (domestic) groups of companies which are controlled by foreign parent companies. Therefore the admissibility of foreign parent corporations as group parents within the meaning of Sec. 9 para. 3 KStG is analyzed in a first step,

\textsuperscript{160} Part 9 chapter A.IV, p. 612 et seq.
\textsuperscript{161} For a graphical presentation see p. 615.
\textsuperscript{162} Part 9 chapter B.I, pp. 614 et seq.
\textsuperscript{163} Part 9 chapter B.I, pp. 618 et seq.
\textsuperscript{164} Part 9 chapter B.II, pp. 623 et seq.
\textsuperscript{165} Part 9 chapter C, p. 627 et seq.
\textsuperscript{166} Part 9 chapter C, pp. 628 et seq.
starting with the differentiations caused by Sec. 9 para. 3 indent 5 KStG. Foreign corporations resident in third countries are excluded from group taxation (at least as far as their position as group parent is concerned) even if all other requirements stipulated also for comparable EU or EEA companies are met. This difference in treatment infringes upon the PE-non-discrimination clauses as contained in bilateral tax treaties and therefore has to be omitted. Following the prevailing opinion also corporations which are resident outside the EU or EEA have to be accepted as group parents, provided that they are comparable to a domestic corporation within the meaning of Sec. 9 para. 3 indents 1 to 4 KStG and maintain a registered branch in Austria to which the participations in the group members can be attributed.\footnote{Part 10 chapter A.I, pp. 631 et seq.}

Section A.II then deals with the already mentioned “registered branch”-requirement pursuant to Sec. 9 para. 3 KStG. According to this requirement, non-resident companies which hold the shares in a non-registered PE \textit{prima facie} would not be admitted as group parent.\footnote{Part 10 chapter A.II, pp. 635 et seq.} All in all, this requirement (i.e. the registration of a PE as branch in the registrar of companies) is excessive, although not all constellations constitute an infringement of Community and/or tax treaty law. This is particularly true for third country corporations. Under these circumstances neither Art. 56 EC (due to its inapplicability) nor the PE-non-discrimination principle of tax treaties provide protection (as the registration-requirement as such does not lead to higher taxation and furthermore, also resident companies have to be registered in the registrar of companies).\footnote{Part 10 chapter A.IV, pp. 642 et seq.} Nevertheless, the requirement of a sufficient nexus for tax purposes (i.e. as a rule the existence of a domestic PE) to which the shares in the group members are attributable has to be approved from the perspective of tax treaty law in order to secure the (domestic) taxing rights with respect to the income of the (domestic) group members. As demonstrated in section II, this requirement can also be read into the registered branch proviso of Sec. 9 para. 3 KStG.\footnote{Part 10 chapter A.III, pp. 639 et seq.} If, however, one approves the requirement of such a domestic nexus, the same must - \textit{argumentum e contrario} - also hold true for shares which are held by tax-resident (Austrian) companies through foreign (treaty exempt) PEs. Consequently, the admissibility of a resident company as group parent within the meaning of Sec. 9 para. 3 KStG which maintains a foreign PE to which the shares in the (domestic) group members are attributable has to be denied.\footnote{Part 10 chapter A.II, p. 638 et seq.}

Chapter B subsequently examines the question whether Art 24 para 5 OECD-MC (shareholder-non-discrimination clause) or Art. 43 EC requires the attribution (and thereby non-taxation) of domestic group profits to foreign parent companies in the case of final losses incurred by the parent company. Looking at the \textit{Oy AA} case this seems questionable. However, in this respect it has to be borne in mind that - according to the facts of the case - the losses concerned in \textit{Oy AA} were current losses and not final losses. A final answer as to the treatment of final losses of parent companies
(which corresponds to a down-stream loss compensation) is still missing. As demonstrated in Part 5 the Oy AA case and particularly its interpretation by the Swedish Supreme Administrative Court could point to a differentiation between up-stream and down-stream loss compensation, even in the event of final losses which the author does not find convincing after all. However, Art. 24 para. 5 OECD-MC does not impose any obligation to allow for a set-off of (final) losses of foreign parent companies against taxable profits generated by Austrian companies.\(^{172}\)

The final question addressed is the issue of offsetting profits and losses between financially integrated “sister companies” the shares of which are held by a non-resident parent company (without a domestic PE to which the shares are attributable).\(^{173}\) *De lege lata* such a set-off is not possible; a result which at least the Luxembourg Supreme Administrative Court in a similar case considered as being in conformity with the obligations imposed by both, tax treaty law (PE-non discrimination principle) and Community law (Art. 43 EC).\(^{174}\) Indeed, from the Oy AA case it may be concluded that non-resident parent companies without any domestic fiscal presence may be excluded from group taxation. If this finding is applied one-to-one to the case of loss relief between sister companies, it does not seem to be fallacious to also deny the possibility of group taxation between sister companies. However, this reasoning has to be countered in the light of the ECJ’s judgment in the *Papillon* case. In this case the Court regarded the exclusion of “sandwich-groups”, in which two domestic companies are financially integrated through a non-resident intermediary company as infringement of Art. 43 EC. If, however, one considered the “broken chain”-requirement as *de facto* discrimination in “sandwich-constellation” the same must also hold true for financially integrated sister companies (maybe subject to the condition that this horizontal group taxation does not result in a double dip due to simultaneous compensation abroad). However, this issue still requires clarification by the ECJ. Contrary to Art. 43 EC, Art. 24 para. 5 OECD-MC does not require the compensation of domestic losses between sister companies *de lege lata*, as this would encroach upon the integrity of the stepwise attribution system as provided for by Sec. 9 KStG.\(^{175}\)

\(^{172}\) Part 10 chapter B, pp. 647 et seq.

\(^{173}\) For an illustration see p. 651.

\(^{174}\) Part 10 chapter C.II, p 651 et seq.

\(^{175}\) Part 10 chapter C.III, pp. 652 et seq.