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# REVERSE DISCRIMINATION – HOW FUNDAMENTAL RIGHTS MIGHT BE CHANGED WITHOUT NOTICE

**Key words:** reverse discrimination, EU Law, freedom of establishment

**Abstract**

This article addresses the issue how meaning of fundamental rights might be amended by international treaties, based on example of non-discrimination principle, in particular context of putting own national in less favoured situation than non-national (reverse discrimination).

Two European Union (EU) member states, the United Kingdom (UK) and Poland, were then selected for testing the practice. The main reason for the choice of the UK and Poland lies on their opposite legislation tradition. Polish Constitution expressly prohibit any kind of discrimination, whereas in the UK there is no such an unified act.

Firstly, articles defined that the reverse discrimination is. Secondly, it seeks whether the possibility to offset losses from a subsidiary is treated equally to residents and non-residents. National provisions guarantee general rights and freedoms, but their scope and the meaning are continuously modified. Not only judgements of national courts, but also international treaties might define the true meaning of fundamental rights.

## Reverse Discrimination

The principle of non-discrimination is a crucial principle of EU law[1]. First, it is expressly included in the Treaty on the Functioning of the European Union [TFEU] Treaty[2]. Article 18 TFEU states, "Within the scope of application of the Treaties and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited"[3].

Secondly, Article 19 TFEU[4] provides that "Without prejudice to the other provisions of the Treaties

[1] E. Ellis, P. Watson *EU Anti-Discrimination* Law Oxford, Oxford Scholarship Online, 2013, p. 44; C-311/97 *Royal Bank of Scotland v Elliniko Dimosio (Greek State)* [1999] ECR I-2664 par. 22.

[2] Article 18, 19(1), 45(2) and 157(2) Treaty on the Functioning of the European Union – TFEU Consolidated version of the Treaty on the Functioning of the European 2012/C 326/01 Union Official Journal C 326, 26/10/2012 P. 0001 – 0390.

[3] Article 49 supra, no. 2.

[4] Supra, no. 1.

and within the limits of the powers conferred by them upon the Union, the Council, acting unanimously in accordance with a special legislative procedure and after obtaining the consent of the European Parliament, may take appropriate action to combat discrimination based on sex, racial or ethnic origin, religion or belief, disability, age or sexual orientation". As established by Article 19 TFEU, discrimination based on protected characteristics is widely stipulated in a number of directives[5] and in the Charter of Fundamental Rights of the European Union[6].

Reverse discrimination takes place when nationals are in a worse position than non-nationals[7]. According to case law, the Court of Justice of the European Union [CJEU] has prohibited reverse discrimination where member states subjected their own nationals to more burdensome requirements than non-nationals[8].

It should be noted that in terms of the free movement of goods, the CJEU has ruled on reverse discrimination issues[9] only if a member state wished to proclaim the non-discrimination principle in its national legal systems. Member states are free to decide if they wish to protect their nationals against placing them in a less favourable situation than non-nationals. Even if they do so, the national juridical system, not the CJEU, should deal with the matter.

This was shown in *Guimont*[10], which concerned a French national producing Ementhal cheese. There was a special regulation describing the qualities of cheese and, accordingly, to use the name "Ementhal", a cheese must possess rind. The defendant argued that in other member states the cheese did not have rind and that he was entitled to use the name even if his own product did not have rind. The French authorities claimed that the regulation on cheese was created to protect consumers and was of overriding value to the freedom of establishment. Mr Guimont claimed that he was subjected to reverse discrimination. The CJEU agreed and found that less restrictive measure was possible, i.e. the "Ementhal" name could be used, but some additional information must be included on the label. Notably, the decision was in line with the ruling prohibiting even non-discriminatory measures, but which could hinder exercising the right of establishment.

The similar approach of the CJEU was welcomed in *Vale Epitesi kft*[11]. In the case, an Italian company, Vale Construzioni S.r.l (limited liability company) transferred its seat to Hungary. It was required to liquidate the company and remove it from the Italian register and then to apply for a new incorporation in Hungary. Vale Epitesi S.r.l. claimed to be registered as the legal successor of the Italian company.

In *Vale*, the company was refused re-registration as the successor of the Italian company. Nonetheless, such a conversion was available for Hungarian companies. The CJEU stated that it would be discriminatory to allow purely domestic companies to convert and did not permit foreign companies to do the same.

The CJEU clearly ruled that denial of conversion and registration as a successor might hinder the freedom of establishment. The derogation might be saved purely on the basis of an overriding reason of public interest[12]. The Court noted that in some particular situations, for example, "protection of the interests of creditors, minority shareholders and employees, the preservation of the effectiveness of fiscal supervision and the fairness

[5] Inter alia Council Directive 2000/43/EC of 29 June 2000 implementing the principle of equal treatment between persons irrespective of racial or ethnic origin (Race Directive), Council Directive 2000/78/EC of 27 November 2000 establishing a general framework for equal treatment in employment and occupation, Council Directive 2004/113/EC of 13 December 2004 implementing the principle of equal treatment between men and women as regards access to and supply of goods and services, Directive 2006/54/EC of the European Parliament and of the Council of 5 July 2006 on the implementation of the principle of equal opportunities and equal treatment of men and women in matters of employment and occupation (Recast Directive).

[6] Charter of Fundamental Rights of the European Union 2010/C 83/02.

[7] C. Ritter *Purely internal situations, reverse discrimination, Guimont, Dzodzi and Article 234* "European Law Review" 2012.

[8] This solution stays in line with CJEU case law inter alia C-107/94 *Asscher v Staatssecretaris van Financiën* [1996] ECR I-3089., A. Ljungberg, *Limitations of deductibility of intragroup interest* payments Lund, University of Lund, 2009.

[9] C. Ritter *Purely internal situations, reverse discrimination, Guimont, Dzodzi and Article 234* "European Law Review" 2012.

[10] C-448/98 *Guimont* [2000] ECR I-10663.

[11] C-378/10 *VALE Epitesi kft*, Unreported July 12, 2012 (CJEU).

[12] Ibid., par. 39: "In so far as concerns justification on the basis of overriding reasons in the public interest, such as protection of the interests of creditors, minority shareholders and employees, the preservation of the effectiveness of fiscal supervision and the fairness of commercial transactions, it is established that such reasons may justify a measure restricting the freedom of establishment on the condition that such a restrictive measure is appropriate for ensuring the attainment of the objectives pursued and does not go beyond what is necessary to attain them (...)".

of commercial transactions"[13], the national law could deny a conversion. However, this could not be done in a general manner, as it makes any cross-border conversion impossible. The conversion shall be possible when it is available for national companies[14].

Conversely, the European Court was clear that conversion is possible only by virtue of national law[15]. If national law does not allow conversion both for national and non-national companies, it would then be considered as compatible with EU freedoms. Otherwise, nationals would be put in a less advantageous position (reverse discrimination)[16].

"As regards the principle of equivalence, the Court notes that, pursuant to that principle, a member state is not required to treat cross-border operations more favourably than domestic operations. That principle merely implies that the detailed rules of national law aimed at safeguarding the rights which individuals derive from European Union law cannot be less favourable than those governing similar situations under national law"[17].

In this case, the prohibition of reverse discrimination becomes a general principle and does not need to be based on national provisions. Moreover, the Court ruled that a company may provide documents from a host member state and these need to be accepted. Otherwise, the conversion formally allowed would not be possible in practice[18]. However, this is a separate case and this judgement cannot *per se* indicate that prohibition of reverse discrimination is a general principle.

Therefore, it is needed to tackle the question, whether the reverse-discrimination is allowed and applied in EU member states. To proceed this analyse, two member states the United Kingdom and Poland, have been select

## The Legal Position in the United Kingdom

There is no relevant provision to prohibit UK nationals to be put in a worse position than non-nationals. The core example is that all English- national students are due to pay for university degree in Scotland, but any other nation of EU are not due to pay for their education there.

However, this only opens a long list of reverse discrimination in the UK. A UK business might not be eligible to offset foreign losses. Nonetheless, the business is not deprived of the possibility of offsetting losses in principle. Under the Corporation Tax Act 1988 [ICTA] the business is allowed to offset final losses if the condition relating to the exhaustion of all possibilities of the non-resident subsidiary's losses are taken into account in the member state where the subsidiary is resident. However, as shown in *Marks & Spencer*[19], despite the formal wording of ICTA, it is not very likely that a company would be able to meet all the conditions.

Marks & Spencer is a company incorporated in England and Wales and trades through a number of companies established either in the UK or in other member states[20]. Marks & Spencer, as a group of companies, seeks to benefit from the British group tax scheme by claiming group tax relief in respect of the losses incurred by its subsidiaries in Belgium, Germany and France[21]. However, the British provisions were open only to British undertakings or undertakings active within the UK. The relief was denied, as the subsidiaries were neither registered nor active in the UK[22]. The UK tax authorities claimed that the profits of concerned subsidiaries were not taxed in the UK. Under section 11(1) ICTA,

[13] Ibid., par. 23.

[14] J. Borg-Barthet *Free at last? Choice of corporate law in the EU following the judgment in Vale* "International & Comparative Law Quarterly" 2013, p. 503.

[15] C-378/10 *VALE Epitesi kft*, Unreported July 12, 2012 (CJEU) p. 27 'To this end, the court's decision in VALE began with a sense of worrying déjà vu as it reminded us that, in the absence of a European definition of companies, companies only exist by virtue of national legislation, carrying the hallmarks of the decision in *Daily Mail*' Gajjar Jay 'Your dominion or mine? A critical evaluation of the case law on freedom of establishment for companies and the restrictions' [2013] International Company and Commercial Law Review.

[16] Some authors suggest that *Carpenter* should be based on non-discrimination issue. According to existing EU law, a British national and his spouse are entitled to reside in the State where services are provided for a period during which they exercise business activity there. It might lead to reverse discrimination. Mrs Carpenter was entitled to reside anywhere in the EU but not in the UK. Moreover, if Mr Carpenter was a non-UK national, he would be entitled to reside in the UK. C. Ritter *Purely internal situations, reverse discrimination, Guimont, Dzodzi and Article 234* "European Law Review" 2012, p. 690.

[17] C-378/10 *VALE Epitesi kft*, Unreported July 12, 2012 (CJEU), p. 54.

[18] EU Focus *Hungarian law on conversion of companies criticized* "EU Focus" 2012, p. 15.

[19] C-62/00 Marks & Spencer [2002] ECR I-6325.

[20] Ibid, par. 18.

[21] Ibid, par. 22.

[22] Ibid, par. 24.

non-resident companies are charged corporate tax solely in respect of the profits attributable to their United Kingdom branches or agencies[23]. Thus, if the profits are not taxed, the offset of losses generated by such a subsidiary must be denied.

The CJEU ruled that such a provision constituted a hindrance to the freedom of establishment[24]. However, the offset denial might be applied in a non-discriminatory manner if it is justified by imperative requirements in the general interest, is suitable for securing the attainment of the objective which they pursue and does not go beyond what is necessary in order to attain it[25].

Participant member states have submitted three arguments to justify the restriction. Firstly, it was submitted that profits and losses are two sides of the same coin and must be treated symmetrically in the same tax system in order to protect a balanced allocation of the taxing power of the different member states. The CJEU agreed that giving a company the option to have its losses taken into account in the member state in which they are established or in another member state may jeopardise a balanced allocation of the taxing power[26]. Secondly, participant member states claimed that such a legal provision might cause the same losses to be offset twice. Once more, the CJEU agreed that such a danger exists[27]. Finally, member states submitted that, if the losses were not taken into account in the member state in which a subsidiary is established, there would be a risk of tax avoidance. The CJEU accepted that the risk of tax avoidance exists. A concerned entity may decide to transfer the losses incurred by a non-resident company to a resident company with the consequence that 'companies losses will be transferred to companies established in the member states which apply the highest rates of taxation and in which the tax value of the losses is therefore the highest'[28].

In summary, the Court observed that concerned restrictive provisions pursue legitimate objectives, are justified by overriding reasons in the public interest and are apt to ensure the attainment of those objectives[29].

Finally, the CJEU examined if the concerned provisions do not go beyond what is necessary to attain the objective. The CJEU ruled that there are less restrictive measures available and stated that the offset cannot be prohibited in general. It shall be permitted if the non-resident subsidiary has exhausted the possibilities to offset losses in the host member state[30] and the loss is final[31].

The suggested solution in *Marks & Spencer* has been highly criticised, as the automatic deduction is contrary to both arm's length principle[32] and the ability-to-pay principle and also promotes tax planning. In her Opinion in the *European Commission v. United Kingdom*[33], Advocate General Kokott noted that the CJEU registered 142 academic publications which deal directly with the judgment and provides a criticism for wide range of possible interpretations of *Marks & Spencer*.

Following the *Marks & Spencer* judgment, the UK introduced cross-border group relief. Under the Corporation Tax Act 1988 [ICTA] final losses are allowed to be offset if the condition relating to the exhaustion of all possibilities of the non-resident subsidiary's losses is taken into account in the member state where a subsidiary is resident. Thus, the *Marks & Spencer* was again under the scrutiny of the UK Supreme Court. The Supreme Court ruled on 22 May 2013 that the concerned losses must not be deducted. The reform of the UK provisions relate to losses incurred on or after 1st of April 2006 and do not reflect the losses incurred in preceding periods.

On 19 July 2007, the Commission sent a letter of formal notice to the UK informing that this new regulation rise incompatibility issue and it is based on restrictive interpretation of *Marks & Spencer*[34]. The UK did not agree that the concerned provision is not consistent with the *Marks & Spencer* judgment. Thus, the Com-

[23] Ibid, par. 5.

[24] Ibid, par. 33.

[25] C-55/94 *Gebhard* [1995] ECR I-4165, par. 40, summary point 6.

[26] C-62/00 Marks & Spencer [2002] ECR I-6325, par. 46.

[27] Ibid, par. 48.

[28] Ibid, par. 49.

[29] Ibid, par. 51.

[30] Ibid, par. 55.

[31] The Court stated that member states might stipulate differently if wholly artificial arrangements are concerned. C-62/00 Marks & Spencer [2002] ECR I-6325, par. 57.

[32] "The parent company may support certain losses incurred by a subsidiary particularly if subsidiary is not entitled to relatively high profits or if the parent company has an own interest in providing such a support.' J. Monsenego *Taxation of Foreign Business Income within European Internal Market* Göteborg, Intellecta Infolog, 2011, p. 178.

[33] Opinion of Advocate General Kokott delivered on 23/10/2014 in case C-172/13 *European Commission v. United Kingdom of Great Britain and Northern Ireland* [2015] ECR I-0000.

[34] C-172/13 *European Commission v. United Kingdom of Great Britain and Northern Ireland* [2015] ECR I-0000, par. 8.

mission brought the action before the CJEU[35] claiming that Section 119(4) of the CTA 2010 makes it virtually impossible for a resident parent company to obtain cross-border group relief[36]. In the Commission's opinion, there are only two situations when a loss may be offset. Firstly, if there are no legal provisions in the state of residence of the non-resident subsidiary for losses to be carried forward. Secondly, if a non-resident subsidiary enters into liquidation before the end of the tax year in which the losses occurred[37]. The Commission argued that the lack of the possibility to offset non-resident losses shall be assessed at the time when a claim is made[38].

However, the CJEU did not agree with the Commission. Accordingly, Section 119 (4) of the CTA 2010 sets the date by reference to which it must be decided whether losses sustained by a non-resident subsidiary are definitive. The Court ruled that the Commission failed to prove that the concerned provisions made the offset virtually impossible.

Next, the CJEU ruled that it is not inconsistent with EU law that the CTA 2010 applies to the period after 1 April 2006. The cross-border group relief is available for preceding periods based on the legislation applicable to those earlier periods, construed in accordance with EU law[39].

A further justification may be found in the Opinion of the Advocate General Kokott[40]. The Advocate General advised that the judgment of *Marks & Spencer* should not be followed[41]. She stated that solutions presented in *Marks & Spencer* are impracticable. She added that this regime does not protect the interests of the internal market but constitutes 'a virtually inexhaustible source of legal disputes' between taxpayers and tax authorities[42]. This reasoning is also supported by the literature[43]. The Advocate General offered four reasons for this statement. Firstly, the definitive lack of possibility to offset losses exists only if a subsidiary ceased to exist in law[44]. In other situations it is always possible to argue that the offset may become possible. Moreover, it may lead to long disputes between the real and theoretical possibilities to deduct losses. This is not recommended as it does not provide legal certainty[45]. Secondly, as mentioned above, the case law following *Marks & Spencer* does not support the possibility of offsetting the losses of a foreign subsidiary[46]. Third, the Advocate General pointed out that the impossibility of loss relief elsewhere can be created arbitrarily by the taxpayer[47]. In her Opinion, "it is very difficult to clarify in a specific case when, for example, a subsidiary is wound up for tax reasons and when it is not"[48]. Finally, member states are obliged, under the freedom of establishment rules, to accord equal treatment. Thus, to grant cross-border relief, a member state may need to determine retrospectively what tax results the non-resident subsidiary would have produced had it been established within that member state[49]. Thus, for the reasons presented above, the Advocate General recommended to the Court to abandon the "*Marks & Spencer* exception". The further advantages are legal certainty[50], consistency

[35] Article 267 TFEU.

[36] C-172/13 *European Commission v. United Kingdom of Great Britain and Northern Ireland* [2015] ECR I-0000, par. 14.

[37] Ibid, par. 15.

[38] Ibid, par. 16.

[39] Ibid, par. 42.

[40] Opinion of Advocate General Kokott delivered on 23/10/2014 in case C-172/13 *European Commission v. United Kingdom of Great Britain and Northern Ireland* [2015] ECR I-0000.

[41] Ibid, par. 42.

[42] Opinion of Advocate General Kokott delivered on 23/10/2014 in case C-172/13 *European Commission v. United Kingdom of Great Britain and Northern Ireland* [2015] ECR I-0000, par. 44.

[43] See for example Y. Brauner, A. Dourado, E. Traversa *Ten years of Marks & Spencer* "Intertax" 2015, p. 308. 'It is therefore widely recognized that the ECJ is not at ease with its *Marks & Spencer* decision. The above-mentioned controversial issues and especially the justifications put forward by the Court and analysed below, demonstrate that *Marks & Spencer* is not the rule (a precedent) but an exception. [...] Ten years after the decision *Marks & Spencer*, the time has maybe come for the Court to reassess whether it really brings and added-value or whether it sheds only more confusion to an already complex and protean case law.'

[44] Opinion of Advocate General Kokott delivered on 23/10/2014 in case C-172/13 *European Commission v. United Kingdom of Great Britain and Northern Ireland* [2015] ECR I-0000, par. 45.

[45] Ibid.

[46] C-337/08 *X Holding* [2010] ECR I-1215; C-231/05 Oy AA [2007] ECR I-6373.

[47] Opinion of Advocate General Kokott delivered on 23/10/2014 in case C-172/13 *European Commission v. United Kingdom of Great Britain and Northern Ireland* [2015] ECR I-0000, par. 47.

[48] Ibid, par. 47.

[49] Opinion of Advocate General Kokott delivered on 23/10/2014 in case C-172/13 *European Commission v. United Kingdom of Great Britain and Northern Ireland* [2015] ECR I-0000, par. 48.

[50] Ibid, par. 52.

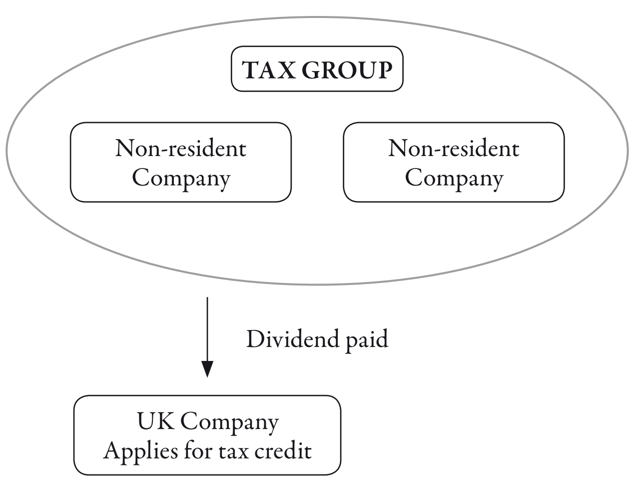
of CJEU case law[51] and reaffirming the ability-to-pay principle[52].

The CJEU ruling in *European Commission v. United Kingdom*[53] completed the "saga" of the *Marks & Spencer* litigation. The case led to thousands of commentaries and was widely discussed. As a result of 14 years of proceeding before the courts, Marks & Spencer was not allowed to deduct the final losses incurred by the foreign subsidiary.

However, the issue of special relief for tax groups requires additional attention[54]. The relief is the result of the implementation of the European Mergers Tax Directive (EMTD), which covers partial divisions. Jonathan Cookling wisely defined a partial division as an operation such a company transfers, without being dissolved, one or more branches of activity, to one or more existing or new companies, leaving at least one branch of activity in the transferring company. In his opinion UK terms a partial division is a demerger of part of the demerging company's business. Transfers between companies resident in the same the EU member state will therefore not benefit from this relief. Thus, this relief has usually of no use for non-UK resident persons[55].

The relief was implemented in the Taxation (International and other Provisions) Act 2010 and takes into account the tax group of non-resident companies. The tax relief is open for non-resident subsidiaries only.

Figure 1. Tax group




The relief provided in the Directive does not apply to UK residents and the question is posed as to whether it would constitute reverse discrimination. Firstly, this thesis seeks to establish whether the principle of non-discrimination is recognised in UK law. The issue is not straightforward, because the UK has no single core constitutional document which includes the most important principles. Usually the constitution results from revolution, peaceful negotiation or freedom from colonial rule, where in the UK there was no such political shift[56]. The answer might be found in a number of acts and case law. However, there is no indigenous principle of equality or non-discrimination in the UK[57]. The non-discrimination principle is expressly proclaimed in, for example, the Chronically Sick and Disabled Persons Act 1970, the Equality Act 2010 and the Employment Relations Act 1999. It might be thus stated that the no-reverse-discrimination principle is present in the UK's legal system, and that the above-mentioned sources of UK law are commonly accepted. Accordingly, the non-discrimination principle applies.

In the UK there are a number of special schemes provided for nationals: Venture Capital Scheme; Venture Capital Trust; and Corporate Venturing Scheme. However, they are available only for a specific purpose and so their scope is limited. On the other hand, there are special reliefs for non-resident companies regulated separately. For example, there is no similar relief to these provided by EMTD open to nationals. Nationals are subject, for example, to 18 or 28 per cent capital gains

[51] Ibid, par. 51.

[52] Ibid, par. 53.

[53] C-172/13 *European Commission v. United Kingdom of Great Britain and Northern Ireland* [2015] ECR I-0000, par. 8.

[54] In addition, the Finance Act of 2006: section 35 and 29 and Schedule 15 and Section 393 CTA 2010 provide a prohibition to offset losses of a UK branch of a non-UK-resident in scope of the worldwide debt cap. Losses are accepted only if the UK net debt exceeds the 75 per cent of the worldwide gross debt. The exemption might be derogated by statute. The surrendering company must be a subsidiary of a claimant company which is resident in the UK or the surrendering company and the claimant company must be 75 per cent subsidiaries of a third party which is resident in the UK. Also, the surrendering company must be within the charge to tax under the law of any EEA territory either because it is resident there or because it trades through a branch there. As explained above, the CJEU has already established criteria, which must be met to deny offset of losses incurred in another member state. The requirement provided in CTA 2010 does not match the CJEU line of ruling. However, the provisions relate only to large enterprises and they will not be the subjects of the further discussion here.

[55] J. Cooklin *European mergers tax directive: partial divisions and mergers* "British Tax Review" 2009.

[56] S. Eden *Chapter 16 United Kingdom* "Comparative Perspective on Law and Justice" 2012, p. 305.

[57] Ibid, p. 12.

tax. It might be noted that Entrepreneurs' Relief provides relief and 10 per cent capital gains[58].

Moreover, national businesses are not only deprived of a tax advantage but are exposed to less favourable treatments. The tax group is predetermined in the UK. A Tax Group created inside the UK is called an Associated Company. According to HMRC, the companies are associated if one has control over the other, or both companies are under the control of the same person or persons[59]. If the conditions are met, HMRC uses different accountancy rules and small profit relief may be reduced. It does not include the possibilities to account for losses or profits generated by another associated company.

It may also be argued that this is not purely a national situation. The EMTD requires that the merging companies do not reside in the same member state. However, it is possible that the merging companies are resident in the same member state but are involved in cross-border activity. The cross-border activity will therefore trigger a consideration of EU law. Thus, it must be noted that a national business is in a less favourable situation than a non-national one. National undertakings cannot benefit from the relief which constitutes reverse discrimination. It was stated that the UK should not accept any kind of discrimination, even those concerning its own nationals.

So, there is a need to find out if there is any justified reason for derogation. It is believed that there is neither argument for fiscal cohesion, nor effectiveness of the fiscal system, nor misuse of the EU law. In this case, there is no justification to treat a member state's own nationals differently from non-nationals.

## The Legal Position in Poland

Based on article 32 of Polish Constitution[60] everyone are entitled to be treated equally and no one can be discriminated. This non-discrimination principle is addressed to everyone and not limited to its own national. Thus, Poland has rejected non-discrimination treatment of any person, regardless of its nationality. Moreover Poland is a member of the EU and it is obliged to applied non-discrimination principle to all EU nationals. However, it is argued that despite a very long-standing and clear legal prohibition on discrimination, there remain many obstacles which inhibit the right.

An example of obstacle, might be lack of possibility to offset of losses from a foreign subsidiary. The Polish Tax Authority justifies the position by the fact that profits from the foreign subsidiary are not taxable in Poland[61]. It means that Poland decided that if the Tax Authority could not get revenues from a source, the losses from that source could not be deducted. According to existing agreements on avoiding double taxation, Poland is allowed to offset losses incurred only in Austria and Belgium[62]. Losses from other member states cannot be offset.

Moreover, this issue has not been discussed in the literature. It is considered to be obvious that an entity that is not liable to taxation in Poland cannot offset losses incurred in a different jurisdiction. The only theoretically possible situation is the creation of the tax group.

Secondly, The Polish legal system provides for the possibility of creating Tax Capital Groups [Podatkowe Grupy Kapitalowe] (Tax Group). A Tax Group entitles the parties to joint assessment of costs and profits. It may provide substantial benefit for members of a Tax Group. According to article 1a Income Tax on Legal Persons Law [Ustawy o Podatku dochodowym od osob prawnych] (CIT) Act, joint stocks and limited liability companies [spolki kapitalowe][63] have the opportunity to establish Tax Group. Nonetheless, the CIT provides that all members of a Tax Group must have their seats

[58] The first £10 million from 6 April 2011, so medium enterprises might be affected. However, it is not open to some business vehicles, for example, limited liabilities companies, and has some ceilings.

[59] CTM03710 – Corporation Tax: small profits relief: associated companies – detailed provisions – introduction: http://www.hmrc.gov.uk/manuals/ctmanual/ctm03710.htm.

[60] Article 32 Constitution of the Republic of Poland dated on 2nd April 1997 (Dz.U. 1997 Nr 78 poz. 483) 1) All persons shall be equal before the law. All persons shall have the right to equal treatment by public authorities. 2) No one shall be discriminated against in political, social or economic life for any reason whatsoever.

[61] This kind of reasoning has been denied; for example, in *Deutsche Shell*, which is broadly discussed below. What is more, the solution provided by the Polish tax system seems to be contrary to rulings of the CJEU, as for example in *Marks & Spencer*. In this case, the CJEU ruled that the final loss should be deducted if the non-resident subsidiary cannot offset the loss in the State of residence.

[62] It is highly criticised that Poland has opted out of the EU law by concluding bilateral international agreements with other member states.

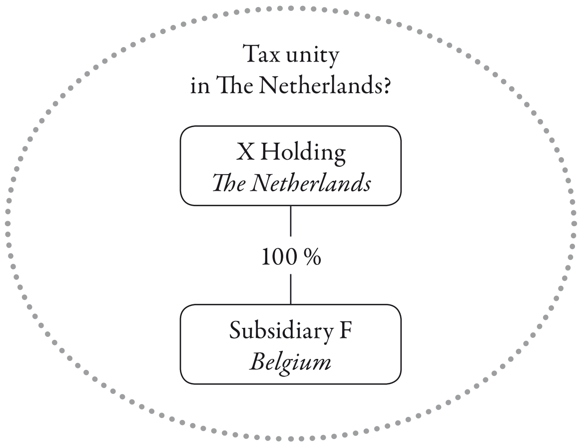
[63] Associations of companies – translation provided by J. Pienkos *Legal dictionary [Słownik prawniczy]*, Zakamycze, Zakamycze, 2002.

in Poland and be effectively managed from Poland. If a controlling company does not possess its seat in Poland, a Tax Group cannot be formed[64]. Moreover, neither a non-resident subsidiary nor a branch can become part of a group. A Tax Group can be established in the form of a notary act only after registration with the Polish Tax Authority[65]. These provisions constitute the discrimination of non-residents undertakings and seriously obstruct the freedom of establishment.

The issue has been raised by the CJEU in the case *X Holding*. The Dutch "tax unity", presented in this seminal case, serves the same aim as Polish tax groups as it provides an opportunity to constitute a consolidated tax entity between companies belonging to the same group. It is necessary to refer back to *X Holding*[66]. In this case the CJEU ruled that a member state is allowed to limit a right for constituting tax unity for a domestic subsidiary only.

In *X Holding*[67], a Dutch parent company claimed 'tax unity' with its subsidiary in Belgium. The Dutch "tax unity" law provides an opportunity to constitute a consolidated tax entity between companies belonging to the same group. According to article 15 of a corporation tax law from 1969, a parent company and one or more subsidiaries owned to 95% could be taxed as one entity. All assets and activities are deemed to be undertaken by a parent company. As a result, all internal transactions are deemed not to exist and a group can submit only one tax return. The tax is levied only on the parent company for all companies included in the tax unity.

Figure 2. Tax unity




The CJEU denied the right for a Dutch parent company to constitute a tax unity with its Belgian subsidiary[68]. The CJEU concluded that the home member state is not obliged to apply the same tax scheme to non-resident subsidiaries and to foreign permanent establishment[69]. The CJEU pointed out the risk of a shift of income from Belgium to The Netherlands[70]. The Court noted that a significant risk of double deduction of losses exists.

When considering the factual situation outlined in *X Holding*, the question that needs to be posed and answered is whether the business may establish a subsidiary. It must be restated that a Polish subsidiary cannot surrender losses incurred by a foreign parent company. Moreover, a foreign subsidiary of a Polish company cannot establish a tax group, and thus losses incurred are not deductible. Likewise, the taxation of groups is in accordance with the current *acquis communautaire*, but its compatibility with Polish Constitution might rise a question.

## Summary

Finally, it is concluded that there is observed reverse discrimination can be observed in both selected member states: the United Kingdom and Poland. On the one

[64] Some authors suggest that in order to ensure full implementation of the EU freedoms, losses from controlled foreign companies should be offset by the 'Polish mother' company. It will not be possible to register CFC with the Polish Tax Authority, but if all other conditions are met, the offset should be allowed. However, this cannot be implied directly from the Law. Ł. Adamczyk, H. Litinczuka, *Direct Taxation. Polish Law and Community La, (author translation) – oryginal title Podatki Bezpośrednie. Prawo Polskie a Wspólnotowe*, Oficyna Prawa Polskiego, Warszawa 2009, p. 421.

[65] To operate as TCG very strict requirements (i.e. high share capital) are posed. At the end of 2005 there was only two operating CTG at all. K. Szymański *Taxing capital companies. Mergers, divisions and restructure. (author translation) – oryginal title Opodatkowane spółek kapitałowych. Polaczenia Podziały i inne czynności restrukturyzacyjne* Wolters Kluwer, Warszawa 2006, p. 411.

[66] C-337/08 *X Holding* [2010] ECR I-1215.

[67] Ibid.

[68] There was a suggestion to compare a subsidiary with PE but this was rightly denied by the CJEU. The proper comparator seems to be resident and non-resident subsidiaries (vertical comparison).

[69] C-337/08 *X Holding* [2010] ECR I-1215.

[70] J. Monsenego *Taxation of Foreign Business Income within European Internal Market* Göteborg, Intellecta Infolog, 2011, p. 178.

hand, the UK national system does not guarantee its own national the most favoured treatment and their situation can be worse than non-nationals. On the other hand, Poland did not accept any form of discrimination and this fundamental right is provided in the Constitution. However, discriminatory treatment can be observed in practice, in both member states.

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