Analysis
M&S and the 'no possibilities' test

SPEED READ **Claims for group relief for the losses of companies in the group in other EU Member States must meet the condition that the possibilities for past, present and future use of the losses locally must be exhausted. The Supreme Court has concluded, in the latest stage of the *M&S* case, that the date upon which that condition must be met is the date of the claim and not, as HMRC has advocated, the end of the accounting period in which the loss was incurred. Steps taken by taxpayers, such as the liquidation of the loss making subsidiary, will not exclude the making of a claim.**

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When might the losses of a company resident in another Member State of the EU be surrendered by way of group relief to offset the profits of a UK resident within the group, in accordance with the principles in the *Marks & Spencer* case (C-446/03, ECR 2005 I-10837)? According to the CJEU, it would be when the possibilities of local use had been exhausted for past, current and future accounting periods (para 55 of that judgment). What the CJEU meant by that condition, in particular regarding how the possibilities of future use might be exhausted, has been the principal focus of the *M&S* case since that pronouncement in December 2005. It has, in the intervening eight years, occupied every level of national tribunal and court, including two different panels of the Court of Appeal, until it reached the Supreme Court last month.

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When then might future use become impossible? When the maximum period for carry forward under local law had expired? When trading has ceased? When the loss making entity had ceased to exist following liquidation? When upon merger or sale local rules prohibit further use? Perhaps when the losses become so great that any meaningful future use becomes entirely implausible?

End of the accounting period?

According to HMRC, a possibility of use of a loss locally could not be properly exhausted through any intentional act of the taxpayers concerned. One ground – to HMRC, the dominant ground – justifying the restriction of group relief to domestic losses, in circumstances not covered by the 'no possibilities' exception, was the need to protect the balanced allocation of taxing rights. That protection would be compromised were the taxpayers to have the choice of the jurisdiction in which the profits would be taxed by taking steps to render the losses incapable of future local use.

From that principle, HMRC extrapolated to the conclusion that the moment when the taxpayers had to prove that all future possibility for the use of the losses had been exhausted was the day after the end of the accounting period in which the losses arose. That was the date by which the conditions for group relief domestically had to be met and only such a tight time frame could prevent the ability of the taxpayer to take steps to render the loss unusable.

HMRC accepted that their reading of the 'no possibilities' condition would render it highly unlikely that losses could qualify for surrender. About the only occasions mentioned where losses might meet HMRC's test were upon the insolvent liquidation of a company or, in jurisdictions with a schedular system (i.e. Ireland) upon the cessation of trade. Even then, the requirement that the loss be beyond possible future use by the end of the accounting period in which it was incurred, would exclude from recovery any losses in accounting periods other than the final one even if several years of continuing losses preceded the cessation or liquidation.

Or the date of the claim?

In the case of *M&S*, the reality was that several years of increasing losses preceded the decision to cease trading in Germany and Belgium. Efforts to sell the two subsidiaries were unsuccessful and the companies remained inactive before being liquidated some six years later. For HMRC, none of the losses therefore qualified. The decision to liquidate amounted to the exercise of a choice offending the balanced allocation of taxing rights and had of course not been completed in any year when losses were incurred.

For M&S, it was never exercising a choice which might offend that justification. It had no choice at all of the jurisdiction in which its losses could be taken into account. The only choice was between claiming them in the UK or not at all. The acts of liquidating these long inactive subsidiaries did no more than prove that the losses were indeed beyond possible future use. The logical date, it followed, on which to test the 'no possibilities' condition should be the date on which the group relief claim was made: i.e. the date when the claimants had to establish that they were able to meet all the requirements of a claim.

Nor was it correct to assert that events after the end of the accounting period had no effect upon

domestic claims for group relief. As David Milne QC observed, domestically it would be far from unusual for a situation to arise where a company claimed group relief, only to find in the next year that it incurred a loss which could be carried back. Time limits permitting it would be entirely in keeping with the group relief provisions for the group relief claim to be withdrawn and the surrendered loss carried forward, or surrendered to another company in the group.

The lower courts had found in favour of M&S on the issue, but not without the Court of Appeal, on the second visit in 2011, indicating that it only did so because it was bound to follow the previous decision of that Court in 2007. That indication led the Court of Appeal to grant permission to appeal to the Supreme Court.

The CJEU's clarification: *A Oy*

Shortly before the hearing in the Supreme Court, however, there was a further development from the CJEU which proved decisive: its judgment of 21 February 2013 in *A Oy* (C-123/11). After its subsidiary incurred trading losses, a Finnish group ceased trading in Sweden and closed its sales outlets there. It planned to merge the Swedish subsidiary with the Finnish parent. If the Swedish subsidiary had also been Finnish, its trading losses could have been carried forward in the Finnish parent. Among other questions, the CJEU was asked whether the restriction of this treatment to the losses of domestic companies would be compatible with the *M&S* judgment.

On HMRC's understanding of *M&S*, clearly such legislation would be entirely permissible. The decision to merge would be the exercise of choice, the prohibition of which would be justified by the dominating effect of the protection of the allocation of taxing rights. Significantly, the advocate general had reached the same conclusion for very similar reasons. The merger was the free decision of the group, taken no doubt for sound commercial reasons, but which would enable the group to choose the jurisdiction where its losses would be taken into account.

Notably, however, the CJEU did not follow its advocate general. The decision to merge was considered not to preclude the availability of relief; nor did the fact that the losses were capable of carry forward under local law exclude a claim. Rather, the court asked whether on the facts of the case all of the possibilities of local use had been exhausted.

The Supreme Court's view

The Supreme Court was unanimous, Lord Hope delivering the only judgment. The clarification given by *A Oy* was clearly regarded as decisive. HMRC's depiction of *M&S* as excluding any action by the taxpayer which had the effect of exhausting the possibilities of future use, such as merger or liquidation, was incompatible with that ruling. It followed that no applicable principle could underpin the selection of the end of the accounting period as the appropriate date on which to establish if the 'no possibilities' condition was met. Such a date was otherwise too restrictive to permit claims realistically to be made. Accordingly, M&S was right that the relevant date to establish the test is the date of the claim.

The decision surely concludes that part of the debate. All Member States permit the carry forward of losses. Had HMRC been correct in establishing the date for the testing of the condition as the end of the accounting period, there would be few losses which might ever have qualified. Yet also significant is the judgment's guidance that in determining whether the possibilities of use have been exhausted, it is the facts of the case that are to be considered. Previous decisions in *M&S* had found that it was the moment when the liquidations of those companies had commenced that the 'no possibilities' test had been met. Once commenced, it was fanciful to suggest that the companies would be taken out of liquidation. The relatively defined period the liquidators required before completing the liquidations also permitted a reasonable assessment of those losses which would remain unutilised at its conclusion.

What next?

Unhappily, however, this does not conclude the *M&S* debate. The Supreme Court is yet to hear three remaining issues in the appeals. First, where time limits still permit group relief claims to be made, for instance while an enquiry or appeal remains pending, should cross-border claimants also be permitted to make further claims once they have been able to show that the no possibilities test is met, with the effect that the test is then assessed at the date of those later claims? Moses LJ, in the second Court of Appeal, had felt that the outcome to that issue was also decided by the answer to the principal timing issue, but for procedural reasons that issue was not before the Supreme Court on this occasion. The second issue yet for the Supreme Court to hear is whether the time period for making group relief claims under the pay and file system should be extended given that, although M&S made its claims within time, the CJEU did not reveal the existence of the 'no possibilities' test until after that time period had expired. Finally, there is the question of how to compute the losses for surrender.

The Supreme Court's clear and concise judgment does resolve the major remaining point of disagreement in the application of the *M&S* ruling. HMRC's knockout blow, which would effectively have excluded almost all claims on timing grounds, has missed its target. For many other claimants, however, the issue remains as to whether distinctions in group structure still exclude them from relying on *M&S* where, for example, the surrender is to a UK resident subsidiary of a common parent rather than to the parent itself. That litigation is yet to commence in earnest.

The author acts on behalf of Marks and Spencer in this case. ■

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***M&S*: cross-border group relief** (Alison Last, 20.10.11)

Cases: *Re A Oy* (Alan Dolton, 21.3.13)