

Latvian Tax & Legal Alert

The current issue of Tax & Legal News focuses on the following developments:

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CARRY OVER OF LOSSES WITHIN THE GROUP OF COMPANIES AMONG EU RESIDENTS: MARKS & SPENCER CASE AT THE EUROPEAN COURT OF JUSTICE

RECENT PROPOSALS FOR AMENDMENTS IN CUSTOMS LAW

CARRY OVER OF LOSSES WITHIN THE GROUP OF COMPANIES AMONG EU RESIDENTS: MARKS & SPENCER CASE AT THE EUROPEAN COURT OF JUSTICE

At the European Court of Justice (ECJ) a hearing took place in the case where the Court of the United Kingdom (UK) seeks an opinion from the ECJ, whether the UK Law prohibiting the parent company (UK resident) to offset the losses that are incurred by the subsidiaries of this undertaking in other EU Member States against its profits earned in UK and accordingly taxed by UK Corporate Income Tax, complies with the principles of EU Common Market: Article 43 of the Treaty establishing the European Community (right of establishment) and Article 48 (freedom to provide services). UK based retail network 'Marks & Spencer' (M&S) has filed the claim with the High Court of Justice of England and Wales against the UK tax administration, the Court has suspended the proceedings and referred to the ECJ for a preliminary ruling the essentially following question: *does the existing restriction preventing a UK parent company from reducing its taxable income by offsetting its losses incurred by the subsidiaries in Belgium, France, Germany and Spain (between 1998 and 2001) may be considered as a restriction within the meaning of Articles 43 and 48, and if it may be justified under the EC law?*

The leading UK tax consultants have already acknowledged that it is a normal state practice and in principle complies with generally accepted international taxation principles that losses between parent company and subsidiaries may be carried over within one jurisdiction thus ensuring that the tax base is set under the same rules for both parent company and its subsidiaries, and subsequently preventing unreasoned tax base reduction. For its part EU still does not have uniform rules for calculating the tax base for undertakings operating in the Common Market.

Meanwhile widely interpreting the EC Common market principles, anything capable of hindering the undertaking to run business in another Member State or anything that causes comparatively higher expenses in case where an undertaking operates outside the territory of one Member State is to be regarded as an obstacle to the functioning of Common Market. Thus the restriction may be considered as contradicting the Common Market and therefore as abolishable, if only its existence is not objectively justified with the efficiency and uniformity of a general tax system. It should also be taken into account that income tax systems are still not harmonized in the EU. M&S has calculated that the abolishing of particular UK rules would allow it to save around 30 million GBP.

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Tax law experts have also acknowledged that the ECJ judgment could cause serious consequences also for other Member States since in fact all Member States (with few exceptions), including Latvia, have similar rules providing that losses may be taken over within group only among undertakings of one State (Section 141, Para. 7 of the law "On Corporate Income Tax"). Moreover we must take into account that ECJ in recent years have ruled in favor of considerable amount of taxpayer's claims, which are based on similar grounds about rules on tax rates when their practical application creates or potentially can create restriction on the effective operation of an undertaking within the Common Market. Although several Member States (Germany, Greece, Ireland, the Netherlands, Finland, Sweden and the UK), with the exception of France, which has traditionally been an "advocate" of Common Market principles, have expressed their view that the challenged rules may not be regarded as an obstacle to the operation of an undertaking in the Common market. In case if such an obstacle is found, it may be justified by objective grounds. The European Commission, however, defends the position that this restriction must be abolished.

It may be concluded that in case of a positive ruling for M&S it may serve as a ground also for other EU companies to file similar claims within the national courts. The provisions of the Latvian Law 'On Corporate Income Tax' (Art. 141) with respect to the carry over of losses within the group of the companies, may be challenged in such instance as well. However, for the practical application of this principle the EU-wide common criteria for the calculation of the taxable base would be needed. At least such carry over of losses between the companies situated in different Member States may be possible only in cases, where the provisions on the calculation of taxable income in different states are similar or comparable.

It follows from the above described analysis that the ruling in M&S Case would not be applicable automatically to the cases concerning the Latvian Corporate Income Tax calculation. Yet it will be binding on other Member States as well. In case it will be positive for M&S the State Revenue Service and the Parliament, as well as the national courts of Latvia, when deciding on similar cases, shall have to take a proper account of it. Still the main outcome of this case would be that it may give rise to the grounds also for Latvian taxpayers to file similar claims.

After the latest amendments to the Law 'On Corporate Income Tax', which entered into force on 1 January 2005, the definitions of the 'the main company' and 'the sub-company of the main company' have been amended. They allow now only to take into account the participation of the EU resident in the Latvian company, when determining whether these companies constitute *the group of companies* for the purposes of offsetting the losses against the taxable income of a Latvian company. The losses can still be carried over only between the '*Latvian statute companies*' (unfortunately, also this term is still not harmonised with the Latvian Commercial Law).

It has to be noted, that following the plans to complete a single market in the area of company taxation at this very moment the Common Consolidated Corporate Tax Base Working Group has been established by the European Commission for the purposes of drafting common rules for the calculation of the tax base of companies working within the Common Market. It may therefore be concluded that there appears to be a certain movement in the stagnation for the drafting of common rules for the income taxation within the EU. It is a good opportunity for the representatives of the Latvian Government to take part in the formulation of the common position and to defend interests in this field. However, taking into account that until now almost all the initiatives to harmonise the income tax aspects have remained without considerable results or at least have been very slow, it is almost impossible to make a reliable prognosis about the time frame within which the EU Member States would achieve a common sense on such EU-wide rules.

RECENT PROPOSALS FOR AMENDMENTS IN CUSTOMS LAW

At the very end of February 2005 Cabinet of Ministers of Latvia accepted the amendments to Customs Law. Proposed amendments will enter into force as soon as they will be approved by main legislative body Saeima. Two most important proposals are the following:

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- The main body responsible for issuing rulings on customs clearance and customs control shall be the Cabinet of Ministers instead of tax authority – State Revenue Service (SRS). Thus the Cabinet of Ministers will be the main institution regulating customs related questions left for decision of national authorities by European Community, in particular, by Community Customs Code (Regulation No 2913/92) and Community Customs Code Implementing Provisions (Regulation No 2454/93). Since enlargement of European Union in 2004 there are 49 rulings issued by State Revenue Service of Latvia, regulating several matters in customs field. According to national legislation of Latvia all rulings issued by other executive state authorities than Cabinet of Ministers will not be effective after 1 January 2006, thus all SRS rulings (e.g. on application of simplified customs procedures, customs duty payments, exemptions from customs duty, customs guarantees etc.) shall be re-issued as rulings of Cabinet of Ministers until the end of 2005.
- According to the proposal of Association of Customs brokers and Logistics the direct representation rights will be allowed only for customs brokers excluding other service providers. The proposal is supported by Article 5 of Community Customs Code, providing that Member State may restrict the right to make customs declarations so that the representative must be a customs agent carrying on his business in that country's territory. Association has stated that thus proper quality of services will be ensured and fraudulent activities will be eliminated.



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