THE NORDEA BANK DENMARK CASE

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1. Introduction

On 17 July 2014, the European Court of Justice (ECJ) gave its decision in the *Nordea Bank Denmark*[2] case, which concerned a Danish tax rule that recaptured losses derived from permanent establishments located in another EU Member state or EEA state.[3] The Danish tax rule applied a loss recapture mechanism on the losses incurred by its permanent establishment in the event of total or partial transfer of the permanent establishment's activities to an affiliated company established in the same State as the permanent establishment. The Court held that this rule was incompatible with the freedom of establishment enshrined in Articles 49 TFEU and 54 TFEU and, because Norway was involved, Articles 31 and 34 of the EEA agreement. This paper will analyse the Court's decision. Firstly, all the relevant facts will be stated. Secondly, the considerations of the Court will be covered separately. Finally, this paper includes comments and comparisons with previous ECJ cases and the opinion issued by Advocate General Kokott.[4]

2. Facts

Between 1996 and 2000 Nordea Bank engaged in retail banking activities in Norway, Finland and Sweden. These activities had been carried out by bank branches (permanent establishments) in the aforementioned countries and generated operating losses. Under Danish tax law the resident company was entitled to deduct the branches operating losses, with a total of DKK 204.402.324, from its taxable income. Due to the creation of the Nordea-group in 2000 the foreign

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2 *Nordea Bank Denmark A/S v Skatteministeriet*, C-48/13, ECLI:EU:C:2014:2087

3 Danish recapturing loss rule, §33D, paragraph 5 of the Danish Tax Assessment Act

4 Opinion of Advocate General Kokott, C-48/13, ECLI:EU:C:2014:153

branches were closed and accounts were transferred on identical terms to subsidiaries of Nordea Bank in the countries concerned. Previous generated losses could not be deducted from the taxable income of the acquiring companies. The transactions which had taken place triggered the Danish loss-recapture rules. Firstly, the rules implied a partial sale of business which taxed the Danish company on the residual value after a deemed arms' length disposal of its branches. In addition the Danish tax authority increased the tax base of Nordea Bank by the amount of losses for which deduction had been claimed in the previous years. Nordea Bank did not dispute the partial sale of business.[5] However, according to the Nordea bank the recapture of losses was contrary to the freedom of establishment. Nordea Bank challenged the recapture of losses in Denmark and the Danish Easter Regional Court asked the ECJ for a preliminary ruling. [6]

3. Decision of the Court

Firstly, the Court restated the question of the Danish court:[7]

> *By its question, the referring court asks, in essence, whether Articles 49 TFEU and 54 TFEU and Articles 31 and 34 of the EEA Agreement preclude legislation of a Member State under which, in the event of transfer by a resident company to a non-resident company in the same group of a permanent establishment situated in another Member State or in another State that is party to the EEA Agreement, the losses previously deducted in respect of the establishment transferred are reincorporated into the transferring company's taxable profit*

a. Is there a restriction of the freedom of establishment?

To answer this question the Court provided a summary of the concept of freedom of establishment by referring to its previous cases. Article 49 TFEU in accordance with Article 54 TFEU gives European nationals, companies or firms, formed in accordance with the law of a member state, the right to exercise their activity in another member state through a subsidiary, branch or agency. This definition had

5 *Nordea Bank Denmark A/S v Skatteministeriet*, C-48/13, ECLI:EU:C:2014:2087, paragraph 12

6 Danish Court of appeal

7 *Nordea Bank Denmark A/S v Skatteministeriet*, C-48/13, ECLI:EU:C:2014:2087, paragraph 16

been confirmed in the *Saint-Gobain* and *Marks & Spencer* cases[8] and its aim is to ensure that foreign nationals and companies are treated equally in the Member State of origin and the host Member State. In addition the Court stated that, predicated on the *Lidl Belgium* case[9], the freedom of establishment precludes the Member State of origin from hindering establishment in another Member State of a company incorporated under its legislation, particularly through a permanent establishment. This definition also applies to Articles 31 and 34 of the EEA Agreement which are similar in nature.

The Court highlighted that the possibility to offset losses incurred by a permanent establishment in another Member State against the profits of the Danish company, constituted a tax advantage.[10] However, by recapturing losses legally deducted in respect of the transferred foreign branch which does not apply if a Danish branch is transferred in identical circumstances, Danish tax law includes different treatment which constituted a disadvantage for the Danish company with a foreign branch. Such a disadvantage is liable to deter a Danish company from conducting its business through a permanent establishment situated in a Member State other than Denmark and therefore constituted a restriction of the freedom of establishment.[11]

b. Are the situations objectively comparable?

As the Court identified a restriction of the freedom establishment, since a transfer of a domestic branch would not have triggered the recapture of losses, such a restriction was lawful only if it related to situations which were not *objectively comparable* or if it was justified by an overriding reason in the public interest. [12]

The Court pointed out that, in principle, a branch situated in another Member State was not in a comparable situation to a resident branch in relation to a rule which

8 *Marks & Spencer plc v David Halsey* (Her Majesty's Inspector of Taxes), C-446/03, paragraph 30 and *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt*, C-307/97, ECLI:EU:C:1999:438, paragraph 35

9 *Lidl Belgium GmbH & Co. KG v Finanzamt Heilbronn*, C-414/06, ECLI:EU:C:2008:278, paragraph 19 and 20

10 *Nordea Bank Denmark A/S v Skatteministeriet*, C-48/13, ECLI:EU:C:2014:2087, paragraph 20 and *Lidl Belgium GmbH & Co. KG v Finanzamt Heilbronn*, C-414/06, ECLI:EU:C:2008:278

11 *Nordea Bank Denmark A/S v Skatteministeriet*, C-48/13, ECLI:EU:C:2014:2087, paragraph 22

12 *Nordea Bank Denmark A/S v Skatteministeriet*, C-48/13, ECLI:EU:C:2014:2087, paragraph 23 and *The Commissioners for Her Majesty's Revenue & Customs v Philips Electronics UK Ltd,* C-18/11, ECLI:EU:C:2012:532, paragraph 17

was designed to prevent or mitigate double taxation of the resident company's profits.[13] However, by making the profits of the foreign branches subject to Danish tax, Danish tax law opted to equate those branches with resident branches with regard to the deduction of losses. Predicated on *Denkavit Internationaal,* the Court held that in the *Nordea Bank* case the situations have to be considered to be 'comparable situations'.[14]

Surprisingly, the Court applied the comparability test conversely to the opinion issued by Advocate General, Kokott. This was despite the fact that the Advocate General had stated in her opinion that there was no need to apply the comparability test:[15]

> *The requirement of objective comparability may be regarded as a doctrinal vestige from a time when, in matters relating to freedom of establishment, the Court accepted only grounds of justification expressly provided for in the Treaty. A new state of affairs came into being, however, when the Court also began to recognise unwritten grounds of justification. Grounds in support of a difference in treatment are now regularly considered as part of the examination of the various grounds of justification that are already recognised — or that may be recognised in future. It is not therefore surprising that, in cases where it examines the objective comparability of the situations seriously, the Court essentially looks at the same factors as it later re-examines from the point of view of justification.*

The Advocate General claimed that the difference in treatment should be assessed only by reference to whether there were grounds capable of providing a proportionate justification for that difference in treatment.[16] The Court, however, strictly and separately assessed both the comparability and the restriction test before proceeding to assess the presence of a proportionate justification for the difference in treatment. This separation underscores what had been pointed out in *Phillips Electronics, X-holding*[17] and *Columbus*[18]**.**

13 *Nordea Bank Denmark A/S v Skatteministeriet*, C-48/13, ECLI:EU:C:2014:2087, paragraph 24

14 *Denkavit Internationaal and Others v Bundesamt für Finanzen*, C-283/94, C-291/94 and C-292/9, ECLI:EU:C:1996:387, paragraph 34 and 35

15 Opinion of Advocate General Kokott, C-48/13, ECLI:EU:C:2014:153, paragraph 23

16 Opinion of Advocate General Kokott, C-48/13, ECLI:EU:C:2014:153, paragraph 28

17 *X Holding BV v Staatssecretaris van Financiën*, C-337-08, ECLI:EU:C:2010:89, paragraph 20 and *The Commissioners for Her Majesty's Revenue & Customs v Philips Electronics UK Ltd,* C-18/11, ECLI:EU:C:2012:532

The Court concluded the existence of a restriction in principle because the Danish tax law entails a different treatment for Danish companies having a permanent establishment in Denmark compared with those having permanent establishment abroad. However, in paragraph 38 the Court stated that:[19]

> *In principle, permanent establishments situated in another Member State or in another State that is party to the EEA Agreement are not in a situation comparable to that of resident permanent establishments in relation to measures laid down by a Member State in order to prevent or mitigate the double taxation of a resident company's profits.*

In the *Nordea bank* case the disadvantage did not result from the connection of two national systems but from Danish legislation only. The same situation applies in the *Denkavit Internationaal* case wherein France's taxation of non-residents was at issue and the discrimination did not result from the juxtaposition of two national systems, but from the French rules only.[20]

Danish national tax rules made the profits of foreign permanent establishments subject to Danish tax. By implementing this national tax rule, it had chosen to treat foreign and domestic permanent establishments equally. This not only concerns the profits but, logically, also the losses. This equal treatment clarifies that there were no objective differences in the situations of foreign or domestic permanent establishments. The situations should, therefore, be treated with objective comparability and can only be justified by way of an overriding reason in the public interest.

c. Is there a justification by an overriding reason in the public interest?

After the Court stated there was a restriction of the freedom of establishment and that the situations were objectively comparable, the only escape for Denmark was to justify the restriction by an overriding reason in the public interest.

According to the explanatory memorandum of the Danish loss-recapture rule, the objective of the Danish rule was to avoid the risk of tax avoidance when a resident company deducted losses of its foreign branches and then, once the branches became profitable, the company would transfer its branches to affiliated companies,

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18 *Columbus Container Services BVBA & Co. v Finanzamt Bielefeld-Innenstadt*, C-298/05, ECLI:EU:C:2007:754

19 *Nordea Bank Denmark A/S v Skatteministeriet*, C-48/13, ECLI:EU:C:2014:2087, paragraph 38

20 *Denkavit Internationaal and Others v Bundesamt für Finanzen*, C-283/94, C-291/94 and C-292/9, ECLI:EU:C:1996:387

resident in foreign states, with the aim of ensuring that future profits will be taxed outside the Danish tax jurisdiction. [21] In relation to the justification for the restriction, the Court stated that the Danish Government substantiated the necessity of the restriction in order to ensure a balanced allocation of the power to impose taxes between the Member States in connection with the prevention of tax avoidance.[22]

In the light of this, the Court held that the transfer of the permanent establishment would artificially erode the Danish tax base if Denmark did not have the power to recapture, and thereby tax, previously deducted losses. This is based on the fact that after the transfer the Danish principal company would lose his right to tax future profits. The Danish tax rules were intended to prevent a possible erosion of its tax base. Its objective was to ensure a balanced allocation of the power to impose taxes between Member States in connection with anti-tax avoidance. The Court recognized the Danish objective as a justification of the restriction by an overriding reason in the public interest.[23]

It is noteworthy that even though the Court recognised the anti-avoidance objective of the Danish loss-recapture rule[24], the Court did not solely assess the anti-avoidance objective as a justification. The Court stated explicitly that the Danish objective was:

1) To prevent tax avoidance, ***in connection*** with
2) Ensuring a balanced allocation of the power to impose taxes.

This connective approach is frequently used by the ECJ since the delivery of its judgment in the *Marks & Spencer* case.[25]

On the basis of existing ECJ case law, the objective of preventing tax avoidance may be invoked as a justification for national laws. However, in order to be accepted as a stand-alone justification in, the national law must be designed to

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21 *Nordea Bank Denmark A/S v Skatteministeriet*, C-48/13, ECLI:EU:C:2014:2087, paragraph 29

22 *Nordea Bank Denmark A/S v Skatteministeriet*, C-48/13, ECLI:EU:C:2014:2087, paragraph 26

23 *Nordea Bank Denmark A/S v Skatteministeriet*, C-48/13, ECLI:EU:C:2014:2087, paragraph 30

24 *Nordea Bank Denmark A/S v Skatteministeriet*, C-48/13, ECLI:EU:C:2014:2087, paragraph 26

25 *Marks & Spencer plc v David Halsey* (Her Majesty's Inspector of Taxes), C-446/03

specifically target wholly artificial arrangements.[26] The *Cadbury Schweppes*[27] case clarifies this point by stating that the UK CFC-rules could be justified only in cases where it targeted wholly artificial arrangements which did not reflect economic reality. This was subsequently reaffirmed in the *Thin Cap GLO* case, where the Court held that thin-capitalisation rules were not specifically intended to target fictitious arrangements made solely to circumvent the legislation of the Member State concerned.[28] In both cases the Court added that the type of behaviour which the national rule tries to prevent can undermine the right of member states to exercise their taxing rights on activities carried out in their territory, which jeopardises the balanced allocation of taxing rights between member states. [29]
All in all, national rules that are designed to tackle wholly artificial arrangements but also apply to economically motivated arrangements cannot be justified only on the grounds of the need to prevent tax avoidance. In the *SGI* case the Court explained that:

> *national legislation which is not specifically designed to exclude from the tax advantage it confers such purely artificial arrangements – devoid of economic reality, created with the aim of escaping the tax normally due on the profits generated by activities carried out on national territory – may nevertheless be regarded as justified by the objective of preventing tax avoidance, taken together with that of preserving the balanced allocation of the power to impose taxes between the Member States*[30]

By providing that the resident company is to be taxed in respect of any unusual or gratuitous advantage granted to an affiliated company established in another Member State, the Belgian rules at issue were able to combat such practices which the Court noted were "designed only to avoid the tax normally due in the member state in which the company granting the advantage has its seat". [31] With the

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26 *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt*, C324/00, ECLI:EU:C:2002:749, paragraph 36 and 37 and *Imperial Chemical Industries v Colmer*, C-264/96, ECLI:EU:C:1998:370, paragraph 26

27 *Cadbury Schweppes and Cadbury Schweppes Overseas* , C-196/04, ECLI:EU:C:2006:544

28 *Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue*, C-524/04, ECLI:EU:C:2007:161, paragraph 72

29 *Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue*, C-524/04, ECLI:EU:C:2007:161, paragraph 75 and *Cadbury Schweppes and Cadbury Schweppes Overseas*, C-196/04, ECLI:EU:C:2006:544, paragraph 56

30 Société de Gestion Industrielle (SGI) v Belgian State, C-311/08, ECLI:EU:C:2010:26, paragraph 66

31 Société de Gestion Industrielle (SGI) v Belgian State, C-311/08, ECLI:EU:C:2010:26, paragraph 68

emphasis on rules designed only to avoid the tax normally due the Court concluded that such anti-avoidance rules were appropriate to achieve their objective. [32]

The justification of the need to maintain a balanced allocation of taxing rights between Member States was first accepted by the Court as a general interest justification in the *Marks & Spencer* case.[33] Following this case it also played a decisive role in the *X-holding* case and the *National Grid Indus* case. [34] If there is a restriction imposed by a Member State, national rules may be justified when these are necessary to maintain a balanced allocation of taxing rights. However, in order to accept this justification a Member State must clarify what exactly jeopardises the balanced allocation of taxing rights. There can be various ways to substantiate the possible threat to the balanced allocation of taxing rights. For example in the *X-holding* case the possibility of loss trafficking jeopardised the balanced allocation of taxing rights:

> *To give companies the option of having their losses taken into account in the Member State in which they are established or in another Member State would seriously undermine a balanced allocation of the power to impose taxes between the Member States*

In the *SGI* case,[35] tax avoidance threatened the balanced allocation of taxing rights. Belgium tried to combat arrangements which were designed only to avoid the tax normally due in the Member State in which the company granting the advantage had its seat.

These cases affirm that a Member State can invoke the need to maintain a balanced allocation of taxing rights. However, it has the obligation to prove that in the absence of its national rules the balance allocation of taxing right will be in danger. 'In danger' because in practice some tax arrangements would then occur and precisely these arrangements would jeopardise the balanced allocation of taxing rights. Simply arguing that the balance in the allocation of taxing rights might be affected is not enough.[36]

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32 Tom O'Shea, 'CFC reforms in the UK – some EU law comments', (2012/13) ECTL, 13, pp. 65-89, at 78-79

33 *Marks & Spencer plc v David Halsey* (Her Majesty's Inspector of Taxes), C-446/03

34 *X Holding BV v Staatssecretaris van Financiën*, C-337-08, ECLI:EU:C:2010:89 and *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam*, C-371/10, ECLI:EU:C:2011:785

35 *Société de Gestion Industrielle (SGI) v Belgian State*, C-311/08, ECLI:EU:C:2010:26

36 Tom O'Shea, 'News Analysis: Dutch Fiscal Unity Rules Receive Thumbs up From ECJ', (2010) Tax Notes International, March 8, p. 835

It is clear that the Danish recapture rules are not specifically designed to exclude from the tax advantage purely artificial arrangements that are not economically viable and were created for the sole purpose of avoiding taxation to which profits would normally be subject. This had been confirmed by the Court as it did not solely assess the objective of anti-tax avoidance as a stand-alone justification. Denmark tried to ensure the symmetry between the taxation of profits and the deduction of losses, which had been deducted previously from the taxable profits of the principal company. This is why the Court rightly held that, in line with the *SGI* case, the objective of preventing tax avoidance should be taken together with that of preserving the balanced allocation of the power to impose taxes between the Member States. Denmark showed that a transfer of the foreign permanent establishment would artificially erode the Danish tax base if Denmark did not have the power to recapture, and thereby tax, previously deducted losses. Denmark proved that in practice, in the absence of its national rule, tax arrangements would jeopardise the balanced allocation of taxing rights.

By construing the need to preserve the balanced allocation of taxing powers as the need to safeguard the symmetry between the taxation of profits and the deduction of losses, the ECJ clarified that it allowed Denmark to tax the profits and gains present in the foreign branches assets and liabilities that accrued during the period that they were branches of the Danish transferring company.[37] The objective of ensuring the symmetry between the taxation of profits and the deduction of losses also came up in the *Krankenheim* case.[38] In this case Germany applied a deduction and recapture mechanism for foreign permanent establishments. The Court clarified that deduction and recapture rules can be necessary to ensure the coherence of the German tax system:[39]

> *The reintegration of the amount of the permanent establishment's losses in the results of the principal company is the indissociable and logical complement of their having previously been taken into account.*[40]

It is clear, with reference to the *Krankeheim* case, why the Court allowed Denmark to tax the profits and gains present in the foreign branches' assets and liabilities that accrued during the period that they were branches of the Danish

37 *Nordea Bank Denmark A/S v Skatteministeriet*, C-48/13, ECLI:EU:C:2014:2087, paragraph 30

38 *Finanzamt für Körperschaften III in Berlin v Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt GmbH*, C-157/07, ECLI:EU:C:2008:588

39 For an analysis of this case see; T O'Shea, 'German Loss deduction and reintegration rules and the ECJ', Tax Notes International, March 16, 2009, p. 967

40 *Finanzamt für Körperschaften III in Berlin v Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt GmbH*, C-157/07, ECLI:EU:C:2008:588, paragraph 55

transferring company. However, it is important to note that the Danish rules are divided into two. In effect Denmark tried to ensure the taxation of profits and gains present in the foreign branches by:

1. A (partial) 'arm's length' sale immediately prior to the transfer
2. A recapture of all previously deducted losses

In practice, the Danish rules first taxed the principal company on gains present in the foreign branches assets that accrued during the period that they were branches of the principal company and in addition also taxed the principal company on all previously deducted losses. It may come as no surprise that the Court subsequently assessed the proportionality of the Danish rule.

d. Is the justification proportionate to achieve its objective?

According to the Court, the subsequent recapture of losses goes beyond what was necessary to attain its objective. By taxing the gains made on the transfer, Denmark in effect taxed the profits that accrued during the period that the branches of the Danish transferring company were within the tax jurisdiction of Denmark. Therefore, Denmark did not need to recapture the previously deducted losses. This is in conformity with the opinion of the Advocate General wherein she considered that the symmetry between the taxation of profits and the deduction was in principle guaranteed without the need to recapture the previously deducted losses. This symmetry occurs as from the moment that Denmark opted in its legislation to take into account both the profits and the losses of foreign permanent establishments. In addition, the symmetry also included the profits deriving from the partial transfer of the permanent establishments (irrespective of possible adjustments based on the arm's length principle).[41]

The difference in the recapturing of losses in the *Nordea Bank* case and *Krankenheim* case is that Denmark first taxed the principal company on a (partial) sale of its foreign branches, whereby it effectively taxes profits which arose during the time the branch had been part of the principal company (up to the date of the transfer), and then also recaptured all the losses which had previously been deducted. Conversely, in the *Krankenheim* case, the German principal company only recaptured the losses after the permanent establishment started making profits on the proviso that the recapture was limited to the amount of profits made during the time it had been part of the principal company. Even though the German rules were a restriction, these rules could be justified to ensure symmetry with the German system of incurring foreign permanent establishments losses in the

41 Opinion of Advocate General Kokott, C-48/13, ECLI:EU:C:2014:153

principal company's taxable profits.[42] In the *Nordea bank* case, Denmark goes further than necessary by both recapturing the losses and taxing the (partial) sale.

4. Conclusion

In the *Nordea Bank Denmark* case the ECJ considered that a Danish tax rule regarding the recapture of losses previously deducted from permanent establishments located in another EU Member State or EEA Member State, was not compliant with EU Law. The ECJ considered that the Danish rule was non-compatible based on an infringement of the freedom of establishment enshrined in Articles 49 and 54 TFEU and Articles 31 and 34 EEA. The case reaffirms the Court's previous jurisprudence which assessed the restriction of the freedom of establishment. The ECJ identified a restriction since a transfer of a domestic permanent establishment would not trigger a recapture of losses. Subsequently, the ECJ examines whether both situations are objectively comparable. The Court held that both situations were indeed objectively comparable since Denmark had chosen to treat domestic and foreign permanent establishments equally and would in both situations tax the profits.

Following these conclusions, the ECJ examined whether the restriction could be justified. The Danish rule was intended to prevent tax avoidance and Denmark emphasised the need to need to preserve the balanced allocation of taxing powers. In line with its previous cases, the Court examined both justifications jointly. Denmark clearly addressed what kind of tax arrangements it tried to block. In the absence of its national rule at issue a resident company could deduct losses of its foreign branches and then, once the branches became profitable, the company would transfer its branches to affiliated companies, resident in foreign states, with the aim of ensuring that future profits will only be taxed outside the Danish tax jurisdiction. This kind of tax avoidance would genuinely undermine a balanced allocation of the power to impose taxes.

By construing the need to preserve the balanced allocation of taxing powers as the need to safeguard the symmetry between the taxation of profits and the deduction of losses, the ECJ clarified that it allowed Denmark to tax the profits and gains present in the foreign branches assets and liabilities that accrued during the period that they were branches of the Danish transferring company. In other words, it was permissible to recapture previously deducted losses from a permanent establishment in another Member State. However, a recapture is permissible only

42 *Finanzamt für Körperschaften III in Berlin v Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt GmbH*, C-157/07, ECLI:EU:C:2008:588, paragraph 55

to the extent that it corresponded with profits made in respect of that establishment before it was transferred

Denmark, in effect, safeguarded the symmetry by taxing the profits that derived from the partial transfer of the permanent establishments and a recapture of all previously deducted losses. However, this symmetry was already in place from the moment that Denmark opted in its legislation to take into account both the profits and the losses of foreign permanent establishments. There can be little doubt that the application of a partial-sale mechanism coinciding with a recapture mechanism went beyond what was necessary to attain its objective. It should be noted that the Danish recapturing rule was abolished in 2005.