International Fiscal Association

2023
Cancun Congress

cahiers de droit fiscal international

VOLUME 107

A: Sharing and shifting of corporate losses – The new profit shifting?

1938-2023

CAHIERS DE DROIT FISCAL INTERNATIONAL

Studies on International Fiscal Law
by the International Fiscal Association

Volumes 107A

107A: Sharing and shifting of corporate losses –
The new profit shifting?

General report
René Matteotti (Switzerland)

EU report
Adam Zalasiński

Branch reports

List of Cahiers published since 1939

General report Subject 1

Sharing and shifting of corporate losses – The new profit shifting?

René Matteotti (Switzerland)

Sharing and shifting of corporate losses – The new profit shifting?

Table of contents

General reporter

René Matteotti (Switzerland)[1]

Summary and conclusions

The topic of corporate losses has been the subject of research over the years. In times of economic downturn, the issue is of utmost relevance. The reasons for this are evident. Corporations contribute a significant share to a state's tax revenues. Due to the possibility of carrying forward losses in most countries, an economic downturn can affect tax revenues for years, even after the economy has recovered and companies start generating profits again. It is therefore not surprising that numerous countries regulate the tax treatment of losses and restrict the offsetting of economically incurred losses in different ways to ensure the stability of tax revenues, which can be considered a fiscal-budgetary principle. In contrast, companies that are primarily accountable to their shareholders have an interest in being able to effectively compensate for economically incurred losses in accordance with the ability-to-pay principle and the total profit principle derived from it.

National legislators face the challenge of balancing the ability-to-pay principle and fiscal-budgetary stability, taking into account additional factors such as neutrality, practicability, economic policy, and EU law. These considerations result in diverse national regulations on loss offsetting, which can become subject to national and international tax planning by companies. The OECD 2011 Report on "Corporate Loss Utilization through Aggressive Planning" identified concerns about tax planning with losses, including reorganizations, group taxation, foreign permanent establishments, hybrid arrangements, and artificial losses.

Subject 1 of the 2023 IFA Congress "Sharing and shifting of corporate losses – the new profit shifting?" examines how corporations can claim economically incurred losses, planning possibilities for shifting losses or creating artificial losses, and the impact of financial crises and BEPS measures on loss offset rules. Findings from the 39 branch reports and the EU law report reveal the following conclusions:

1. It can be firmly stated that the loss offset regimes in all states lag far behind the ideal of the total profit principle. Due to budgetary considerations, states rely on loss carryforward rules and are reluctant to allow taxpayers to carry back losses. However, even the loss carryforward options are often limited in terms of time or amount, as the carryforward can frequently only be offset against a certain percentage of taxable profit before the offset. To make matters worse, only a few countries (Mexico, Uruguay, and to a limited extent, Australia) seem to provide for an inflation adjustment of loss carryforwards.

[1] Professor of Law, Chair in Swiss, European and International Tax Law at the University of Zurich, and Of Counsel with Tax Partner AG, Switzerland.

Essential parts of this general report were prepared at Northwestern University Pritzker School of Law in Chicago. I would like to express my sincere gratitude to Philip F. Postlewaite, Harry R. Horrow Professor of Law and Director of the Tax Program at Northwestern University Pritzker School of Law, for enabling a productive and inspiring research stay in Chicago.

2. The Covid-19 crisis prompted temporary legislative changes in approximately 40% of participating countries, focusing on both temporary loss carryback and flexible carryforward regulations.
3. As far as loss shifting in the framework of reorganizations is concerned, most of the 39 countries deny the transfer of loss carryforwards from one taxpayer to another one if there is a change of ownership (change of ownership test) and the previous loss generating activity is not continued (continuity of activity test) after the reorganization. Economic policy considerations play an important role in determining whether loss carryforwards can continue to be utilized in cases of ownership change and change of business. Countries that apply a generous continuity-of-business test create a favorable tax environment for businesses to adapt to constantly changing economic conditions, including technological advancements, digitization, and consumer behavior. In contrast, those countries that completely exclude loss transfer, such as Brazil, Peru, Panama, Mexico, and Uruguay, or make it dependent on meeting strict change of ownership tests (e.g., Argentina, Poland, and Finland) or strict continuity-of-business tests with stringent time constraints, are driven not only by fiscal and budgetary considerations but also by employment policy considerations, as exemplified by Italy, Japan, and the Republic of Korea. However, such strict regimes run the risk of inhibiting structural change, which ultimately led New Zealand and Australia to amend their legislation and administrative practices in recent years.
4. It is remarkable how widespread group taxation systems are nowadays. Out of the 23 OECD member states, 20 allow for intra-group loss offsetting. Group taxation systems are providing significant relief in the absence of or limited loss carryback rules. The benefits for small and medium-sized enterprises (SMEs) require further examination. A notable, albeit not surprising, finding is the complete absence of South American countries among the countries with group taxation regimes. States implementing group taxation regimes include provisions to prevent the offsetting of pre-entry losses with group profits or profits of other group members. Exit provisions aim to prevent the double utilization of loss carryforwards.
5. The ability-to-pay principle requires that incurred losses from foreign branches are deducted from the corporation's profits. Both the credit method, which allows for the immediate deduction of foreign permanent establishment losses, and the exemption method with loss offset at the time the losses are realized by the foreign permanent establishment, respect the ability-to-pay principle. However, some countries' liberal approach of allowing the importation of foreign permanent establishment losses has been used in the past through various structures to deduct the same loss in different countries. Looking at the rules in the individual states, it is fair to say that the double use of foreign branch losses is largely prevented today both when applying the credit method and the exemption method with loss offset. The anti-hybrid mismatch rules recommended in Action 2 of the BEPS project, which have been implemented in numerous states in recent years, are likely to prevent the double or multiple utilization of foreign permanent establishment losses in many states if this has not already been restricted earlier due to the adoption of SAARs.
6. Unsatisfactory situations arise in countries that disallow the offsetting of foreign branch losses. This is particularly prevalent in South America. In the EU, the recent overturning of the ECJ's case law on final losses in the W. case (C-538/20) has created new challenges for companies, leaving them vulnerable to over-taxation if the final losses cannot be carried back due to the lack of provisions for loss carryback

or offsetting against the profits of another group member within a group taxation regime.
7. The branch reports suggest that the dual or multiple use of the same loss in hybrid arrangements remains sporadic after twelve years since the 2011 OECD Report. South American countries have not implemented BEPS Action 2 recommendations, but their strict regulations limit tax planning with loss importation via hybrid mismatch arrangements. Hong Kong and Singapore's territorial tax systems also prevent cross-border loss importation. In contrast, India allows the double use of the same loss for foreign companies with dual residence. Challenges also persist with trusts. Meanwhile, most EU member states, Australia, the UK, and New Zealand have successfully addressed concerns about dual and multiple loss use in hybrid mismatch arrangements.
8. Artificial loss creation varies across countries, with some effectively preventing it through anti-abuse provisions. Challenges related to artificial losses exist in countries such as Australia, Canada, Denmark, Luxembourg, the Netherlands, New Zealand, Poland, and Italy. However, they are addressed through GAARs or SAARs.

This report attempts to address the provocative question: Is corporate loss sharing and shifting the new profit shifting? The short answer is no. At least, the evidence from the branch reports does not support the view that corporate loss sharing and shifting is the new profit shifting.

Part One: Introduction

1.1. Complexity of the topic due to conflicting policy goals

The topic of corporate losses has been the subject of research over the years, both from a domestic and an international perspective. In times of economic downturn, the issue is of utmost relevance, not only from an academic but also from a practical standpoint. The reasons for this are evident. Corporations contribute a significant share to a state's tax revenues.[2] Losses incurred by companies during an economic crisis have a significant impact on tax revenues.[3] Due to the possibility of carrying forward losses in most countries,[4] an economic downturn can affect tax revenues for years, even after the economy has recovered and companies start generating profits again.[5] In other words, an economic upturn does not automatically lead to an immediate increase in tax revenues. The increase in tax revenues

[2] OECD, *Corporate Tax Statistics* (OECD 2022), at pp.3.

[3] OECD, *Corporate Loss Utilisation through Aggressive Tax Planning* (OECD 2011), at p.9 [hereinafter OECD, *Corporate Loss Utilisation*]; OECD, *Addressing Tax Risks Involving Bank Losses* (OECD 2010), at p.7 [hereinafter OECD, *Addressing Tax Risks*].

[4] See OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint Inclusive Framework on BEPS* (OECD 2020), at para. 286 [hereinafter OECD, *Tax Challenges Arising from Digitalisation*].

[5] OECD, *Fundamental Reform of Corporate Income Tax*, (OECD 2007), at para. 4.1 seqq.; OECD, *Tax Challenges Arising from Digitalisation*, *supra* n. 4, at para. 299 seq.; M. Burda & C. Wyplosz, *Macroeconomics: A European Text*, at s. 17.3.1. (2017); R.A. Brealey et al., *Principles of Corporate Finance*, at s. 18.3. (2020).

may be delayed due to the possibility of offsetting carried-forward losses over an extended period.[6]

Losses incurred during an economic downturn can therefore jeopardize the stability of tax revenues.[7] The reliability of corporate taxes is a pillar of stable fiscal policy, aiming to ensure a reliable source of income for the state budget to finance public expenditures and support sustainable economic growth. If state revenues fluctuate or are uncertain, it can lead to budget deficits, debt problems, and economic uncertainties.[8] It is not surprising, therefore, that numerous countries regulate the tax treatment of losses and restrict the offsetting of economically incurred losses in different ways to ensure the stability of tax revenues, which can be considered a fiscal-budgetary principle.[9]

In contrast, companies, primarily accountable to their shareholders, have an interest in being able to offset economically incurred losses effectively. The ability to offset economically incurred losses is a requirement of taxation according to the ability-to-pay principle.[10] National legislators face the challenging task of balancing the ability-to-pay principle and the fiscal-budgetary principle of tax revenue stability. As will be shown, this balancing act is carried out differently in various countries, taking into account additional aspects. These include, amongst others, the tax policy principles of neutrality and practicability, as well as economic policy considerations, particularly in terms of location. The latter also influences the decision on whether foreign losses can be offset or if the offsetting is limited to domestic losses. EU member states also need to consider the freedom of establishment and the relevant case law of the European Court of Justice (ECJ) in this regard. The balancing of various, sometimes diverging interests by the legislator ultimately depends on the relationship between the ability-to-pay principle and the fiscal-budgetary principle of tax revenue stability. Are these two principles considered of equal importance, allowing the legislator significant discretion in weighting them, or is the ability-to-pay principle understood as a fundamental or even constitutional principle of justice that generally takes precedence over the more technical principle of tax stability?

The diverse aspects considered by national legislators in their decision-making process result in significant divergences in national regulations regarding the offsetting of losses. The more a legislator tries to restrict loss offsetting, the more it might become a subject of national and international tax planning by companies.[11] This, in turn, prompts tax authorities and legislators to combat abuses, driven by concerns about the integrity of the tax system and revenue planning. The inherent conflict between the postulate of revenue continuity and taxation based on the ability-to-pay principle can, in the worst case, result

6 IMF, *Corporate Taxation in the Global Economy* (IMF 2019), at para. 13; IMF, *Home or Away: Profit Shifting with Territorial Taxation* (IMF 2022), at para. 6; IMF, *International Corporate Tax Reform* (IMF 2023), at para. 18; OECD, *Tax Incentives and Global Minimum Corporate Tax* (OECD 2022), at para. 18; OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2022), at para. 4.1 seqq.

7 N.G. Mankiw & M.P. Taylor, *Economics*, at pp. 179 (2020); P. Krugman & R. Wells, *Economics*, at pp. 197 (2013).

8 D. Romer, *Advanced Macroeconomics*, at s. 13.3. (2019): "[…], *wars and recessions are times when the expected future ratio of government purchases to output is less than the current ratio. Consistent with the tax-smoothing model, we observe that governments usually run deficits during these times*.".

9 See here: Mankiw & Taylor, *supra* n. 7, at pp. 668; Krugman & Wells, *supra* n. 7, at pp. 819.

10 OECD, Tax Challenges Arising from Digitalisation, *supra* n. 4, at para. 302: "*The loss carry-forward is needed to prevent taxation in excess of economic income under the GloBE rules*."

11 See also: J. Lüdicke et al., *Cross Border Loss Utilization*, Bull. Intl. Taxn. 6/7, at s. 6.1. (2014), Journals IBFD.

in a cat-and-mouse game between tax authorities and taxpayers, leading to a confusing tangle of anti-abuse provisions, which already exists in some countries.

1.2. OECD's work

In recent years, the topic of loss utilization has received significant attention from the OECD. Prompted by the high amount of losses incurred in the financial sector during the financial crisis - estimated at USD 1.3 trillion in 2010 - the OECD published the report "Addressing Tax Risks Involving Bank Losses" in the same year.[12] In 2011, shortly before the launch of the OECD/G20 Inclusive Framework's Base Erosion and Profits Shifting ("BEPS") project, the report "Corporate Loss Utilization through Aggressive Planning" was published.

The OECD 2010 report was based on information from 17 countries, Australia, Canada, Denmark, France, Germany, Ireland, Italy, Mexico, the Netherlands, New Zealand, Spain, Switzerland, the United Kingdom (UK), and the United States of America (USA). In its analysis, the OECD found that the losses incurred by banks worldwide during the financial crisis posed a significant risk not only to tax authorities but also to the banks themselves.[13] It estimated the globally realized and unrealized bank losses to be at least USD 700 billion, resulting in tax revenue losses of around USD 230 billion. The OECD emphasizes in its report that the complexity of national loss utilization regulations can be exploited cross-border, and tax authorities must be vigilant regarding potential tax compliance risks arising from aggressive tax planning.[14] This is particularly relevant in countries that provided substantial support to the banking sector or directly participated in banking institutions. As the OECD 2010 report indicates, the relationship between the tax losses carried forward and the possibility, in individual countries, to include tax losses in regulatory capital should also be considered for banks. Such regulatory treatment, on the one hand, reduces incentives for a bank to derive benefits from transferring these losses outside the group.[15] On the other hand, it increases the incentive to engage in tax planning to ensure that the losses are deductible.[16] Only then can the losses be activated as Deferred Tax Assets (DTAs) and potentially attributed to regulatory capital.[17] If such recognition as DTA is not possible, there is an incentive to sell the losses.

The OECD 2010 report identifies the following areas where tax planning related to loss utilization takes place:

- Transfer pricing, where transactions not in line with the arm's length principle are conducted to shift losses.
- Reorganizations involving the transfer of profits or losses, including tax planning techniques that anticipate probable losses or exploit Controlled Foreign Company (CFC) rules to import foreign losses.
- The use of financial instruments for the transfer of profits or losses.

12 OECD, *Addressing Tax Risks supra* n. 3, at p.7
13 OECD, *Addressing Tax Risks supra* n. 3, at p. 64.
14 OECD, *Addressing Tax Risks supra* n. 3, at p. 9.
15 OECD, *Addressing Tax Risks supra* n. 3, at pp. 46.
16 OECD, *Addressing Tax Risks supra* n. 3, at pp. 46.
17 OECD, *Addressing Tax Risks supra* n. 3, at pp. 46.

- Circumvention of national regulations, particularly through reorganizations or the use of financial instruments, that restrict loss utilization.
- Exploitation of different rules for realizing losses related to loans and securities, which may be accounted for under the realization principle in some cases and the impairment principle in others.
- Circumvention of national ring-fencing rules that do not allow losses to be offset against unrelated income.
- The use of hybrid mismatch arrangements (hybrid financial instruments, hybrid entities, and dual-resident entities) to enable multiple deductions of losses.
- Back-to-Back arrangements.

The report acknowledges that banks expect economically incurred losses, confirmed by auditors, to be recognized by tax authorities.[18] It concludes with recommendations for both tax authorities and banks to balance the interests of both parties. Tax authorities should provide clear guidance on loss offsetting, engage in real-time discussions with taxpayers, and find solutions. Potentially risky situations that tax authorities plan to investigate should be communicated in a timely manner.[19] Meanwhile, banks are advised to engage in dialogue with tax authorities, be transparent, address uncertainties, and consistently apply transfer pricing guidelines.[20]

In its 2011 report, the OECD further analyzed the tax treatment of corporate losses. While the 2010 report also examined the issue of loss offsetting from the perspective of taxable banks and their interest in being able to offset actual incurred losses, the 2011 report primarily focused on combating aggressive tax planning using corporate losses. The 2011 report's purview was not limited to banks. Once again, the OECD compiled the legal framework and practices of the 17 countries that participated in the 2010 report.[21] The 2011 report also highlights the significant differences in loss offsetting rules among the countries involved in the study.[22] The core areas identified by the OECD 2011 Report where tax planning is carried out with losses are the following: reorganizations, the use of financial instruments, and the determination of transfer prices.[23] These techniques are used to shift losses and circumvent regulations limiting loss carryforwards, such as time limitations or the exclusion of loss offsetting in cases of change of ownership or business activity. In particular, financial instruments are used to create artificial losses, i.e., losses claimed even though the taxpayer did not incur an actual loss, or to deduct losses multiple times. The purpose of the OECD 2011 Report was to raise awareness among tax authorities regarding the areas and techniques of aggressive tax planning using losses and to show how they can detect and combat such practices. In this regard, the report notes that aggressive tax planning models involving losses are typically discovered during tax audits or disclosure initiatives.[24] Specific reporting obligations for losses, mandatory disclosure requirements, tax rulings, and cooperative tax compliance programs are mentioned as disclosure initiatives. According to the OECD's

18 OECD, *Addressing Tax Risks supra* n. 3, at pp. 38.

19 OECD, *Addressing Tax Risks supra* n. 3, at pp. 10.

20 OECD, *Addressing Tax Risks supra* n. 3, at pp. 10.

21 OECD, *Corporate Loss Utilisation supra* n. 3, at p. 3.

22 OECD, *Corporate Loss Utilisation supra* n. 3, at p. 63.

23 OECD, *Corporate Loss Utilisation supra* n. 3, at p. 3.

24 OECD, *Corporate Loss Utilisation supra* n. 3, at p. 10.

findings, general and specific anti-abuse provisions are applied to combat aggressive tax planning models involving losses.

The OECD Report 2011 made the following recommendations to the states:[25]

- They should consider regulations that restrict the offsetting of losses, including so-called built-in losses, in the context of mergers, acquisitions, or group taxation arrangements in cases of aggressive tax planning.
- They should limit the multiple use of the same loss.
- They should particularly analyse the policy concerns and tax compliance issues related to models such as after-tax hedges and evaluate possible defensive measures against them.
- They should assess the economic and fiscal impact of temporary measures for loss offsetting to determine whether they should be abolished, extended, or made permanent.
- Finally, they should introduce specific reporting obligations related to losses, as well as cooperative tax compliance programs, and continue the exchange of information between authorities regarding aggressive tax planning involving losses, their detection, and the effectiveness of selected strategies to generate additional tax revenue or increase tax compliance.

Although the OECD attaches great importance to the issue of aggressive tax planning, it did not explicitly include it in the list of 15 action points of the BEPS (Base Erosion and Profit Shifting) project launched in 2013. However, the topic of loss offsetting is mentioned in various contexts.[26] This will be discussed later.

1.3. Former treatment of the subject by IFA

At the 2023 congress, IFA is naturally not addressing the offsetting of corporate losses for the first time. As early as 1979, the congress focused on the impact of losses in one country on the profits of a company or affiliated entities in other countries within multinational enterprises.[27] The report was based on 24 branch reports[28] and examined whether and how the administrations of those countries where the enterprise has affiliates or establishments:

- Allow the offsetting of losses across tax borders of individual establishments or affiliates;
- Ensure that taxes are imposed only on net profits after compensating for profits and losses of establishments or affiliates in different countries; and
- Treat enterprises engaged in international activities as a unified entity.[29]

25 OECD, *Corporate Loss Utilisation supra* n. 3, at p. 11.

26 OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report* (OECD 2015), at para. 244; OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2: 2015 Final Report* (OECD 2015), at para. 1 [hereinafter OECD, *Action 2: 2015 Final Report*]; OECD, *Action 2: 2015 Final Report* (OECD 2015), at para. 201; OECD, *Designing Effective Controlled Foreign Company Rules, Action 3: 2015 Final Report* (OECD 2015), at para. 99; OECD, *Measuring and Monitoring BEPS, Action 11: 2015 Final Report* (OECD 2015), at para. 178; OECD, *Mandatory Disclosure Rules, Action 12: 2015 Final Report* (OECD 2015), at para. 118 seqq.

27 See G. Laule, *Denmark*, *The effect of losses in one country on the income tax treatment in other countries of an enterprise or of associated companies engaged in international activities* (IFA Cahier de droit fiscal international vol. 64b, 1979), at 1 seqq.

28 Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Israel, Italy, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Sweden, Switzerland, UK, USA, Uruguay.

29 G. Laule, *supra* n. 27, at s. 1.

In 1998, the offsetting of corporate losses was systematically examined through a comparative legal analysis during Subject 1 of the IFA Congress in London.[30] Thirty-four countries participated in the study.

Moreover, aspects of loss offsetting were repeatedly incorporated into various other subjects and seminars in the following years.[31] Some noteworthy examples include group taxation regimes that enable the offsetting of losses between group companies. Another instance is observed in operating companies with trading interests, where expenses can be offset against other income.

It is worth recalling the seminar “Cross-Border Loss Utilization” chaired by Jürgen Lüdicke[32] during the 67th Congress of the IFA, held in Copenhagen on 26 August 2013.[33] The seminar focused on the offsetting of foreign corporate losses, including those received or attributed through a tax transparent partnership. It is evident that the work carried out by the OECD in 2010 and 2011 inspired this seminar. Although the panel discussion in Denmark was more specific than Subject 1 of the 2013 IFA Congress, it undoubtedly covered an important aspect of this year’s seminar as well. Seminar C considered different aspects of cross-border loss utilization, including systematic and policy considerations, possibilities and limitations, and anti-avoidance measures.

Jürgen Lüdicke and the other panelists[34] discussed cases related to the offsetting of losses from foreign permanent establishments, losses from foreign subsidiaries, and the issue of double deduction of losses within a group, which may result from the tax regulations of the state where the parent company is located if a state extends group taxation to include partnerships or hybrid entities.[35] The work of the OECD on the 15 Action Points of the BEPS project had just begun. Regarding the provisions aimed at neutralizing the effects of hybrid mismatch arrangements, only public discussion drafts were available, leading the panel participants to believe that the OECD would not find a simple solution to the issue of double loss offsetting.[36] The panelists demonstrated convincingly that excessive anti-abuse measures increase the risk of double taxation.[37] They warned that the gap between taxpayers’ expectations and the overall development of tax law, which has been strongly influenced by the OECD’s engagement in recent years, would continue to widen. Lawmakers are urged, in future legislative projects, to consider both the principle of neutrality and the

30 A. Michelsen, *London, Tax Treatment of Corporate Losses*, (IFA Cahiers de droit fiscal international vol. 83a, 1998), at sec 1.1 seqq.

31 J. Hey & A. Schnitger, *Germany, Group approach and separate entity approach in domestic and international tax law*, (IFA Cahiers de droit fiscal international vol. 106a, 2022) at s. 1.3.2.; J. Gadwood & P. Morton, *London, Interest deductibility: the implementation of BEPS Action 4*, (IFA Cahiers de droit fiscal international vol. 104a, 2019), at sec 3.1.2; Lüdicke, *supra* n. 11; References to older seminars that address specific aspects of loss offsetting can also be found here: Laule, *supra* n. 27; Michelsen, *supra* n. 30.

32 Jürgen Lüdicke, who passed away too soon, was posthumously awarded honorary membership at the 2022 IFA Congress. He was a sharp-thinking tax jurist, a gifted speaker, and a true member of the IFA community.

33 Seminar C of the 67th Congress of the International Fiscal Association (IFA) held in Copenhagen on 26 August 2013. Seminar C considered different aspects of cross-border loss utilization, including systematic and policy considerations, possibilities and limitations, and anti-avoidance measures; For more information on this, please refer to: Lüdicke, *supra* n. 11.

34 Lüdicke, *supra* n. 11,s. 6.1. (2014), Journals IBFD).

35 See also: Lüdicke, *supra* n. 11, at sec. 5.3.

36 Lüdicke, *supra* n. 11, at s. 5.3.

37 Lüdicke, *supra* n. 11, at s. 7.

justification for loss offsetting.[38] In the cross-border context, coordination of regulations is necessary since most cases of double taxation and double non-taxation are the result of mismatches of domestic rules. Striking the right balance between the legitimate demand for eliminating over-taxation resulting from the non-recognition of foreign losses and the equally legitimate need to prevent companies from engaging in double loss offsetting is crucial.

The panelists of the seminar conducted around ten years ago confessed that companies engage in tax planning involving losses. Such planning is considered legitimate, not abusive, given the sometimes criticized national regulations that restrict loss offsetting. From their discussions, the panelists drew the following conclusion:

> "[I]t is fair to say that cross-border loss utilization remains an issue for business as well as for governments. In many countries, many of the rules are not completely satisfactory. This is true from a systematic and policy point of view as well as from a business perspective. Anti-avoidance rules are, of course, legitimate. Nevertheless, their introduction requires good judgment by policymakers of what is really necessary – in a triangle between justified business needs, legal certainty for cross-border commercial activities, and the public interest."

1.4. Subject 1 of the 2023 IFA Congress: Scope and structure

Although various key aspects of loss utilization have been addressed in the past, the dynamic evolution of tax law in the last decade and the experiences gained with losses during the financial and economic crisis justify once again making loss utilization the subject of an IFA Congress.

The international tax policy of the last decade was marked by the financial and economic crisis of 2007-2009: Companies worldwide generated significant losses during this period. As a result, public budgets faced government deficits, which in turn called for measures to stabilize public finances. The reports published by the OECD in 2010 and 2011 are to be seen in this context. The increased international cooperation reached its preliminary peak with the establishment of the OECD/G20 Inclusive Framework on BEPS, which on March 16, 2016 adopted minimum standards in the corporate tax area as well as recommendations to combat BEPS. The direction of these measures is clear: States were given tools for internationally coordinated, more restrictive tax policies in the hope of increasing or at least stabilizing state revenues. In addition to the already strained financial budgets, the COVID-19 pandemic in 2020 further exacerbated the fiscal challenges faced by many countries worldwide.[39] The widespread lockdowns and economic restrictions are likely to have led to new, partially significant potential for tax loss carryforwards in certain industries globally. At the same time, government spending increased to cushion the impact of the pandemic on the economy and the population. It is also important to consider the Ukraine conflict, which has led to an increase in defense spending in some countries or at least an

[38] Lüdicke, *supra* n. 11, at s. 7.

[39] IMF, *The Impact of the IMF's COVID-19 Support to Developing and Emerging Economies* (IMF 2022), at p. 33 seq.; IMF, *Tracking Economic and Financial Policies during COVID-19* (IMF 2022), at p. 2; OECD, *Tax and Fiscal Policies after the COVID-19 Crisis* (OECD 2021), at pp. 3.

increase in political pressure for such an increase.[40] In this geopolitical context, it is not surprising that both the OECD and the EU would prefer to see the implementation of global minimum taxation sooner rather than later.[41]

The following 39 IFA branches participated in the present study: Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, Chinese Taipei, Denmark, EU, Finland, France, Germany, Hong Kong, India, Israel, Italy, Japan, Republic of Korea, Liechtenstein, Luxembourg, Mauritius, Mexico, Netherlands, New Zealand, Norway, Panama, Peru, Poland, Portugal, Singapore, South Africa, Spain, Sweden, Switzerland, Türkiye, United Kingdom, Ukraine, Uruguay, and the United States.

With regard to the previous work on the utilization of corporate losses (see Part One/ chapters 2 and 3 above) and in light of the outlined developments in recent years, the present General Report is structured as follows:

In Part Two, the first focus is on examining how a taxable corporation can utilize the losses it has incurred in each jurisdiction where they occurred. A distinction is made between current loss offset and inter-period loss offset. Current loss offset refers to the tax utilization of losses in the tax period in which they were incurred. If there is a loss surplus, the question arises whether it can be offset against previously generated profits (referred to as loss carryback) or future profits (referred to as loss carryforward). The more comprehensive the ability of a taxable company to utilize losses on its own, the less pressure there is to shift incurred losses to other domestic or foreign taxpayers.

Previous studies, particularly those conducted by the OECD, have shown that reorganizations and group taxation regimes are commonly used for loss trafficking purposes, in order to shift losses onto other taxpayers. These topics are the focus of Parts Three and four.

Part Five is dedicated to foreign permanent establishment losses. Previous studies have shown that the various regulations in individual countries regarding the recognition of losses from foreign permanent establishments are particularly susceptible to being used to claim the same loss in two countries. Part Five examines how often this happens and, if so, what measures different countries have taken to prevent the dual or multiple deduction of the same loss. The cause of this is the interaction between the rules governing the recognition of foreign losses in one country and the loss offset rules applicable in another country.

According to the OECD reports in 2010 and 2011, hybrid mismatch arrangements can be used to claim the same economic loss as a deduction in two or more countries. They are the subject of Part Six.

So-called artificial losses, which are also highlighted as a central issue in the OECD reports published in 2010 and 2011, represent another focal point of this General Report. Part Seven presents the extent to which artificial losses continue to be a problem in the examined countries today and how states are attempting to curb their claiming through General Anti-Avoidance Rules (GAARs) and Special Anti-Avoidance Rules (SAARs).

The branch reports have revealed that, in terms of substantive impact, the anti-hybrid mismatch rules proposed in Action 2 of the BEPS measures primarily affect the utilization

40 A. MacDonald & D. Cameron, *Global Military Spending Hits Record and Amid Ukraine War, China Tensions: Military expenditure in Europe rises at fastest rate in 30 years* (2023), Wall Street Journal.

41 OECD, *Tax Challenges Arising from the Digitalisation of the Economy - Global Anti-Base Erosion Model Rules (Pillar* Two): Inclusive Framework on BEPS (OECD 2021), at p. 7 [hereinafter OECD, *Tax Challenges*]; Council Directive (EU) 2022/2523 of 14 December 2022 providing for a global minimum level of taxation of multinational groups of companies and large domestic groups in the Union.

of corporate losses. However, the measures related to Action 3 on CFC rules, Action 5 on harmful tax practices, and Action 6 on treaty abuse have either no or insignificant relevance in the examined countries regarding loss offset. The measures recommended in Action 4 on interest deduction limitation and Actions 8-10 on transfer pricing, according to the branch reports, are significant for this project insofar as they contribute to preventing the creation of losses due to excessive interest payments or non-arm's length transfer pricing. However, they do not directly impact the application or cross-border interaction of loss offset regulations in individual countries.

Based on the findings derived from the branch reports, this general report primarily focuses on the discussion of the effects of BEPS measures on the utilization and shifting of corporate losses, with particular emphasis on the anti-hybrid mismatch rules implemented in each country. Given their significance, especially in combating the multiple utilization of losses related to permanent establishment structures and hybrid arrangements, these rules are discussed in Parts Five and Six. This approach not only highlights the interaction between loss offset regulations and anti-hybrid mismatch rules more succinctly but also avoids repetition.

The OECD, in its reports published in 2010 and 2011, emphasizes the importance of disclosure requirements in combating aggressive tax planning models involving losses. Part Eight, therefore, examines whether the implementation of the recommendations contained in Action 12, which require taxpayers to disclose aggressive tax planning models, as well as the revised transfer pricing documentation requirements, including Country-by-Country Reporting, will assist tax authorities in discovering the abusive use of losses. From an academic perspective, an overreach of tax authorities and tax legislators is a concern. This occurs when anti-abuse provisions go beyond their intended scope, leading to the denial of loss utilization based solely on fiscal reasons or even resulting in double taxation. In the discussion of each part, the regulations in each country will also be evaluated from this perspective.

A central aspect of this project is also to examine the impact of the financial and economic crisis of 2007-2009, as well as the Covid-19 crisis, on the legislation and practices of individual countries regarding loss offset regulations. Where deemed appropriate based on the information provided in the branch reports, each part devotes a specific chapter to exploring the temporary or permanent measures implemented by individual states during these crises in the field of loss offset.

The 66 branch reporters have all made significant and valuable contributions to this study. They come from academia, government, and consulting backgrounds. It is important to note that when it comes to the question of which tax planning models are applied in practice and tolerated by tax authorities, scholars, tax advisors, and tax officials have different levels of experience. Agreements reached among tax authorities or through tax rulings are typically not made public due to tax confidentiality. Therefore, the branch reports and the general report cannot claim to fully reflect the practices of individual countries. Comparative law encounters limitations in this regard. Therefore, with regard to comparative legal statements on which tax planning measures involving losses are still possible in which countries, this general report intentionally adopts a highly cautious approach. However, an important goal is achieved when the general report and the branch reports can identify trends and serve as a source of inspiration for future research projects in the field of loss utilization.

When IFA designated the topic "Sharing and shifting of corporate losses: the new profit shifting" as Subject 1 of the IFA Congress 2023, the OECD/G20 Inclusive Framework on

BEPS two-pillar program was still in its early stages.[42] While the fate of the first pillar is still difficult to anticipate today, global minimum taxation is likely to be implemented in the first countries only from 2024 onwards. Since the treatment of losses under the GloBE (Global Anti-Base Erosion) rules primarily depends on the application of the GloBE rules and the national implementing provisions based on them, the questions related to GloBE are not addressed in the branch reports or the present general report. Given this context, the current general report does not delve into the various questions raised by Pillar 2, particularly in relation to corporate losses. These will be the subject of a separate academic project.

A true game-changer in the EU could be the reform project “The Business in Europe: Framework for Income Taxation” (BEFIT).[43] If this project were implemented, corporate losses could be offset across borders within the EU, and transfer pricing could no longer be used to shift losses cross-border. At least within the EU, there would be no need for it. However, the present general report will not delve further into BEFIT. Nevertheless, BEFIT reminds us that tax law could continue to develop rapidly in the coming years. What we write about loss utilization today may only interest legal historians to some extent tomorrow.

Part Two: The utilization of own losses by corporate taxpayers

2.1. Introduction

Part Two provides an overview of the basic principles of loss offset regulations in the 39 countries participating in this IFA project. The purpose of the following discussions is not to compare the regulations in detail, but rather to examine the options provided by each country to offset corporate losses and how they balance the interests of companies in offsetting economically incurred losses as fully as possible with the fiscal budgetary interests of the state in maintaining a steady stream of revenue from companies. Of particular interest is whether the various loss offset possibilities have undergone changes due to the financial and economic crisis of 2007-2009 and more recently due to the Covid-19 pandemic. The goal of the following discussions is to identify legislative tendencies and assess the risks that the existing loss offset regulations in each country pose for companies and tax authorities. The categorization of the loss offset regulations described in the following sections largely follows the OECD Report 2011. This is done primarily to increase the comparability of this general report with the OECD Report 2011 and to better capture any developments that have occurred in the last twelve years.

[42] OECD, *Tax Challenges*, *supra* n. 43.

[43] European Commission, *Communication from the Commission to the European Parliament and the Council, Business Taxation for the 21st Century*, Brussel 18 May 2021.

2.2. Sideway loss relief

2.2.1. Comprehensive income tax versus schedule tax

The first question that arises in a comparative analysis of loss offset is whether losses from one business activity can be offset against profits from another business activity within the same corporation. If such offsetting is possible, it is referred to as "sideways loss relief;"[44] otherwise, it is called "basket limitation."[45]

Whether sideways loss relief is possible largely depends on whether a profit tax system is based on the principle of comprehensive income tax or is structured as a schedule tax.

The comprehensive income tax consists of taxing the entire net profit, ensures equal treatment of all income and enables a unified individual overall tax calculation based on the ability-to-pay principle. Losses from one business activity can be offset against profits from another business activity.

In contrast, a schedule system allows certain economic activities to be subject to specific tax rates to promote or discourage them, or to mitigate perceived unjustified progression effects. Policy goals have a greater impact in a schedule tax system compared to a profit tax based on the net principle. In a schedule system, losses from one income category generally cannot be offset against profits from another income category.

As shown below, the profit tax systems of individual countries can sometimes not be clearly assigned to the two categories described above when they include elements of both the net income principle and the schedule income principle. In his 1994 general report, Aage Michelsen already noted that most of the countries he examined followed the net income principle, but there was a tendency for schedule tax provisions to spread even in countries that primarily adhere to the net income principle.[46] A similar finding was also reached by the OECD in its 2011 Report.[47]

The BEPS project has further fueled the trend towards schedule tax systems. This is due to fiscal or location policy-motivated Controlled Foreign Company (CFC) rules, patent box regimes, as well as the new inventions associated with Pillars 1 and 2, such as the top-up tax on profits of large multinational groups from foreign business units and the taxation of Amount A in market states. The branch reports also indicate that even states that tax the entire net profit apply special tax rules for certain income, which typically result in ring-fencing of losses. In addition to income from CFCs, notable examples include the participation exemption for qualified shareholdings, unilateral or treaty-based exemptions for foreign branch profits or other income from foreign sources.

2.2.2. Country comparison

The countries participating in this IFA project can be broadly divided into three categories:
1. Category: Countries without basket limitations.
2. Category: Countries with limitations on capital losses.
3. Category: Countries whose tax laws have additional or different basket limitations.

44 OECD, *Corporate Loss Utilisation supra* n. 3, at p. 30.
45 Michelsen, *supra* n. 30, at s. 2.4.
46 Michelsen, *supra* n. 30, at s. 2.1 seqq.
47 OECD, *Corporate Loss Utilisation supra* n. 3, at pp. 30.

The majority of the examined countries fall into the first category. This includes not only most European countries but also Asian countries such as Chinese Taipei, Japan, Republic of Korea, Singapore, and Türkiye, as well as Chile, New Zealand, and South Africa. The reporters of these countries emphasize that the taxation of profits in these jurisdictions is based on the principle of comprehensive net income tax respecting the net income principle. In Italy, Spain, Switzerland, and Liechtenstein, the ability-to-pay principle underlying comprehensive net income taxation is even explicitly constitutionally anchored. Most countries in Category 1 (Austria, Belgium, Chile, Denmark, France, Germany, Italy, Japan, Netherlands, Peru, Singapore, Sweden, Switzerland, Republic of Korea, Spain, Uruguay, Ukraine and Türkiye) base the determination of corporate losses on the financial statements, although the significance of this may vary among countries. The expenses recorded according to accounting rules are then subject to tax adjustment provisions. According to this two-step concept, corporate tax losses arise when allowable deductions exceed the company's income for a given tax period, both determined starting from the profit and loss statement prepared according to company law rules and/or applicable GAAPs and adjusted to the tax law provisions concerning business income. Among the countries in the first category, only Chines Taipei and South Africa follow the two-book system, in which the overall net income, including any corporate losses, is determined independently of the commercial accounts.

Systems in which capital losses cannot be offset against operational profits and operational losses cannot be offset against capital gains are particularly common in North and South America. The United Kingdom, Australia, India, and Israel also provide for separate treatment of capital losses. In countries belonging to Category 2, where capital losses cannot be offset against operational profits and vice versa, over-taxation occurs in cases where a loss in one basket cannot be offset against future or past profits from the same basket. If future offsetting is possible, the taxable company at least incurs an interest loss when the benchmark for appropriate taxation is the comprehensive net income taxation. Countries with strict ring-fencing of operational losses and capital losses include Argentina, Australia, Israel, Mexico, Panama, Poland and the United States. In the United States, losses from the sale of an asset can only be offset against gains from a comparable asset. Regarding Argentina, it should be noted that the limitation on the offsetting of capital losses applies only to losses from equity investments, securities, and digital currencies. In Mexico, non-deductible capital losses are limited to those arising from the sale of shares. In Ukraine, losses from one taxable activity can reduce taxable income derived from other activities. However, the financial result from security transactions is computed separately. Therefore, incurred losses in the securities context cannot be deducted but may be carried forward to offset future gains in such transactions, as stated by the Ukrainian branch reporter.

In Brazil, Canada, and the UK, although capital losses cannot be offset against operational profits, there is at least the possibility of offsetting operational losses against capital gains. Canada also has the unique feature that the taxable company can choose the timing for offsetting the loss.

It is not surprising that countries that segment the profits and losses of a taxable company tend to follow the two-book system approach (Australia, Brazil, Canada, Mexico, Poland, United States). The fact that separate tax treatment of capital losses requires the preparation of segmental accounts leads to a tendency for the tax-relevant company profits to become more detached from the commercial accounts. However, the special treatment of capital losses does not necessarily have to be based on a two-book system, as shown by the examples of Argentina, India, Panama, and the United Kingdom. According to the

Brazilian and the Polish branch reports, the separate treatment of capital losses can also be viewed as a SAAR that prevents non-operating assets from being sold at a significant loss that could be used to offset operating profits.[48]

Various countries introduce additional baskets that result in ring-fencing certain losses. It is worth mentioning the loss offsetting restrictions in the extractive sector in Argentina, Norway, and New Zealand. In Argentina, losses incurred in activities related to the exploration and exploitation of living and non-living natural resources carried out in the continental platform and exclusive zone, including artificial islands, installations, or structures located in such zones, can only be offset against net income from Argentine sources. This rule specifically applies to the "exploration and exploitation of living and non-living natural resources," which mainly encompasses fishing activities and the exploration and exploitation of hydrocarbons in the Argentine sea's continental platform. The policy implemented for these particular activities is to limit the utilization of losses only against profits derived from Argentine sources. For instance, Argentine resident corporate taxpayers (branches or companies) engaged in these activities in the continental platform would be "required" to undertake some other activity within the country (not abroad) if they wish to effectively utilize any losses incurred in fishing or hydrocarbon activities.

In New Zealand, there are special rules that "ring-fence" losses incurred in the business of mining specified minerals, excluding petroleum. This means that the losses from mining specified minerals cannot be offset against taxable profits from other sources.

The Finnish tax law includes a separate basket for profits from agricultural activities, which means that losses from agricultural activities cannot be offset against other business profits.

India, which has a pronounced schedular system, differentiates between the following baskets: losses from house property, business or profession (other than speculation business), unabsorbed depreciation, speculation business, and capital assets. Losses must first be offset against profits from the same basket. If there is an excess, the law allows for offsetting against profits from other baskets. The loss arising from the transfer of short-term capital assets can be set off against both short-term capital gains and long-term capital gains. However, losses from the transfer of long-term capital assets can only be set off against long-term capital gains, which are taxed at a lower rate. The law provides different time limitations for the offsetting of any carry-forward losses in the various baskets.

Finally, Hong Kong tax law provides for a specific basket for concessionary income, which is subject to lower taxation (e.g., income from aircraft or ship leasing activities or operating a qualifying corporate treasury center). However, offsetting losses from one basket against profits from another basket is still possible. To account for the different tax rates applicable to each basket and avoid distortions, the amount of loss to be offset against profits from another basket is adjusted.

In Liechtenstein, the offsetting of losses from the sale of real estate against business profits is not allowed because capital gains from the sale of immovable property are subject to a separate property gains tax.[49] In New Zealand, losses from residential rental interests

48 With respect to the schedular rules as a tool to combat the deliberate creation of tax losses see also OECD Tax Policy Studies, *Fundamental Reform of Corporate Income Tax* (OECD 2007), at pp. 75; D. Shaviro, *Corporate Tax Shelters in a Global Economy*, at pp. 6 (2004).

49 In Switzerland, a similar situation arises at the cantonal level. The question of to what extent and under which conditions losses from the sale of properties can be offset against business profits is a matter of cantonal tax law. In cases involving multiple cantons, it becomes a question of inter-cantonal tax law.

are ring-fenced, meaning they can only be offset against income from the same category.

The branch reporters from Brazil and Norway mention alternative forms of corporate taxation in their reports, which can be applied instead of the regular corporate income tax. For example, Brazilian taxable companies can opt for a tax regime that is based on a certain percentage of revenue from core business, capital gains, and other income. Such companies are not allowed to offset losses. When switching to the regular tax regime, any losses cannot be carried forward. In Norway, the Supreme Court concluded that a company incurring financial losses while subject to the Norwegian tonnage tax regime could offset those carried forward losses against future income after exiting this special regime.

2.2.3. *Impact of the 2007-2009 financial and economic crisis and the Covid-19 crisis*

The branch reports do not indicate a trend that the recent financial and economic crisis of 2008-2009 or the COVID-19 pandemic led to a relaxation or tightening of the observed basket limitations in individual states. However, the Danish branch report does mention that during the tax periods 2020-2022, in response to the COVID-19 crisis, the special Danish regime on capital expenditure allowance for R&D expenditures was increased to 130% for the income years 2020-2022.[50] Loss-making companies were also eligible for a tax credit for losses related to R&D costs, subject to certain conditions.[51] Losses from the special capital expenditures not covered by the tax credit could be carried forward.

2.2.4. *Interim conclusion*

Overall, it can be stated that in 24 out of the 39 examined countries, there is a sideway loss relief due to the taxation of the entire net profit. In the other 14 countries, however, there is a risk that losses incurred in the tax period in which they arise cannot be deducted, even if the company has generated profits. This is particularly true regarding capital losses, which cannot be offset against operating profits in nine countries. Examples from Argentina, Norway, and New Zealand show that losses from certain mining activities are also subject to deduction restrictions. Even though the loss carryforward resulting from the limitation of sideway loss relief can be offset against future profits in the same basket, taxable companies face at least an interest disadvantage. This is especially true when losses are not automatically adjusted for inflation. Among the countries suffering from high inflation, only Mexico and Uruguay, but not Argentina or Brazil, provides for inflation adjustment. If offsetting is not possible due to lack of future profits, over-taxation occurs when the ability-to-pay principle is used as a benchmark. A hidden restriction on loss offset also occurs when the amount of losses is not adjusted for inflation.

The branch reports only sporadically indicate the policy goals pursued by individual countries with their partially differentiated sideway loss relief regulations. The Brazilian and the Polish branch reports at least suggests that the limitation of the tax use of capital losses is intended to combat base erosion.

[50] 108 % in 2023 to 2025 and 110 % in 2026 and onwards.

[51] The cash credit amount is maximized to the tax value of an allowance equivalent to DKK 25 million (approx. EUR 3.3 million) at group level.

2.3. Carry-over of losses

2.3.1. Introduction

The total profit concept, derived from the ability-to-pay principle, aims to tax companies based on the total profits they have generated throughout their entire existence.

The implementation of the total profit concept, however, proves to be difficult as the government relies on generating continuous tax revenues to meet its ongoing financial needs.[52] Therefore, the ability-to-pay principle is constrained by the fiscal-budgetary periodicity principle.

However, periodic profit determination brings problems with loss offsetting.[53] Corporate losses represent deductible expenses of a fiscal year that cannot be covered by the revenues of the same fiscal year. The company suffers a reduction in its ability to pay by not being able to dispose of already taxed retained profits, or future earnings to the extent of the business loss. Since the business loss reduces economic ability to pay, the ability-to-pay principle requires supplementing the periodicity principle with inter-period loss offsetting. To the extent that inter-period loss offsetting is excluded, the periodicity principle results in a situation where a company is taxed on more profits than it actually earned during all tax periods. However, the ability-to-pay principle opposes such over-taxation. The Portuguese legislator explicitly highlighted the problematic tension between the ability-to-pay principle and the periodicity principle in article 7 of the preamble to the Portuguese Income Tax Code.

As correctly stated in the 2011 OECD Report, the optimal solution from the perspective of the ability-to-pay principle would be to grant the taxpayer a tax credit in the amount of the tax value of the loss. To the extent that taxes have already been paid in previous periods, an immediate payout of the credit should be made to the taxpayer for the previously taxed profits. In the remaining amount, the taxpayer would have a tax credit that could be offset against future tax liabilities, transferred to another taxpayer within the same group, or at the end of the tax obligation, the taxpayer could receive a payout from the tax authority or sell it to a third party.

However, the instrument of tax credits, which is used to offset tax liabilities, does not represent the means by which countries attempt to approach the ideal of the total profit concept. Instead, the focus is primarily on the instruments of loss carryforwards and carrybacks, which are sometimes complemented by special regulations at the end of a company's tax obligation. Even with the use of carrybacks and carryforwards, the total profit concept could be realized. However, this would require giving priority to an unlimited loss carryback, both in terms of time and amount, which is ultimately comparable to a tax credit. An unlimited carryforward, in terms of both amount and time, would allow for the offsetting of unutilized losses against future profits.

Looking at the legislation of different countries, it can be concluded that all countries recognize the need for loss offsetting. However, the respective legal regulations lag far behind the optimal solution from the perspective of the ability-to-pay principle. Regarding loss carrybacks, there is a great deal of restraint in various countries. Only a few countries

[52] OECD, Action Plan on Base Erosion and Profit Shifting (OECD 2013), at p. 8; OECD, Addressing Base Erosion and Profit Shifting (OECD 2013), at p. 39; OECD, Fundamental Reform of Corporate Tax, supra n. 5, at pp. 152.

[53] See on this and the following: OECD, Fundamental Reform of Corporate Tax, supra n. 5, at pp. 60. R. Matteotti, *Steuergerechtigkeit und Rechtsfortbildung* (2007), p. 50 with further references.

provide for such provisions, and if they do, they are significantly limited in terms of time. Therefore, intertemporal loss offsetting mainly occurs through the instrument of loss carryforwards.

As the following country comparison shows, the intertemporal loss offsetting regulations implemented in each country differ greatly. Even 12 years after the publication of the 2011 OECD Report, it remains true that a variety of budgetary and administrative reasons lead tax systems to place limitations on the utilization of economically incurred losses.

In the following chapter, regulations concerning loss carrybacks, loss carryforwards, and supplementary provisions related to the treatment of losses after the end of a company's tax liability are addressed together. Only when these provisions are considered as a whole can it be assessed to what extent individual countries actually implement the total profit concept. The fewer legal possibilities for a company to offset economically incurred losses, the greater the pressure for companies to shift losses to other domestic or foreign entities through tax planning measures.

2.3.2. *Country comparison*

2.3.2.1. *Loss carryback*

As outlined in the previous section, the loss carryback represents the core of a company's taxation based on the principle of total profit. However, as can be seen from the country comparison, the countries participating in this project show the greatest reluctance in this regard. Out of the 39 countries participating in the present study, only twelve countries have a loss carryback provision. The scope of the respective regulations is strongly limited in terms of time, amount, and substance.

Canada has the most generous provision with a three-year loss carryback for operating losses and net capital losses, which is granted regardless of additional conditions. Interestingly, the legislation justification for granting the carryback was not based on the implementation of the total profit principle but rather on economic policy grounds: The comparatively generous loss carryback aims to allow for improved cash flow for entities and help businesses take advantage of and contribute to economic recovery.

The United Kingdom also allows an unlimited amount of loss carryback, but it is limited to one year. It can be utilized if no group relief is possible within the UK's existing group relief regime. Dutch tax law also includes a one-year loss carryback, but it is limited to EUR 1 million plus 50% of taxable profits to ensure a minimum taxation.

Unlike Canada, the United Kingdom, and the Netherlands, the carryback provisions in France, Germany, and Singapore are only of interest to Small and Medium-sized Enterprises (SMEs) (maximum EUR 1 million in France and Germany, SDG 1,000,000 in Singapore) due to restrictive amount limitations. Germany has extended the carryback period from one year, as applied in France and Singapore, to two years permanently in response to the COVID-19 crisis. From a technical perspective, the French regulation stands out as the carryback creates a tax credit. However, this credit is not immediately payable but must first be offset against taxes for the following five years before it is paid out. Japan also allows a one-year loss carryback only for SMEs, but it can only be utilized in the presence of a restructuring or liquidation procedure and requires the company to meet certain accounting standards. The justification for granting the carryback within a restructuring procedure is that offsetting in future years is not feasible due to a lack of profit expectations.

Since the 2017 tax reform, the United States has limited the carryback to capital losses, which can be carried back for three years. Additionally, the US tax law includes a two-year limited loss carryback for agricultural businesses and non-life insurance companies. Belgium also provides a sector-specific carryback provision: Losses incurred by agricultural businesses due to extraordinary weather conditions in a region can be carried back for three years. In Denmark, a carryback is also provided for in the Hydrocarbon Tax Act.

Sweden follows a special approach. Although Swedish tax law does not contain a loss carryback provision, it allows for the formation of a profit periodization reserve. Contributions to this reserve are tax-deductible, while the dissolution of the reserve constitutes taxable income. Taxable companies can allocate up to 25% of their profits to this reserve, which must be capitalized and becomes tax-effective after six years. Losses incurred during the six-year period can be offset against the reserve, leading to a reduction in interest burden and tax consequences upon dissolution after six years.

As an interim conclusion, it can be observed that the carryback provision has a subordinate significance in most countries. Taxation based on the overall performance principle plays a minor role. Rather, economic policy considerations take precedence. The measure primarily aims to strengthen the liquidity of companies. The scope of the carryback provision is deliberately designed selectively in some tax regimes, with only SMEs benefiting in some jurisdictions and only specific sectors benefiting in others.

2.3.2.2. *Loss carry forward*

At least all countries allow for a loss carryforward. Among the 39 countries examined, the following loss carryforward regimes can be distinguished:

- Provisions that allow for a time unlimited carryforward without quota or amount restrictions for offsetting.
- Provisions that also allow for a time unlimited carryforward but restrict the amount of offsetting through quotas or amounts.
- Provisions that allow for a time limited carryforward without quota or amount restrictions for offsetting.
- Provisions that limit both the time and the amount of carryforward through quotas or amounts.

Out of the 39 countries, 12 countries allow for an unlimited carryforward of losses, which can be offset without quota or amount restrictions. These countries are the following: Australia, Belgium, Chile, Hong Kong, Israel, New Zealand, Norway, Panama, Singapore, Sweden, the UK and Ukraine. However, it should be noted that the aforementioned basket limitations apply to capital losses in Australia, Israel, Panama, the UK, and Ukraine, as well as to losses from resource extraction activities in New Zealand. This means that only in Belgium, Chile, Norway, Singapore, and Sweden, loss carryforwards can be offset without limitation in terms of both time and amount against future profits.

Losses can also be carried forward indefinitely in Brazil, Austria, Denmark, France, Germany, Italy, Liechtenstein, the Netherlands, Portugal, South Africa, Spain, and the USA. However, the loss deduction is subject to a quota restriction in these countries. The applicable quotas range from 30% to 80% and mostly relate to taxable income (before the deduction of the loss carryforward) to ensure a minimum taxation. However, a few countries simply allow for a percentage of the loss to be deducted. In Italy, the quota is applied only in the fourth year. As a policy exception, Brazil allows unlimited loss offsetting for agricultural companies. The UK introduced complex loss restriction modalities starting from £5 million, ensuring that too many losses within a group are not offset. According to the UK's reporter, the rules limiting the loss carryforward in the UK constitute a fundamental departure from the separate entity principle for the taxation of a company. The quota of the offsettable loss is also determined at the group level in Denmark to adhere to the neutrality principle. As far as can be seen, under the tax laws of all states that limit the offsetting of the loss carryforward with a quota, the unutilized loss carryforwards can be carried forward.

Canada, Chinese Taipei, Finland, India, Republic of Korea, Luxembourg, Mexico, Switzerland, Türkiye, and Uruguay belong to the states that generally limit the possibility of carrying forward losses. The time limit varies among these countries, ranging from five years (Uruguay) to 20 years (Canada and Brazil). In India, different periods for carrying forward losses apply to different loss categories (four years for speculative losses and eight years for capital losses and operational losses).

Peru is the only country that allows companies to choose between a time limit (four years) and a quota limit (maximum 50% of taxable income before the deduction of the loss carryforward).

Japan and the Republic of Korea are among the countries that have both a time and a quota limit in their loss carryforward regulations. However, the quota limitation does not apply to SMEs in Japan.

Regarding the inflation adjustment of loss carryforwards, it is noteworthy that, besides the branch reports from Mexico and Uruguay, only Australia seems to provide for an inflation adjustment of loss carryforwards. However, this is limited to losses from certain infrastructure projects. In Argentina, the question of inflation adjustment is controversially discussed. A lower court has denied the obligation to adjust for inflation. The Argentine reporters assume that the issue will eventually have to be decided by the Supreme Court.

In some countries, companies undergoing restructuring benefit from facilitations in relation to loss offsetting. These include exemptions from time restrictions (Switzerland) or quota restrictions (Japan), or the ability to carry forward losses in the amount of debt write-offs without reduction (Chinese Taipei) or without applying amount restrictions. For example, France allows companies in need of restructuring to carry forward losses not only up to EUR 1 million but also up to the amount of forgiven debt without restriction in terms of amount or time.

2.3.2.3. Pre-operating losses

As far as pre-operating losses are concerned, the fundamental question arises as to whether they can be capitalized and amortized at the start of business operations or must be directly deducted, resulting in the accumulation of losses even before the commencement of business activities, or whether the deduction is entirely denied for tax purposes. The branch reports indicate that the question of deductibility or amortization of pre-operating losses is answered differently in each country.

Argentina, France, Luxembourg, Panama, Peru, and Türkiye allow newly established companies the choice to deduct or capitalize and subsequently amortize pre-operating expenses. In France, Luxembourg, Panama, and Türkiye, a depreciation period of five years is provided, while Peru allows for a period of ten years. Under the generous provision in Japan, pre-operating losses can be deducted at any time.

In Brazil, it appears that no election exists. Pre-operating expenses are accrued and offset.

India and the USA also have specific provisions in their tax laws for the amortization of costs incurred by newly established companies. However, their application is highly limited. The US regulation for the amortization of start-up expenditures and organizational costs is only significant for small businesses. The prescribed amortization must be done within 180 months. In India, pre-commencement expenditures can be deducted over a period of five years in connection with R&D projects, infrastructure development projects, and telecommunications activities.

In Belgium and Finland, preparatory costs incurred for the purpose of generating future income or start-up and pre-operating expenses are deductible. In Australia, Austria, Canada, and Chile, at least the costs of establishing a company are deductible. In Singapore, expenses incurred within one year prior to the deemed commencement of business can be deducted.

In Switzerland, founding and organizational costs cannot be capitalized, which means they must be expensed immediately. However, expenses incurred before the start of business activities that are likely to generate future cash inflows (such as market development costs) can be capitalized if they create an asset that can be disposed of.

Countries that provide for the amortization of pre-operating losses (Argentina, Brazil, France, Japan, Luxembourg, Panama, Peru, Türkiye, India, and the USA) include those with relatively short loss carryforward periods (Argentina, Panama, Peru, Türkiye, India) as well as those that do not limit the carryforward period in terms of time (Brazil, France, USA) or only limit it cautiously, i.e., 10 to 20 years (Japan, Luxembourg). However, in the latter case, the offset of the losses is partially restricted by a quota (Brazil: 30%, France: 50%, Japan: 50%, except for SMEs, but see USA: 80%).

This observation suggests that the special regulations aim to alleviate the limitations on the offsetting of loss carryforwards for newly established companies. This is achieved by waiving minimum taxation measures in the form of quota-based limitations on loss carryforwards, which were implemented due to budgetary reasons. This goal is undoubtedly pursued by the regulations in Italy and Spain as well. However, they do not address the tax capitalization of pre-operating losses but provide that the aforementioned quota-based limitations for the offsetting of loss carryforwards should not apply to start-ups. In addition, Spain applies a lower tax rate of 15%. In Italy, start-up companies can transfer their losses generated in the first three tax periods to listed companies (or companies controlled by the latter) that own at least 20% of their share capital, subject to certain conditions.

Austria takes a different approach: for limited liability companies (small corporations), a reduced minimum tax is applied in the first ten years from the start of unlimited tax liability. According to the Austrian branch reporters, this measure can also be understood as a tax policy to mitigate start-up loss situations.

As an interim conclusion, it should be noted that very few countries have loss carryback provisions, and if they do exist, they are very limited in terms of time. The loss carryforward regulations are also restrictive in most countries to ensure minimum taxation for purely budgetary reasons, despite the presence of losses. Only in the case of newly established companies, some states waive the requirement for minimum taxation. Moreover, most countries do not adjust the carried-forward losses for inflation. Given this situation, there is a risk that companies, upon the termination of their entrepreneurial activities and tax liability, will accumulate loss carryforwards that they were unable to offset against taxed profits. This risk is further heightened if the amount of loss carryforwards is adjusted for inflation. Therefore, the question arises as to whether, and if so, what provisions the tax laws of each country have in place to avoid over-taxation at the end of the tax liability period, considering the principle of overall profitability.

2.3.2.4. *Losses after the end of the business*

There is one possibility to achieve the goal of the total profit principle despite the imperfect loss carryback and loss carryforward regulations. It would theoretically be to either offset the carried-forward losses, which have not yet been utilized until the end of the tax liability, against profits in previous tax periods or convert them into a tax credit that could be transferred to other taxable persons or paid out. In order to comply with the principle of overall success, the amount of the tax credit should not exceed the taxes paid in the past.

Considering the significant reluctance displayed by states regarding loss carryback, it is not surprising that special regulations for loss carryback at the end of the tax liability, which go beyond the already restrictive loss carryback rules, are largely lacking in the examined states.

To the extent that states provide specific regulations or practices regarding loss offset at the end of the tax liability, they can be categorized into three categories:

The first category of provisions or practices does not apply the otherwise provided limitations on the offsetting of loss carryforwards. This is the case with respect to quota limitations that otherwise apply in France, Italy, Portugal, and Spain. In Brazil, the question of whether the 30% limitation applies in the year of termination of tax liability has been the subject of various legal proceedings that have produced different results. In 2022, the Brazilian Supreme Court refused to review a case that concerned the 30% limitation. According to the established case law of the Superior Court of Justice, the 30% limitation is also constitutionally compliant at the time of liquidation. In Germany, the Federal Fiscal Court decided that a deferral of loss offset over time, resulting from the quota-based restriction on the offsetting of loss carryforwards, to achieve minimum taxation is constitutionally compliant despite the interest and liquidity disadvantages generated for the taxpayer. The question of whether such a limitation is also constitutionally compliant in the case of liquidation of a company is the subject of an ongoing case before the German Federal Constitutional Court. It is expected that the court will render its judgment before the end of 2023.

The second category of provisions focuses on the flexibility of loss carryback. Of the 39 examined states, only five have taken this approach. The UK is the pioneer: Where a trade ceases, losses incurred in the twelve months prior to the accounting period in which cessation of trading occurs may be carried back to accounting periods ending within three years of the commencement of the accounting period in which the trade ceases. Losses which cannot be relieved by termination relief are lost. The Austrian tax law contains a similarly generous regulation: In case of liquidation, a special extended taxation period is provided (generally up to three years or up to five years in insolvency cases) to replace the ordinary taxation period. As rightly pointed out by the Austrian branch reporters, the aggregation of the results of several financial years leads to a de facto loss carryback during the extended taxation period. Norway allows loss carryback for the last two fiscal years prior to the cessation of business activities, while Türkiye and Japan only provide for a one-year loss carryback in the case of a company's liquidation. While the possibility of a one-year loss carryback at the end of the tax liability is granted in Türkiye without further conditions, it is limited to SMEs in Japan. Denmark allows for a very limited carryback in the period between bankruptcy notice and winding-up. The Norwegian reporters doubt the practical significance of these short carryback options in the event of liquidation, as it is very rare for a company to generate profits one or two years before the cessation of business activities.

The third category of provisions refers to regulations regarding bankruptcy and insolvency, which cannot be brought under a common denominator. The Italian tax law provides that in case of bankruptcy, pre-insolvency losses can be offset against the income of the insolvency period. The opposite seems to be the case in Sweden: Upon insolvency, taxpayers may not utilize losses that were incurred prior to the insolvency. In the United States and Australia, the respective tax laws provide for a relaxation of continuity of ownership requirements, as the composition of shareholders and/or management may change in the course of bankruptcy proceedings. This is intended to prevent loss carryforwards from being lost in the event of bankruptcy.

2.3.3. *Impact of the 2007-2009 financial and economic crisis and the Covid-19 crisis*

Based on the branch reports, it can be concluded that most of the participating countries apparently did not see the need to tighten their loss offset regulations in the aftermath of the financial and economic crisis of 2007-2009. The OECD Reports of 2010 and 2011 did not directly result in stricter loss offset regulations in most countries. Australia, the Netherlands, and France responded by implementing temporary relaxations of loss carryforward regulations. France immediately paid out loss carryback tax credits in 2009. Companies were not obligated to offset the granted tax credits against tax debts of the following five tax periods. The Netherlands allowed loss carryback up to EUR 10 million for losses incurred between 2009 and 2011 for up to three years. Any remaining losses could be carried forward for six years without quota limitations. Australia introduced a three-year loss carryback starting from the 2012-13 tax period but later repealed it due to budgetary reasons. Permanent relaxations of loss carryforward regulations were implemented in Ukraine in 2012 and Belgium in 2017. Both countries removed the previously applicable time limitations on loss carryforward. France, Japan, Italy, and Spain tightened or modified their loss carryforward regulations for budgetary reasons. France and Japan reduced the carryback period from five and three years, respectively, to one year. Italy and Spain introduced quota limitations on the offsetting of loss carryforwards to ensure minimum taxation. However, in compensation, the previous loss carryforward periods were eliminated in Italy, and they were significantly extended from five to 18 years in Spain.

Unlike the financial and economic crisis of 2007-2009, the Covid-19 crisis resulted in a significantly higher wave of temporary legislative changes. This trend was likely intensified by the recommendation of the European Commission on 18 May 2021. To support companies facing the economic impact of the Covid-19 crisis, the EU Commission recommended that member states allow loss carrybacks for at least the previous tax year, i.e., at least until 2019. The carryback extension should be limited to three years. Furthermore, companies should be able to immediately claim expected losses for the tax year without having to wait until the end of the year. Due to budgetary reasons, the EU Commission recommended a maximum amount of EUR 3 million for loss carryback per tax year in which losses were incurred. States allowing a three-year carryback should make it conditional on not having incurred losses in the tax years 2017 to 2019. This restriction should make sure that only previously successful SMEs can benefit from the generous three-year carryback.

Of the 39 participating countries, approximately 40% have liberalized their loss offset regulations during the Covid-19 crisis. Most of these measures are of a temporary nature. They aim not only for temporary loss carryback, as recommended by the EU Commission, but also for a flexibilization of loss carryforward regulations.

Among the EU member states, Austria, Germany, Belgium, the Netherlands, and Poland temporarily allowed loss carryback for losses incurred during the Covid-19 crisis. The carryback period ranges from one year (Poland) to two years (Austria, Germany). Austria has imposed a limit on the amount of carryable losses (EUR 5 million for 2019; EUR 2 million for 2018). Germany increased the amount of carryable losses for the years 2020 to 2023. In Poland, the conditions for granting the one-year carryback resulted in a 50% reduction in tax revenue for 2020 compared to 2019. Belgium and the Netherlands limited their measures to the provision of tax provisions in 2019, with the Netherlands restricting the provision to the profit earned in 2019.

Norway, as a non-EU European country, introduced a time-limited carryback for losses incurred in 2020 to the years 2019 and 2018.

Outside of Europe, the United States, Australia, New Zealand, Japan, the Republic of Korea , and Singapore temporarily expanded the possibilities for loss carryback. The solutions in the Anglo-Saxon countries are particularly generous. Under the CARES Act, the US allows a five-year carryback for net operating losses (NOLs) from 2018 to pre-2020 years. In Australia, tax losses for the 2020 to 2022 years could be carried back against tax liabilities of the 2019 to 2021 years as a refundable tax offset for companies with a global group turnover of less than $5 billion. Companies can decide how much losses to carry back, and the amount of the refund is based on the corporate tax rate in the loss year. The amount of the offset is limited by the company's franking account balance at the end of the income year. In New Zealand, Covid losses in 2020 and 2021 can be carried back to previous years.

While the Republic of Korea (temporary two-year carryback) and Singapore (extension of the carryback from one to three years) aimed to preserve the liquidity of SMEs, Japan explicitly expanded the one-year carryback, previously applicable only to SMEs, to "certain non-large companies."

Flexibilization of loss carryforward regulations also occurred in some countries during the Covid-19 crisis. Some countries extended the carryforward period (the Republic of Korea from 10 to 15 years), while others increased the amount limit for unlimited carryforward (France: increased from EUR 1 million to include waived rental expenses, and Japan waived the application of the 50% quota). Portugal extended the time limit for carryforward to 12 years, even for large companies, and increased the quota limitation to 80%. In Italy, the Covid-19 legislation allows companies, subject to certain conditions, to convert their deferred tax assets generated by carried-forward losses into tax credits, up to a certain amount of non-performing receivables sold to third parties.

The Netherlands and Portugal took the opportunity of the Covid-19 crisis to improve loss carryforward regulations for companies in general. The Netherlands eliminated the previous time limitation starting from 2022. Portugal did the same while also increasing the deductible quota from 65% to 75% of taxable profit before carryforward. New Zealand relaxed the requirements for granting carryforward when there is a change in the business activity from which the losses originated (introduction of the Business Continuity Test instead of the previous stricter tests). In Switzerland, the Federal Council recently proposed to extend the carryforward period for companies from seven to ten years to allow companies affected by the Covid-19 pandemic, in particular, to have a better chance of recovery. South Africa, on the other hand, tightened the loss carryforward deduction by introducing a monetary limitation (no more than ZAR 1 million or 80% of taxable profit).

2.3.4. *Interim conclusion*

When considering the regulations of the 39 countries examined regarding loss offsetting, it can be firmly stated that the loss offset regimes in all states lag far behind the ideal of the total profit principle. Due to budgetary considerations, states rely on loss carryforward regulations. However, as shown, these are often limited in terms of time or amount, as the carryforward can frequently only be offset against a certain percentage of taxable profit before the offset. A loss carryforward ultimately represents a deferral of loss offsetting in favor of the state, which - since it is not interest-bearing in any state - leads to an interest disadvantage for the taxpayer. When the offsetability of the carryforward is limited in amount to ensure a minimum taxation for budgetary reasons, the deferral is further postponed into the future. One may agree with the German Federal Fiscal Court that the principle of the stability of taxation can justify a deferral of loss offsetting with an interest disadvantage for the taxpayer. However, this deferral of loss offsetting proves problematic when the carryforward period expires. If the expired carryforward could have been covered by profits previously taxed, a definitive over-taxation conflicting with the total profit principle occurs. The same applies when the offsetting of loss carryforwards, to the extent that profits have been taxed in the past, is no longer possible due to the liquidation of a company.

It is a question of the principle of proportionality whether the over-taxation resulting from the absence of loss carryback can be justified by budgetary considerations. It could be argued that there is no public interest for the state to accommodate such companies in liquidation or those that have not generated sufficient profits after a certain period of time with a tax carryback or a corresponding tax credit. However, it remains a fact that when the state denies a loss carryback to a taxable entity, it ultimately benefits from an over-taxation that occurs at the time of liquidation or upon the expiration of the loss carryforward period.

The lack or extremely limited possibility of loss carryback leads to over-taxation completely independent of the design of the applicable loss carryforward regulations, when the loss carryforwards are not adjusted for inflation. Ultimately, it is also a question of proportionality as to what rate of inflation an adjustment would have to be made.

The outlined over-taxations could be addressed by providing an inflation adjustment of previous year's losses and a carryback of otherwise expiring loss carryforwards to previously generated profits. Alternatively, a tax credit system could be considered. In such a system, the tax periods in which the taxpayer paid taxes in the past would be identified in the first step. In the second step, the carryforward would be multiplied by the tax rate of the tax period used for the loss offset. If offsetting were possible, a tax credit would be granted to the taxpayer. It is conceivable that in an analogous world, such a system would entail significant bureaucratic effort and may not be implementable at all or only with great effort. However, with the ongoing digitization of tax authorities and the business world, the over-taxations occurring under current legal systems can likely no longer be justified by the lack of practicality of a loss carryback or loss carryback tax credit system.

The current practice of states, which assigns great weight to budgetary considerations in the design of a loss offsetting system, and the fact that the unsatisfactory national regulations in terms of the total profit principle have hardly been reviewed for their constitutionality, indicate that national courts grant significant discretion to national legislators in weighting budgetary considerations. Nevertheless, it is worth noting that the fact that in Germany the Federal Fiscal Court has referred the question of whether the application of a percentage restriction on the offsetting of a carryforward in the liquidation year is in conformity with the constitution to the German Federal Constitutional Court, shows that constitutional doubts arise even in courts when budgetary goals are pushed to the limit. Therefore, it can be eagerly anticipated that the judgment announced by the Federal Constitutional Court for the year 2023 will shed light on this matter.

The fact that the loss offsetting systems are practically restrictive in all states due to budgetary considerations and that taxation based on the total profit principle is not ensured at the level of individual entities certainly provides a reason for companies to try to use accumulated loss carryforwards as tax efficiently as possible in the context of tax planning, either by attempting to shift losses to successful companies or by transferring profits to a company with losses. The present general report focuses on the extent to which losses can be shifted to other domestic or foreign taxpayers. The branch reports primarily address loss shifts within the framework of reorganizations and group taxation regimes.

Part Three: Utilization of losses in the framework of corporate reorganizations

3.1. Preliminary remarks

The term "corporate reorganization" is understood in the following context from a business perspective. It encompasses situations in which a company with loss carryforwards replaces its business operations with a new one, merges with another company, or undergoes a split. In all these scenarios, the question arises whether the existing loss carryforwards can be carried forward or if they will be extinguished as a result of the restructuring.

3.2. Country comparison

3.2.1. Change of business

The regulations of the 39 countries can be broadly divided into four categories:

1. States that deny the further use of loss carryforwards upon the cessation of previous business activities, regardless of a change of ownership. In this scenario, a purely economically focused analysis is conducted. The incurred losses are inseparably linked to the business activities that generated them. Therefore, an economic perspective is decisive.
2. States that only deny the further use of loss carryforwards upon the cessation of previous business activities if a change of ownership occurs. The incurred losses are generally associated with the taxable entity engaged in business activities. However, the objective is to combat loss trading. Here, the focus is primarily on a civil law perspective, but a shift towards an economic perspective occurs in case of a change of ownership.

3. States that allow the use of loss carryforwards upon the cessation of previous business activities, even in the presence of a change of ownership. Here, the civil law perspective alone is decisive.
4. States that reduce the utilization of accumulated loss carryforwards upon a change of ownership, regardless of the cessation of previous activities. This reflects a consolidated view within a group context.

A mere change of business without a simultaneous change of ownership (first category) seems to bring only isolated issues with utilizing loss carryforwards. In France, for example, a loss-making company undergoing a change in its activities is not entitled to carry forward its losses. However, the preservation of loss carryforwards can be ensured by obtaining prior approval from the French tax authorities in the case of a change in business activities. The Belgian branch reporter also reports on a judgment from the Court of Appeal of Antwerp, which has ruled that losses should derive from the same activity as the income from which they are deducted. As a consequence, the deduction of carried-forward losses in the case of a change of activity was denied. However, the Belgian branch reporter questions the correctness of this decision and does not consider it to be established case law.

Most of the 39 countries fall into the second category. Loss carryforwards are only denied upon the cessation of business activities if there is a change of ownership. In other words, companies can claim a loss carryforward if they alternatively meet either the change of ownership test or the continuity of activity test. If there is no change of ownership, the loss remains with the taxpayer who can offset it when changing business activities. However, if a change of ownership occurs, a shift to an economic perspective takes place. The underlying idea behind the shift from a civil law to an economic perspective is to combat "loss trafficking."

The regulations in individual countries regarding the two tests vary in detail. In some states, change of ownership and continuity of activity are merely criteria used to assess whether claiming a loss carryforward is abusive (so-called "shell purchase cases"). Other states, however, have detailed provisions defining change of ownership and continuity of activity. Depending on the specific framework, the offsetting of loss carryforwards is allowed more restrictively or liberally. Economic policy considerations also play a role in determining whether loss carryforwards can continue to be utilized in cases of ownership change and change of business.

For example, in Poland, a change of ownership is acknowledged even with a 25% change in shares. Furthermore, a change of business may already exist if the previous core business is partially altered. Such a regulation goes beyond the scope of combating abuse and is likely motivated by economic policy considerations.

In the Netherlands, if a substantial change of more than 30% in ownership occurs, the carried forward losses will generally be forfeited, unless the tax inspector confirms that available carried forward losses can still be offset with profits generated by the old activities.

Many countries set the threshold for a relevant change of ownership at 50% (Australia, Canada, Germany, Finland, Chile, Italy, India, Japan, Spain), with regulations sometimes being very casuistic and subtle (e.g. Australia, Japan).

Germany and Finland attach significant importance to change of ownership. In both countries, loss offsetting is generally denied in cases of change of ownership. In Germany, however, a statutory exception allows loss offsetting to the extent of existing hidden reserves if the company's activity has not changed. After a lower court found that the current regulation is unconstitutional, the Federal Constitutional Court will review the constitutionality of the German rules on the denial of the deduction of losses carried over in case of change of ownership. In Finland, the Finnish tax authority can grant permission for the continued use of loss carryforwards to a company that does not meet the change of ownership test, upon the company's request. The authority has a certain discretion, taking into account reasonable business considerations in its exercise.

At the other end of the spectrum is the Austrian practice regarding a special anti-abuse rule aimed at shell trading (so-called *Mantelhandel*). Only a change of ownership of 75% is considered problematic in Austria. Additionally, this change must be accompanied by a change in the business purpose and a change in the organizational structure, i.e., the management and administration.

In a comparable direction, other states are likely to approach the question of whether a sold company can utilize loss carryforwards in the case of a change in business activities, based on a GAAR or a more broadly formulated SAAR (e.g. Switzerland, Brazil, Denmark, Luxembourg, Norway, Portugal, Panama, Hong Kong). Some GAARs or SAARs only require a business purpose for the change of ownership (Switzerland and Belgium), which is usually affirmed in the case of continuity of the business but does not necessarily coincide with it.

Certain jurisdictions explicitly consider the ultimate beneficial owner when assessing the Change of Ownership test, meaning that purely intra-group transactions should be less scrutinized by tax authorities (Australia, Canada, Chile, Finland, Japan, and the Netherlands). The focus is thus on combating companies transferring losses to third parties. However, it should be noted that in these states, intra-group transactions could potentially be considered abusive under a GAAR. In Australia, companies are required to track changes in ownership across all intermediaries when considering changes in ownership, with certain exceptions for listed companies. In contrast, some jurisdictions explicitly disregard indirect changes of ownership (Austria).

The criterion of "continuity of business" also varies across different states. The Australian tax authority initially required the same business to be maintained. If the company derives assessable income from a new type of business or new kind of transaction compared to its business and transactions conducted before the change of ownership, the test is failed. This test was judicially confirmed. However, the Australian Taxation Office (ATO) moved away from this strict practice in 2015. The continuity of business test is considered satisfied if the business activities before and after the change of ownership are similar (the so-called "similar business test"). Whether such similarity exists is assessed based on assets (including goodwill), activities and operations, business identity, and the extent to which changes in the former business resulted from the development or commercialization of the assets, product, and processes of the former business. The similar business test has not been reviewed by the courts yet. In Chile, a modification or expansion constitutes a harmful change of business unless the main business before the change of control is maintained. In New Zealand, as of 2021, the use of tax loss carryforwards in the event of a change of ownership will only be disallowed if there is a material change in the business. In France, a significant addition or reduction in the previous activities constitutes a harmful change of activity. Whether a significant addition or reduction exists is assessed based on objective turnover tests. However, the French tax authority can grant permission to continue using loss carryforwards despite the test not being met if it can be demonstrated that the considered restructuring was essential for the pursuit of the business and the preservation of employment.

Some states focus less on the continuation of the previous business and more on the existence of economic continuity (e.g., Switzerland), which does not necessarily require the continuation of the previous business. If the transferred company is not economically liquidated but still possesses intangible assets that are beneficial for the new business activity, there is economic continuity but not necessarily a continuation of the previous business activity.

Some states also impose deadlines during which the previous activity must be maintained. For example, Brazil requires continuity of business from the inception to the utilization of the loss. However, the UK, New Zealand, and Türkiye require business continuity for a period of five years after the change of ownership. In contrast, Chile is satisfied with a 12-month period before and after the change of ownership. In Spain, a change of ownership occurs if a company falls within the scope of the SAAR and has not carried out economic activities in the three months prior to the acquisition, or if the loss-making company starts a new activity within the next two years after the acquisition, deriving from that activity a turnover higher than 50% of the average turnover during the last two years.

Only a small number of states do not make the utilization of loss carryforwards dependent on the continuation of the previous business activity or ownership (third category). These include Argentina, Panama, and Ukraine, which apparently follow a purely civil law perspective.

The regulations in the United States and Sweden represent special cases. In the US, the utilization of losses generated by a corporation that experiences an “ownership change” is limited. An “ownership change” generally occurs when there is a greater than 50 percent change in the value of stock during a three-year period. When there is an ownership change, the utilization of net operating losses (NOLs) is generally limited to the value of the corporation at the time of the change multiplied by the adjusted federal long-term tax-exempt rate

In Sweden, a change of control also leads to a limitation of the loss carryforward amount. A change of control is understood not only as the sale of more than 50% of the votes in a company with tax loss carryforwards but also when an individual acquires decisive influence over a company or if a certain category of persons, for a period of five years, individually or collectively acquires shares with at least 5% of the votes, and together acquire more than 50% of all votes in the company with tax losses. Loss carryforwards exceeding 200% of the purchase price cannot be deducted. According to the Swedish branch reporters, the Swedish legislator has deemed buying and selling loss-making companies undesirable. On 1 May 2022, the rule was tightened to the extent that carryforward losses after changes in ownership taking place after 10 June 2021, cannot be deducted at all if the main reason for the change in ownership was to utilize the losses.

In New Zealand, the offsetting of loss carryforwards was denied in the case of a change of ownership (more than 49%) until 2020. However, as part of the Covid-19 relief measures, the regulation was liberalized. A change of ownership is not harmful if the business continuity test is met (see Part Three, chapter 3).

3.2.2. *Merger*

Unsurprisingly, many states base their regulations on the utilization of loss carryforwards on those developed in relation to changes in business activities (see Part Three, section 2.1). This is particularly true in the context of the Change of Ownership Test. This test can ultimately result in a privileging of the losses of the acquiring company if the previous shareholders exceed the quota required for the existence of a change of ownership after the merger has taken place. This privilege is expressed in particular in the fact that the deductibility of the loss carryforwards already existing in the acquiring company prior to the merger does not require an examination of the existence of the underlying business activity within the meaning of the continuity of business test - as is the case in the event of a change of control. However, various branch reporters (Germany, Japan, and the Republic of Korea) point out that depending on the facts and circumstances of the specific case, the further utilization of loss carryforwards by the acquiring company can be denied due to the application of GAARs or SAARs. Several states (Belgium, Peru, Poland, and likely Italy) even explicitly impose restrictions on the utilization of loss carryforwards by the acquiring company after the merger.

In the various national regulations, several other criteria are used to assess whether loss carryforwards accumulated prior to the merger can be utilized.

In Argentina, Belgium, Austria, France, Finland, Japan, Hong Kong, Singapore, Spain, and Portugal, the transfer of loss carryforwards requires tax neutrality of the merger. In accordance with the Merger Directive, tax neutrality is denied to a merger in a member state if tax savings constitute the main purpose or one of the main purposes of the merger. If this is the case, the loss carryforwards of the disappearing company are extinguished, but not those of the acquiring company, which in turn results in a less favorable treatment of the transferred loss carryforwards. Hong Kong also has an anti-avoidance provision in place.

The Continuity of Business Test is also applicable to mergers. As mentioned in the explanations in Part Three, section 2.1 above, the specification of the Continuity of Business Test varies significantly among different countries. This particularly applies to the temporal requirements related to Continuity of Business that exist in some countries. In this respect, reference is again made to the explanations in Part Three, section 2.1 above.

In addition, it should be noted here that Hong Kong requires the utilization of pre-merger loss carryforwards to be contingent on the existence of an identical business after the merger. The Same Trade Continuation Conditions apply equally to both the transferring and acquiring companies. In India, the transferring company is required to have conducted the transferred business for a minimum of three years and to have held at least three-quarters of the book value of the transferred fixed assets for two years. The acquiring company must continue the transferred business for a period of five years (similar timeframe as in Türkiye). On the other hand, France, for the acceptance of loss carryforwards, requires only that the entrepreneurial activities that generated the losses have not significantly changed during the loss period and are continued without substantial changes for at least three years after the merger, subject to obtaining approval by the administration. Italy applies the aforementioned "vitality test" to mergers, as well. Similarly, Japanese and South Korean regulations also make the allowance of deduction of loss carryforwards in intra-group mergers dependent, among other things, on the expectation that around 80% of the employees of the transferring company will continue to be employed by the acquiring company after the merger. In mergers between unrelated companies, the deduction of losses requires that the primary business of the dissolving company is related to one of the businesses of the surviving company. Various objective tests are used to assess whether the companies involved in the merger are comparable in terms of the nature and size of the business (the so-called deemed joint business requirement). The law even stipulates that at least one senior officer from each of the dissolving and surviving companies (as of the time before the majority control relationship was formed) participates in the management of the surviving company after the merger.

Other countries (Mexico, the Netherlands, the Republic of Korea, Singapore) also allow the deduction of transferred loss carryforwards after the merger only in relation to the same line of business that generated the losses. In the Republic of Korea and the Netherlands, separate books between the merged entity and the surviving entity should be maintained. In Switzerland and probably in other countries that allow the offset of losses with an open GAAR, the requirements are at the lower end of the scale: a certain level of economic continuity of the acquired company after the merger is sufficient, and a continuation of the previous business is not required.

As mentioned, in France, prior approval from the tax authorities is required for the offsetting of loss carryforwards, to which there is an entitlement if the legal requirements are met.

Some tax regimes also limit the loss carryforwards existing after a merger (Belgium, Chinese Taipei, Germany, Italy, Portugal, Türkiye, and Ukraine). The regulations regarding the quantitative limitation vary.

Belgium, Italy, Germany, Türkiye, Portugal, and Ukraine apply "net equity tests," but the modalities of these tests differ in each country. In Belgium, carried-forward losses available to each of the entities involved in the merger are limited in proportion to the net tax value of its assets compared to the total net tax value of its assets and that of the other company (referred to as the neutrality regime). This regulation treats loss carryforwards of the transferring and acquiring companies equally.

Portugal and Ukraine also reduce the deductible losses in proportion to the net worth of the merged company and the value of the net worth of all the companies involved in the merger. However, unlike in Belgium, only the further utilization of the previous year's loss from the transferring company is reduced.

In Italy, the application of the net equity test leads to a quantitative limitation on the offsetting of loss carryforwards. Losses may be used by the company resulting from the merger only up to the amount of the loss-making company's book net equity resulting from the last balance sheet, without taking into account capital contributions made in the last 24 months. The branch reporters do not specify whether any potential goodwill should be taken into account. The net equity test appears to be designed to assess the projected future profitability of the company or companies holding the loss carryforwards.

In Germany, similar to Italy, the offsetting of losses is only possible to the extent of the hidden reserves of the transferred assets. Here too, the question left open by the branch report is to what extent the goodwill of the company can be considered.

In Türkiye, only losses that do not exceed the equity amount of the transferred company as of the date of transfer may be deducted.

Israel also takes a comprehensive approach. The deductible loss carryforwards after the merger are added up and can only be offset up to a maximum of 20% or 50% of the taxable profit (before the offsetting of loss carryforwards) for a period of five years.

In Spain, loss carryforwards of the transferring company are only reduced if the acquiring company already held a stake in the capital of the transferring company or if both participating companies in the merger belong to the same group. In this case, the transferred losses will be reduced by the positive difference between the valuation of the contributions made by current and previous shareholders regarding their participation in the transferring company and the tax valuation of the participation. According to the Spanish branch report, this rule aims to prevent the double use of losses due to the deductibility of depreciation on participations before 2013.

In Chinese Taipei, losses of the transferring company can only be deducted to the extent of the ownership percentage held by the previous shareholders of the transferring company in the acquiring company after the merger.

Another group of countries does not allow the deduction of transferred loss carryforwards by the acquiring company at all. This group includes Brazil, Chile, Peru, Poland, Panama, Mexico, and Uruguay. In Peru, a merger even results in the limitation that the acquiring Peruvian corporation can only offset its own existing loss carryforwards up to the value of one hundred percent of its fixed assets existing before the corporate reorganization.

In contrast, Argentina, Finland, and Ukraine restrict the transfer of losses to intra-group mergers. In Argentina, the transfer of losses is limited to the extent that shareholders can prove that, during the two years prior to the reorganization date, they have maintained at least 80% of their participation interest in the predecessor entities. An intra-group merger exists under Finnish law if the acquiring company or its shareholders held at least 50% of the transferring company before the merger. In Ukraine, associated parties are defined broadly based on transfer pricing rules, taking into account criteria such as ownership, common directors, and common ultimate beneficial owner. Losses can be transferred if the parties were deemed associated for at least 18 preceding months prior to the reorganization.

In Japan, the transfer of losses is also limited to certain intra-group mergers, where the participating related companies must fulfil a "five-year control relationship requirement." An exception to this requirement is provided for tax-qualified mergers for joint businesses.

In Chinese Taipei, losses of a subsidiary acquired through absorption cannot be transferred to the parent company.

In France, the transfer of losses within a merger requires approval from the French tax authorities if the losses exceed EUR 200,000. Approval is granted if the legal requirements are met. Carried-forward losses arising from the management of financial and/or real estate activities cannot be transferred.

In Italy, the tax authorities are authorized to deviate from the vitality test and net equity test in ruling applications if it can be demonstrated that a merging company has not been opportunistically recapitalized to meet the net equity test, that a contradiction of its business activity did not actually occur, and that the company could have offset its losses even on a stand-alone basis.

In Hong Kong, Liechtenstein, Luxembourg, Norway, and Switzerland, the utilization of loss carryforwards from the transferring company to the acquiring company is subject to GAARs or broadly worded SAARs. According to a decision of the Swiss Federal Supreme Court, loss offsetting only requires that the merger makes commercial sense, which is the case if a certain economic continuity regarding the transferring company is maintained after the merger. This is, for example, the case if customer lists of the transferring company provide a benefit to the business activities of the acquiring company. The well-established Luxembourg case law follows the same direction, allowing loss deduction if valid economic reasons exist for the merger.

3.2.3. Demerger

As far as can be seen from the branch reports, the regulations on demergers are based on the same principles as those on changes of business and mergers, and are therefore similar in structure. In the branch reports, the regulations regarding mergers and demergers are sometimes not clearly distinguished, making a comprehensive legal comparison difficult. Nevertheless, selected aspects are highlighted below.

In some countries (Belgium, Portugal), the transfer of losses in a demerger also depends on whether the latter is tax-neutral. Tax neutrality is denied if tax savings are the principal purpose or one of the principal purposes of the demerger. In Austria, Belgium, Brazil, Switzerland, Luxembourg, and Liechtenstein, the use of loss carryforwards from the transferring company to the acquiring company is also subject to an abuse-of-law reservation. However, due to the lack of reported case law, no statements can be made regarding which demergers could fall within the scope of abusive practices.

In Brazil and New Zealand, the continuity of business test applicable to mergers also applies to demergers. The legal situation in Mexico is particularly unique: Mexico does not allow the transfer of tax loss carryforwards from the transferring company to the acquiring company in mergers. However, in demergers, such transfer is possible to the extent that the entity carries out the same business activities as the loss originating entity. In a notable ruling, the Mexican Supreme Court determined that the differential treatment of losses in demergers compared to mergers is not unconstitutional, as the distinct treatment is justified by the fact that the resulting entities in a demerger both contributed to generating such losses at some point in time, which is not the case in mergers.

In the majority of countries (Austria, Belgium, Brazil, Spain, Switzerland), the loss carried forward is transferred to the acquiring company in accordance with the principle of causation. In other words, the net operating loss carryforward of the carved-out business must be quantified. As stated by the Austrian branch reporter, the succession of losses is linked to the transfer of the book value of the loss-producing source of income. In Belgium, the net-equity rule in mergers (as discussed above) also applies if the acquiring company is a pre-existing company. This means that the transferred loss carryforwards are limited even in demergers under the neutrality regime.

In other countries such as Argentina and Mexico, the loss allocation is proportional to the asset allocation. In cases where the loss cannot be allocated based on the causation principle, countries like Finland and Spain also allocate loss carryforwards to receiving entities in proportion to the transfer of net assets.

In some countries, demergers are not possible (Singapore), or the transfer of loss carryforwards in demergers is completely prohibited for tax purposes (Chile, Peru), meaning that they remain with the transferring company. According to the legal framework in Chinese Taipei, losses of the transferring company generally cannot be transferred if the shareholding structure of the companies remains unchanged after the spin-off.

3.3. Impact of the 2007-2009 financial and economic crisis and the Covid-19 crisis

The branch reports do not indicate that the financial and economic crisis has led to increased legislative activity in individual countries regarding the use of tax loss carryforwards in reorganizations. One of the most significant tightening of regulations concerning the utilization of tax loss carryforwards occurred in Germany with the Reorganization Tax Act, which essentially denied acquiring companies the further use of tax loss carryforwards of the transferring companies after a reorganization. This change was implemented at the end of 2006 and did not, as far as can be seen from the branch reports, have an impact on other countries. In Spain, the aforementioned SAAR was introduced in 2014 in relation to a change of ownership. The introduction of the SAAR was justified as a measure against tax planning through the acquisition of inactive or nearly inactive companies that had previously generated tax losses. However, it is not possible to determine from the branch report whether the financial and economic crisis has led to an increase in the trading of loss-making companies, prompting the Spanish legislator to take action.

The Covid-19 crisis also did not trigger a flood of legislation in the field of reorganizations in the countries examined. Sweden supplemented its existing SAAR regarding the offsetting of losses in a change of ownership, which already resulted in a limitation of usable tax loss carryforwards, with an additional SAAR that completely prohibits the utilization of tax loss carryforwards in a change of ownership if the main reason for the change in ownership was to utilize the losses. Apparently, there was a need to ensure, through an explicit anti-abuse provision, that loss trafficking would not only result in a limitation but in a complete loss of tax loss carryforwards for the transferring company. There are no signs of similar tightening measures being taken in other countries.

However, it is worth noting the relaxation of the rules on loss carryforwards in New Zealand, which, due to Covid-19, were implemented in 2021 with a permanent character, unlike the temporary loss carryback rules discussed under Part Two, section 3.3 above. The newly introduced business continuity rules now allow companies to adjust their business activities within reorganizations — as long as it is not considered a major change — without forfeiting the tax loss carryforwards of the transferring company. The new rules aim to stimulate growth and innovation in the economy. It seems that New Zealand was inspired by the Australian Taxation Office (ATO), which introduced the Similar Business Test in 2015 to mitigate the rigidity of the court-approved Same Business Test. This demonstrates the significance of economic considerations in the legislative process and, as in the case of Australia, in the administrative practice in the specific design of regulations regarding the utilization of tax loss carryforwards in reorganizations.

3.4. Interim conclusion

The question of whether a change of business for a taxable legal entity, while maintaining the same ownership structure, allows for the offsetting of carried-forward losses arising from the previous business activities is generally affirmed in most of the examined countries. Carried-forward losses are primarily associated with the taxable corporation rather than with a specific business. This approach allows the taxable entity to adapt its activities to economic changes. Even the strict French regulation, which primarily attributes the losses to the business of a company, seems to take this economic consideration into account by granting the French tax authority the possibility to approve the utilization of loss offsetting upon request when a business activity is replaced by another.

However, the majority of countries deviate from this purely civil law approach when a company with carried-forward losses is transferred to another person or other persons through a sale or reorganization (merger or demerger), resulting in a change of ownership. The idea is that the new shareholders should not be able to benefit indirectly from the losses of a discontinued business in which they have not invested. Offsetting these losses against the profits of the newly undertaken activity would lead to a lower effective tax burden at the company level. The new shareholders, conducting their new activity through a "loss company," would be privileged compared to others who establish a new corporation for their business activity, without a reasonable fiscal or non-fiscal justification being apparent. It should be noted that privileging new shareholders also occurs when the acquired company does not cease its business activity but continues it and is able to offset the carried-forward losses from that activity against profits of the newly undertaken activity. This consideration is likely the reason why numerous countries restrict the use of carried-forward losses in cases of change of ownership due to sale or reorganizations. However, it is difficult to answer the question of what monetary limit would be appropriate from a tax perspective, since a consistent inclusion of the shareholder level would also require taking into consideration the tax position of the shareholders of the transferring company. The branch reports do not provide any statements on this issue.

The considerations presented show that the unrestricted allowance of loss offsetting in cases of change of ownership due to sale, merger, or demerger does not necessarily appear compelling from a tax system perspective. Rather, the decision of countries to fully grant loss offsetting when the nationally designed continuity of business test is met, is likely based on economic considerations. Any potential privileging of new shareholders is accepted and deemed justifiable when the existing business is continued or the acquisition of the company serves at least a reasonable economic purpose. However, considering the role of economic considerations, it is not surprising that the regulations adopted by individual countries differ significantly in detail. Countries that apply a generous continuity-of-business test create a favorable tax environment for businesses to adapt to constantly changing economic conditions, including technological advancements, digitization, and consumer behavior. In contrast, those countries that completely exclude loss transfer, such as Brazil, Peru, Panama, Mexico, and Uruguay, or make it dependent on meeting strict change of ownership tests (e.g., Argentina, Poland, and Finland) or strict continuity-of-business tests with stringent time constraints, are driven not only by fiscal and budgetary considerations but also by employment policy considerations, as exemplified by Italy, Japan, and the Republic of Korea. However, such strict regimes run the risk of inhibiting structural change, which ultimately led New Zealand and Australia to amend their legislation and administrative practices.

Part Four: Loss shifting and sharing in the framework of group taxation regimes

4.1. Preliminary remarks

Group taxation regimes aim to ensure the neutrality of taxation. The level of tax burden should ideally not fundamentally influence the business decision on how to organize business activities. Therefore, business activities conducted through a corporate group should ideally be treated for tax purposes in the same way as if they were carried out through a single company. In line with the principle of neutrality, losses incurred by a group company within the group should be immediately offset against profits of other group companies. The total profit principle should ideally be applied at the group level. Out of the 39 states examined, 22 currently have group taxation systems in place (Australia, Austria, Belgium, Chinese Taipei, Denmark, Finland, France, Germany, Israel, Italy, Japan, Luxembourg, Netherlands, New Zealand, Republic of Korea, Norway, Portugal, Poland, Singapore, Spain, United Kingdom, and United States), which allow for the offsetting of losses within the group under certain conditions. Of these, 17 regimes (Australia, Belgium, Chinese Taipei, Finland, France, Germany, Israel, Italy regarding the domestic consolidation regime, Japan, Republic of Korea, Netherlands, New Zealand, Norway, Portugal, Poland, Singapore, Spain, United Kingdom, and United States) are generally territorially restricted, with the territorial limitation subject to the reservation of EU fundamental freedoms in member states. In contrast, Austria, Denmark, Liechtenstein, and Luxembourg have cross-border group taxation regimes that can cover companies and, in some cases, permanent establishments outside their territory, thus going beyond the requirements of the EU's fundamental freedoms. Italy provides for an optional domestic consolidation regime and an optional worldwide tax consolidation regime. Except for the Danish and Japanese group taxation systems, all systems are optional.

It would go beyond the scope of this general report to compare the substantive scope and design of the individual regulations. In this regard, reference should be made to the general report of Subject 1 of the IFA Congress in 2022, which contains a comprehensive legal comparison and also covers the question on how and to which extent the various member countries implemented the case law of the ECJ. Regarding the requirements of EU fundamental freedoms on the existing group taxation regimes in the EU member states, reference is also made to the EU report of Subject 1 of the IFA Congress 2023. The ECJ significantly restricted, if not practically nullified, the concept of final losses in relation to permanent establishments located in a European Union member state in the judgment C-538/20 concerning case W. The W judgment results in a contradiction with the previous case law of the ECJ regarding the consideration of final losses in connection with national group taxation regimes. This contradiction cannot be legally or economically justified by the reasoning of the ECJ in Case W, according to which companies with domestic and foreign branches which constitute permanent establishments exempted under double taxation treaties are not in comparable situations and therefore no restriction on the right of establishment can arise if no relief is granted for the final losses of the exempted branches. It remains to be seen whether and, if so, what impact this judgment will have on the previous case law of the ECJ concerning final losses of foreign group companies in relation to a fundamentally nationally restricted group taxation system.

The following analysis focuses on the measures that individual states apply to combat loss trafficking. Problems arise when a company enters a group with pre-existing loss carryforwards and when a group company exits with a loss carryforward. Upon entry into a group, the question arises as to whether loss carryforwards that arose before joining the group can be offset against profits within the group.[54] When a group company exits, it must be ensured that the losses of the exiting company are not deducted twice. Based on the above, the utilization of loss carryforwards upon the entry of a company into a group regime and the exit of a company from an applicable group taxation regime will be the main focus of the following chapters.

4.2. Country comparison with regard to entry into a group

As far as can be seen from the branch reports, in all states except Australia, loss carryforwards accumulated by a group member before joining the tax group cannot be offset within the group. In this context, a rough distinction can be made between group taxation regimes that determine the profit of a group through consolidation or aggregation of the profits and losses generated by the group members (Austria, Australia, Denmark, Germany, France, Italy, Republic of Korea, Luxembourg, Netherlands, New Zealand, Poland, Portugal, Spain, United States), group reliefs where a loss-making group member can transfer losses to a profit-making member (Singapore, United Kingdom), and group contribution regimes

[54] OECD, *Corporate Loss Utilisation supra* n. 3, at p. 33.

where a group company can transfer profits to a loss-making group member (Belgium, Finland, New Zealand, Norway, and Sweden).

In group taxation and group relief regimes, loss carryforwards incurred outside the group are ring-fenced. They can only be offset against the profits of the newly joining group member. The purpose of ring-fencing is to prevent the acquisition of loss companies.[55] Various techniques are used to ensure ring-fencing, as exemplified by the following regulations:

In Japan, a newly participating company is generally required to recognize unrealized capital gains/losses on certain assets and write off all carry-forward losses at the time it enters the tax group. Exceptions are made only if the newly joining company has been a wholly controlled subsidiary of the group through a tax-neutral share exchange or has met conditions similar to a tax-neutral merger since its inception.

In Poland and the United States, loss carryforwards of a newly joining member are allowed to be offset within the group. However, the amount of the new subsidiary's losses that can be utilized by the consolidated group is limited to the new subsidiary's aggregate contribution to the consolidated taxable income of the group. The Polish branch report also mentions certain tax planning schemes involving tax groups for which the Ministry of Finance issued a warning.

Denmark, on the other hand, applies a different regulatory technique. Losses can be offset against the consolidated profit; however, only the company that incurred the losses is eligible to carry them forward.

Similarly, the applicability of group contribution systems in New Zealand and Norway, as well as the group relief systems in Singapore and the UK, is limited to current losses.

As mentioned earlier, of the countries examined, only Australia allows the offsetting of pre-consolidated losses carried forward. However, in order to prevent the inappropriate application of the transferred loss against income generated by other members of the group, the utilization of the loss is reduced in proportion to the market value of the joining company compared to the market value of the joined group.

In relation to Spain, an interesting court decision should be noted, in which the court extended the statutory provision regarding the deduction of preexisting losses due to inconsistency with the loss offset rules applicable outside a tax group. According to the Spanish law, preexisting losses can only be offset against the consolidated tax base up to 70% of the current individual taxable profit of that company. However, according to the Central Economic-Administrative Court, the compensation of individual losses up to 1 million EUR against consolidated profits should also be allowed. Since individual taxpayers are allowed to offset a minimum of 1 million EUR in tax losses, the same rule must be applied to a member of a consolidated group. The court's decision demonstrates that inconsistencies between loss offset rules applicable within and outside tax group regimes might be eliminated by the courts in favor of the taxpayer if they cannot be justified by a reasonable policy goal. Probably in response to this decision, the government announced a temporary limitation on the loss carry-forward for consolidated groups in September 2022. According to the government announcement, consolidated groups will only be allowed to offset 50% of their tax losses regardless of their turnover.

In France, the Supreme Court had to decide a case where preexisting losses were at risk of expiring due to the approaching end of the loss offset period. A company belonging to a

55 See Michelsen, *supra* n. 30 at s. 3.2.

tax group converted one of its subsidiaries, which was not part of the consolidated group, into a partnership, which allowed losses to be offset. The Supreme Court held that the entire arrangement was not abusive and therefore confirmed the loss offset.

4.3. Country comparison regarding the exit from a group

As far as can be seen from the branch reports, countries attempt to prevent the double use of the same loss in a domestic context through various measures. There are different approaches to preventing the double use of the same loss. As an example, reference is made to the regulations in Chinese Taipei, the Netherlands, and France. In Chinese Taipei, any carried forward losses of the group are proportionately allocated to the exiting member. In the Netherlands, the carried forward losses realized remain available at the level of the fiscal unity. On request, the losses realized by the excluded entity could be attributed to that entity, provided that the amount attributable to the excluded entity is substantiated. The Netherlands also regulates the exit from the group with additional SAARs. In France, the lossmaking company leaving the group may be eligible to receive compensation for the losses transferred to the tax group, subject to the proof that it could have used such losses against future profits. Such compensation is not taxable.

In the cross-border context, the exit of a foreign group company is somewhat more complex, as the loss offset rules in the residence state of the exiting company are not subject to the jurisdiction of the state applying the cross-border group taxation regime. If foreign losses of an exiting group member have already been offset against group profits, the question arises whether these losses can still be deducted in the state where the foreign company is resident under the loss offset rules existing in the residence state, and if so, whether such double use of loss deduction is accepted or prevented by a specific SAAR or GAAR.[56] In Austria, the double utilization of such foreign losses is prevented through a recapture system: If the (previously deducted) losses of the non-resident group member can be offset with foreign profits abroad, the amount previously deducted will be added to the group income. This recapture system is supplemented by a “final” recapture in case the foreign group member (economically) leaves the group taxation regime or the group as such is terminated. Similar recapture rules are applied in Denmark[57] and Italy.[58] No information is available for Liechtenstein.

4.4. Impact of the 2007-2009 financial and economic crisis and the Covid-19 crisis

There are no indications in the branch reports of increased legislative activity regarding group loss offsetting as a result of the financial and economic crisis of 2007-2009. The introduction of a cross-border group taxation regime in Liechtenstein in 2011 is indirectly related to the financial and economic crisis of 2007-2009, as this crisis was the starting point for the increased efforts by the EU Commission and the OECD to combat potentially harmful tax regimes. Liechtenstein saw group taxation as a measure that could strengthen

56 *Ibid.*

57 J.Hey/A.Schnitger, Germany, *Group approach and separate entity approach in domestic and international tax law*, IFA Cahier de droit fiscal international vol. 106A, 2022, at s. 4.1.7.4.

58 OECD, *Corporate Loss Utilisation supra* n. 3, at pp. 30.

competitiveness in line with international trends in corporate taxation. Cross-border loss offsetting was also discussed in Switzerland but was discarded in favor of increased tax incentives for research and development.

During the Covid-19 crisis, Poland and Japan made their group taxation regimes more flexible. In Poland, until the end of 2021, a tax group was required to achieve a 2% profitability ratio (taxable income to tax revenues). This meant that there was no possibility of offsetting losses within the Polish group loss regime. The requirement of the 2% profitability margin was suspended in 2020 by the Act of 16 April 2020 on special support instruments in connection with the SARS Covid Act, and the profitability condition is considered to be met in 2020 if the taxpayer incurred negative economic consequences in 2020 due to the Covid-19 pandemic. In Japan, the group tax relief system was also made more flexible as of 1 April 2022, with the relaxations appearing to be more of an administrative nature.

4.5. Interim conclusion

It is remarkable how widespread group taxation systems are nowadays. Out of the 23 OECD member states, 20 allow for intra-group loss offsetting. Only Chile, Switzerland, and Türkiye do not have a group taxation regime. However, with respect to Switzerland, it should be recalled that it allows the transfer of losses within the group if, after the merger has taken place, there is economic continuity with respect to the assets that are transferred and to which the loss carry-forwards are related, and the reorganization is not motivated solely by tax considerations. In contrast, the situation is different in Chile, where losses cannot be transferred in the context of reorganizations, and in Türkiye, where the requirements for meeting the continuity of business test are relatively high.

Another notable, albeit not surprising, finding is the complete absence of South American countries among the countries with group taxation regimes. Together with the fact that losses in South America cannot be offset within a group or only with significant limitations during reorganizations, and that inflation adjustment is only possible in Uruguay, this serves as further evidence that loss offsetting in the examined South American countries is handled more restrictively than in other regions of the world. It would be interesting to examine from an economic perspective the potential impact of relaxing this rigid practice, which is based on the fear of budget deficits, on the economic growth of these countries.

As far as the branch reports indicate, states are aware of the risks associated with group taxation regimes. Accordingly, specific provisions can be found in the various group taxation regimes to prevent the offsetting of pre-entry losses with group profits or profits of other group members. Regarding the exit from the group, the regimes also include specific provisions to prevent the double utilization of loss carryforwards. However, as the Polish branch reporter particularly points out, these provisions do not mean that group taxation regimes are immune to aggressive tax planning involving losses.

The possibility of offsetting losses within a group provides a significant alleviation of the absence or only rudimentary loss carryback rules. From an economic standpoint, the question arises regarding which companies primarily derive the most benefits from these regimes and the extent to which small and SMEs can truly avail themselves of these advantages. Depending on the answer to this question, it may be sensible from a legislative standpoint to consider improving loss carryback rules for SMEs by expanding the scope of such rules, bringing the goal of taxation based on the total profit principle closer for them as well.

Part Five: Utilisation of losses from foreign permanent establishments

5.1. Overview

The OECD Report of 2011 already highlighted correctly that the treatment of foreign losses by a state primarily depends on the method used to avoid double taxation. In general, a distinction is made between the credit method and the exemption method.

Under the credit method, the profits and usually the losses of a foreign branch are included in the taxable base of the resident company. Double taxation is eliminated by crediting the tax paid in the foreign state, typically through the ordinary credit method. When applying the credit method, the residence state therefore usually allows for the deduction of losses from foreign branches. Any offsetting of branch losses against future branch profits through loss carryforward provisions, therefore, does not generally lead to distortions since the creditable foreign tax is reduced as a result of the offset. The double use of the loss is essentially neutralized through the functioning of the credit mechanism. Among the 39 countries included in the study, 27 apply the credit method. Countries that exclusively apply the credit method include Argentina, Austria, Belgium, Brazil, Chile, Chinese Taipei, Japan, the Republic of Korea, Mexico, New Zealand, Peru, South Africa, Türkiye, Ukraine, and the United States. However, Belgium, Denmark, India, Italy, Luxembourg, Finland, Norway, Poland, Portugal, Spain, and Sweden also apply the exemption method, either by providing a unilateral right to choose the method of elimination of double taxation or by treaty provisions with respect to certain states.

The situation is different when the exemption method is applied. This method generally does not require the offsetting of foreign branch losses. Among the 39 countries examined, 17 countries apply the exemption method based on unilateral or treaty provisions. These countries are Belgium, Denmark, France, Germany, Hong Kong, India, Italy, Luxembourg, Finland, the Netherlands, Norway, Poland, Panama, Portugal, Singapore, Spain, and Sweden. France, Germany, Hong Kong, the Netherlands, Panama, Uruguay and Singapore are pure exemption countries as far as can be seen.

Hong Kong, Panama, Uruguay, and Singapore apply the exemption method in its pure form. This is due to their strongly territorial-based corporate tax systems. If the worldwide basis of taxation is taken as the benchmark, taxable companies in Hong Kong, Panama, Uruguay and Singapore are subject to over-taxation since even final losses of foreign permanent establishments are not allowed to be carried forward.

Belgium, Denmark, France, Germany, Italy, Luxembourg, Finland, the Netherlands, Norway, Poland, Portugal, Spain, and Sweden, when applying the exemption method, must respect the case law of the ECJ. In the EU and the European Economic Area, the question arises as to the extent to which losses incurred by permanent establishments located in the EU and the European Economic Area must be allowed by the state of residence. Due to the case law of the ECJ, the discussion has primarily revolved around the conditions under which final losses occur and must be allowed. As the EU report shows, this discussion has reached a turning point with the judgment of the ECJ C-538/20 in case W. In this case, the ECJ concluded that companies with domestic and foreign branches which constitute permanent establishments exempted under double taxation treaties are not in comparable situations and therefore no restriction on the right of establishment can arise if no relief is granted for the final losses of the exempted branches. The EU reporter therefore concludes that the W decision "appears to make effectively all the cases examining the concept of 'final loss' outdated." The landmark judgment of the ECJ was delivered on 22 September 2022. It will be interesting to see how this judgment will affect the practice of EU member states regarding the application of the exemption method. If EU Member States refuse to allow the offsetting of final losses on the basis of budgetary considerations and the W ruling, EU resident companies with branches in the EU will be overtaxed, which is contrary to the taxation according to the total profit principle.

Austria, Switzerland, and Liechtenstein, referring to the principle of ability to pay, allow the offsetting of foreign branch losses in the period in which they arise despite exempting foreign branch profits, as long as these losses cannot be offset in the country where the permanent establishment is based. Previous analyses have revealed that the loss offset rules related to foreign branch losses are susceptible to arrangements that can lead to double loss offsetting. This is particularly true for losses that are offset under the exemption method. Undesired double deductions of the same loss occur when the foreign branch loss is offset against branch profits that are exempted under the exemption method at a later point in time. However, all states following this liberal model have introduced recapture provisions to prevent this undesired effect. I will revisit these provisions later.

Not only liberal exemption regimes with loss offset provisions, but also the credit method carries risks of double utilization of branch losses. This is demonstrated by the so-called Branch Model. In numerous states, branches are included in group taxation. In such cases, a branch can already offset its losses with the profits of another group member in the jurisdiction where it is located. If the resident state applies the credit method or the exemption method with loss offset regardless of the application of group taxation in the jurisdiction where the branch is located, the loss that has already been offset in the jurisdiction will also be offset against the remaining profits of the resident company. This means that the loss is utilized twice in the tax period in which it was incurred. This provides a tax advantage to the resident company because without offsetting within the group, the loss could only be offset against branch profits in a later period.

The following sections will discuss selected aspects of the issue of double utilization of branch losses when applying the credit method and the exemption method with loss offset provisions from a comparative law perspective.

5.2. Country comparison: Credit method and dual use of losses

As mentioned earlier, when applying the credit method, states generally allow for the offsetting of losses. However, the country comparison reveals important exceptions: Brazil, Chile and Peru are among the countries that exclusively apply the credit method and tax profits from foreign branches using this method. However, foreign branch losses cannot be offset against taxable domestic profits. The branch reporter for Peru states that this asymmetric application of the credit method is justified by the fact that allowing Peruvian corporations to compensate for foreign source losses would result in the importation of tax generated in other jurisdictions into Peru, eroding the taxable base of Peruvian Corporate Income Tax and reducing the financial resources derived from the collection of income tax. Similar reasons likely influenced Chile to refuse the offsetting of losses against domestic profits. In Brazil and Chile, branch losses can at least be carried forward and offset against future branch profits. If foreign losses of a foreign branch were used to offset foreign profits in a consolidation these losses will have been used and could not be used again in other circumstances since foreign losses should be used only once.

Among European countries, only Spain has a similar regime. The Spanish regulation stands out due to several particularities: Spain generally applies the exemption method. However, there is a mandatory switch to the credit method if the foreign branch in the jurisdiction of location is not subject to a statutory tax rate of 10% (so-called switch-over clause). Additionally, taxpayers are granted the right to opt for the application of the credit method. However, in 2013, Spain enacted legislation that completely prohibits the offsetting of branch losses, regardless of the method applied or chosen to eliminate double taxation. The reason for this amendment was to prevent the double use of tax losses. In 2016, the regulation was further tightened by excluding losses from the transfer of a branch to a subsidiary. Thus, the Spanish regulation also solves the issue of the dual use of branch losses when offsetting the loss within a group taxation regime.

In comparison to the Spanish regulation, the American Dual Consolidated (DCL) Rules prove to be more nuanced. Under the DCL rules, loss compensation is only denied if the taxpayer uses DCLs to reduce the taxable income of a member of the affiliated group. Furthermore, the United States applies Branch Loss Recapture Rules. For example, when there is an outbound transfer of substantially all of the assets of a foreign branch by a US corporation to a specified 10-percent owned foreign corporation, certain losses incurred by the foreign branch that were recognized by the US corporation shall be included in gross income (reduced by any gain recognized on the transfer). Additionally, when a taxpayer disposes of branch assets where an overall foreign loss exists, the amount of the foreign sourced gain on the disposition may be recaptured as US sourced income to the extent of the lesser of the gain or the foreign overall loss - this effectively reduces the foreign tax credit limitation that a taxpayer can claim. Thus, the United States also imposes limitations to the extent there are foreign branch losses claimed against profits of domestic head offices in practice.

Another planning opportunity that leads to a dual use of losses in connection with the credit method is the transfer of a branch with loss carryforwards to a subsidiary. The idea is to reduce the profit in the residence state in the first step by offsetting the losses, and in the second step, to shield future profits from business activities carried out through the branch by transferring it to a fiscally opaque corporation. Norway has explicitly targeted this arrangement. When business activities abroad are completely or partly transferred to an owned or controlled party, any foreign loss deducted from the taxpayer's other income sources in the year of transfer and the preceding four years shall be recognized as income. Portugal has a similar approach with its anti-abuse provision. However, it focuses on the participation exemption and denies the participation exemption to dividends distributed by companies that were incorporated through the conversion of a permanent establishment until those dividends fully offset any losses realized by such permanent establishment in previous years.

Like Spain, Italy and Portugal also grant taxpayers the option to choose the applicable method to avoid double taxation. However, Italy and Portugal primarily apply the credit method and allow taxpayers to switch to the exemption method. This choice carries the risk that taxpayers may import losses into Italy or Portugal under the credit method and then opt for the exemption method. Both Italy and Portugal have implemented recapture rules for such situations. In both countries, after the election, the income of the foreign permanent establishment is included in the taxable income of the resident company up to the amount of the aforementioned net losses.

5.3. Country comparison: Exemption method and dual use of losses

As previously mentioned, questions regarding the dual use of losses also arise in the context of exemption regimes that allow for the offsetting of permanent establishment losses in the residence state. Only Austria, Liechtenstein, and Switzerland have opted in their unilateral tax laws for the exemption method with the credit for foreign permanent establishment losses in the tax period in which they occurred. All three countries apply recapture rules, albeit with slight differences. In Switzerland, a recapture period of seven years is provided. If the permanent establishment generates a profit only after seven years, the loss carryforward in the permanent establishment state - depending on the specific carryforward provision - may still be used again without triggering a recapture in Switzerland. This leads to a dual use of the same loss. Austrian regulations do not impose a time limit for recapture. With countries with which Austria does not have comprehensive information exchange, recapture needs to occur no later than in the third year after their recognition. In Liechtenstein, recapture must be carried out within five years. The recapture takes place regardless of whether the permanent establishment has generated sufficient profits within this period. If the loss cannot be offset in the permanent establishment state, it definitely expires under the Liechtenstein regulation, which raises questions about the compatibility of the Liechtenstein regulation with the European fundamental freedoms which also apply to Liechtenstein.

The application of loss offsetting rules in the presence of a Branch Model is likely excluded in all three countries. Regarding Switzerland, it can be reported that losses from a foreign permanent establishment can only be offset to the extent that these losses have not been taken into account in the permanent establishment state. If the loss has already been offset against profits of another group member, Switzerland denies additional offsetting of the loss, thereby preventing the dual use of the same loss in connection with the Branch Model. The same applies in Liechtenstein. Additionally, Liechtenstein prohibits the use of Liechtenstein based branches for loss duplication by excluding Liechtenstein based branches from Liechtenstein group taxation. In Austria, the double deduction of permanent establishment losses using group taxation regimes is likely covered by the anti-hybrid rules.

5.4. Country comparison: Anti-hybrid rules against cross-border dual use of permanent establishment losses

The scope of the OECD Action 2 Hybrid Mismatch Arrangements extends to payments that, within a hybrid mismatch arrangement, are deductible in the state of the paying entity without the payment being taxed as income in another state, or that result in a deduction in two states. The double or multiple deduction of a loss does not seem to be the primary focus of Action 2.

However, the definition article in article 2 (9) (1) (g) ATAD seems to go further when it mentions as a hybrid arrangement a situation in connection with a taxpayer or with a company in which a double deduction occurs. Article 2 (9) (2) (b) ATAD also limits the scope of article 2 (9) (1) (g) ATAD to the extent that a hybrid arrangement within the meaning of article 2 (9) (1) (g) ATAD arises only - but still - to the extent that in the tax territory of the payer - which is the permanent establishment state (see below) - it is permitted to offset the deduction against a (positive) amount that is not taken into account twice for tax purposes. A double deduction, within the meaning of article 2(9)(1)(g) of ATAD, is considered as the deduction of the same losses in the tax territory where the losses arise (tax territory of the payer) and in another tax territory (tax territory of the investor). In the case of a payment by a hybrid entity or a permanent establishment, the tax territory of the payer is the tax territory where the hybrid entity is established or where the permanent establishment is located. However, the Directive does not specify how the terms "payer" and "amount" should be interpreted. Does a technical interpretation apply, according to which a permanent establishment in which losses arise is considered the payer, even if the permanent establishment does not make any payment to the head office or any other related entity? Losses represent the negative result of income and expenses, so in the context of permanent establishment cases leading to a double deduction, the question arises as to what is meant by the (positive) amount that is not double-counted for tax purposes (see above). Does this language indicate that article 2 (9) (1) (g) ATAD only applies to capital losses incurred by the permanent establishment in a transaction that do not result in an overall loss of the permanent establishment?

The interpretive questions raised have not yet been settled by the courts, and therefore, it remains uncertain whether and to what extent ATAD covers the cross-border double use of a branch's overall losses. If it does, member states would be obliged to combat such practices. However, if it does not, they would be free to extend the scope of ATAD to encompass the double or multiple use of losses, as ATAD, according to article 3, is intended to ensure a minimum level of protection.

Indeed, the anti-hybrid rules of Denmark, Sweden, and the Netherlands explicitly cover the dual use of permanent establishment (overall) losses. The focus is particularly - but not exclusively - on the Branch Model mentioned above. In contrast to the abuse provisions described earlier, which result in the denial of the offsetting of foreign permanent establishment losses in the residence state, the anti-hybrid rules already give the state of the permanent establishment the possibility to deny a deduction for a permanent establishment loss that would otherwise be allowed under national law if it is deductible in the residence state of the taxpayer. As a consequence, a deduction of the loss of a permanent establishment leading to "double-dip" is denied under the anti-hybrid rules unless the similar deduction is denied in the jurisdiction of the head office.

Italian and New Zealand branch reporters generally assume that the anti-hybrid rules enacted in their countries cover the dual or multiple use of permanent establishment losses. The reporters from other countries that have incorporated article 9 of ATAD or the Recommendations on Action 2 into national law also seem to implicitly hold the same view. The application of article 9 of ATAD to permanent establishment structures that allow for a double deduction of losses is not explicitly questioned in any of the branch reports. However, due to the outlined interpretative question, it is not possible to provide a conclusive answer today as to whether those states that simply adhere to the wording of article 9 of ATAD in the implementation into national law will effectively combat the double offsetting of permanent establishment losses based on the anti-hybrid rules implemented in their legislation.

5.5. Impact of the 2007-2009 financial and economic crisis and the Covid-19 crisis

In connection with the utilization of losses from foreign permanent establishments, the branch reports do not provide any indications that the financial and economic crisis directly led to changes in the offsetting of foreign permanent establishment losses. In particular, no immediate legislative changes can be observed that aimed to facilitate the offsetting of foreign permanent establishment losses for internationally active companies. Rather, the trend was heading in a different direction. As evidence of this, the Spanish regulation enacted in 2016, which denied the deduction of permanent establishment losses - in line with certain South American states - even when the credit method was applied, serves as an example. The anti-hybrid mismatch rules recommended in Action 2 of the BEPS project, which have been implemented in numerous states in recent years, may not be as radical as the Spanish solution, but they are likely to prevent the double or multiple utilization of foreign permanent establishment losses in many states if this has not already been restricted earlier due to the adoption of SAARs.

5.6. Interim conclusion

The ability-to-pay principle requires that incurred losses are offset. This applies regardless of whether they occurred domestically or abroad. Both the credit method, which allows for the immediate deduction of foreign permanent establishment losses, and the exemption method with loss offset at the time the losses are realized by the foreign permanent establishment, respect the principle of taxation based on economic capacity. However, what is a blessing for taxpayers turns out to be a curse for tax authorities. The liberal approach of allowing the importation of foreign permanent establishment losses has been used in the past through various structures, including the Branch Model, to deduct the same permanent establishment loss in different countries. According to the views expressed in the branch reports, such double deductions of permanent establishment losses are a thing of the past with the implementation of hybrid mismatch rules. Looking at the regulations in the individual states, it is fair to say that the double use of permanent establishment losses is largely prevented today both when applying the imputation method and the exemption method with loss offset.

The current situation, particularly concerning the exemption method without loss offset, is highly unsatisfactory, especially when it comes to a permanent establishment of an EU-resident company within a member state. The recent overturning of the ECJ's case law on final losses in the W. case (C-538/20) has created new challenges for companies, leaving them vulnerable to excessive taxation. This issue becomes particularly problematic in scenarios where permanent establishment losses cannot be carried back due to the lack of provisions for loss carryback or offsetting against the profits of another group member within a group taxation regime.

Part Six: Dual and multiple use of the same loss in the framework of hybrid mismatch arrangements

6.1. Preliminary remarks

As noted in the OECD Reports of 2010 and 2011, the double and multiple deduction of losses is a concern not only in relation to foreign permanent establishments but also in connection with financial instruments and entities that are treated differently in two or more countries. Within the scope of this IFA project, the 39 participating countries examined whether tax planning models involving hybrid arrangements are known to exist, which, outside the discussion of permanent establishment and group taxation issues mentioned above in Part Five, sections 1.3 and 1.5, can lead to a double or multiple deduction of losses. Additionally, it was examined whether the implementation of the measures recommended in Action 2 of the BEPS project into domestic law - if such implementation has already taken place - is effective in curbing the dual or multiple use of the same losses through the use of hybrid arrangements.

The individual branch reports reveal a wealth of very different structures that could lead to a dual or multiple use of the same losses. It would far exceed the scope of this general report to present and compare the models mentioned in theses reports. Therefore, the following remarks are limited to providing the reader with an overview of which countries, according to the opinion of the branch reporters, consider certain hybrid arrangements to be problematic and whether anti-abuse provisions - be it GAARs or SAARs based on BEPS Action 2 or anti-hybrid rules based on article 9 of ATAD - exist that effectively combat the arrangements identified by the branch reporters. For details of the structures mentioned only briefly in this general report, reference is made to the explanations in the branch reports, which partly reflect the personal views of the branch reporters and may not necessarily correspond to the views of the tax authorities in the respective countries. Many tax arrangements that are addressed in assessments, audits, or ruling requests never see the light of day, either because the tax authorities accept or reject them and the taxpayer does not appeal. Neither the following overview nor the statements of the branch reporters can therefore claim to be exhaustive.

6.2. Country comparison

The 39 countries for which reports are available can be divided into five groups:

1. Countries that have not implemented hybrid mismatch rules in accordance with the recommendations of Action 2 and, according to the branch reporters, do not have significant issues with double deductions of losses in connection with hybrid mismatch arrangements: This fortunate group includes Argentina, Chile, Chinese Taipei, Hong Kong, Israel, Panama, Peru, Singapore, South Africa, Switzerland, Türkiye, and Uruguay.
2. Countries that have partially introduced hybrid mismatch rules following the adoption of the measures under Action 2 of the BEPS project and, according to the branch reporters, are not exposed to significant problems with double deductions of losses in connection with hybrid mismatch arrangements: This group includes Liechtenstein, Japan, Mexico, and the United States.
3. Countries that have incorporated the Hybrid Mismatch Rules according to article 9, 9a, and 9b of ATAD into national law following the adoption of the measures under Action 2 of the BEPS project, or in the case of EU member states, following the implementation of ATAD, and report no problems with double deductions of losses: This group includes Belgium, Finland, France, Portugal, Spain, and the United Kingdom.
4. Countries that have incorporated the Hybrid Mismatch Rules according to article 9, 9a, and 9b of ATAD into national law following the adoption of the measures under Action 2 of the BEPS project, or in the case of EU member states, following the implementation of ATAD, and report that existing issues with double deductions of losses have been resolved: This group includes Australia, Denmark, Germany, Italy, Luxembourg, the Netherlands, New Zealand, and Sweden.

5. Countries that have incorporated the Hybrid Mismatch Rules according to article 9, 9a, and 9b of ATAD into national law following the adoption of the measures under Action 2 of the BEPS project, or in the case of EU member states, following the implementation of ATAD, and according to the respective branch reporters, are still exposed to double deductions of losses. Only Austria falls into this group.

It is noticeable that, to the best of our knowledge, no South American country has implemented the recommendations of Action 2 of the BEPS project and reported problems related to hybrid arrangements leading to double or multiple deductions of the same loss. This finding correlates with the very strict legislation in South American states regarding the offsetting of foreign losses, which effectively limits tax planning opportunities involving losses. The first group of countries also includes Hong Kong and Singapore, which have strong territorial tax systems that prevent the cross-border importation of losses.

Regarding the countries in the second Group, the following observations can be made: In general, India does not recognize hybrid instruments or entities and, therefore, has not adopted the recommendations outlined in BEPS Action Plan 2. However, the branch reporters from India point out that for foreign companies with dual residence, which have their place of effective management, the double use of the same loss is currently possible in India and abroad. Another problem area exists with trusts that are treated as transparent. Depending on the type of private trust, the income of the trust is either taxable in the hands of beneficiaries (in the case of determinate trust) or in the hands of the trustee in a representative capacity (in the case of discretionary trust). However, in the case of an offshore trust, it might be possible for losses to be claimed in one country by the beneficiaries and by the trustees in another country.

Finally, the Norwegian branch reporters state that Norway, due to the absence of anti-hybrid mismatch rules, grants deductions under domestic law regardless of whether a deduction is also granted in the other country for the same loss arising from a hybrid arrangement.

The Canadian branch reporters report issues with dual-resident companies and hybrid entities, which are expected to be resolved with the introduction of the planned anti-hybrid mismatch rules.

The branch reporters for the states in the third group (Liechtenstein, Japan, Mexico, and the USA) report that the work of the OECD/G20 Inclusive Framework on BEPS has led to the targeted introduction or enhancement of existing anti-hybrid mismatch rules. Double deductions of losses could already be largely addressed using GAARs and SAARs. The introduction of new anti-hybrid mismatch rules appears to have further strengthened the defensive capabilities of tax authorities.

Groups three to five comprise countries that have fully implemented the anti-hybrid mismatch rules. Most EU member states, along with Australia, the United Kingdom, and New Zealand, belong to these groups. With the exception of Austria, all branch reporters state that the anti-hybrid mismatch rules have successfully resolved the issues related to the double or multiple deduction of the same loss in cross-border situations resulting from tax planning with hybrid structures. The branch reporters for the countries assigned to Group 5 specifically report that previous issues with dual-resident companies and foreign permanent establishments (Australia) and dual-consolidated entities subject to group taxation in two states (known as double consolidations) (Finland, Denmark, Germany, Netherlands) have now been resolved. Only the Austrian branch reporter reports a problem concerning double consolidation of group parents. It appears that there is no rule against double consolidation of the group parent in Austria and abroad. Therefore, according to the Austrian branch reporter, if an Austrian group parent is consolidated within a group taxation regime abroad, Austrian law does not exclude loss deduction, even if the losses could potentially be deducted in a different state as well.

6.3. Interim conclusion

The branch reports strongly indicate that the dual or multiple use of the same loss in relation to hybrid arrangements is likely to be a sporadic issue 13 years after the 2011 OECD Report. South American countries participating in this IFA project have not yet implemented the recommendations of BEPS Action 2. Nevertheless, their strict regulations effectively limit tax planning involving import of losses by using hybrid mismatch arrangements. Similarly, Hong Kong and Singapore's territorial tax systems prevent cross-border importation of losses, making them unsuitable destinations for hybrid structures enabling double or multiple loss deductions. However, India, despite not recognizing hybrid instruments, appears to allow for the double use of the same loss for foreign companies with dual residence. Challenges also persist with trusts, where the potential for double claiming losses exists across jurisdictions. Norway grants deductions without considering anti-hybrid rules. In general, it seems that most EU member states, Australia, the UK, and New Zealand have successfully addressed concerns regarding the dual and multiple use of the same loss in connection with hybrid mismatch arrangements. Only the branch reporter for Austria highlights ongoing challenges with the double use of losses in the context of double consolidation of group parents.

Part Seven: Generation of artificial losses

7.1. Preliminary remarks

Artificial losses are losses claimed for tax purposes without the taxpayer incurring an economic loss.[59] When examining whether a claimed loss is considered artificial, a consolidated approach is applied. In the OECD Report 2011,[60] artificial losses are described as follows: «[A]rtificial losses are those arising from schemes that seek to generate losses for tax purposes with no economic loss arising anywhere, whether at the level of the taxpayer claiming loss relief or somewhere else.

The generation of artificial losses is caused by technical peculiarities in the tax laws of one or more countries that are not coordinated with each other and allow taxpayers to claim artificial losses for deduction. As the OECD stated in its 2011 report, artificial loss schemes often involve the use of complex financial instruments such as securities lending, equity swaps, and sale and repurchase agreements on shares. Internal reorganizations and the exploitation of domestic merger rules can also result in the generation of artificial losses,

59 OECD, *Addressing Tax Risks*, *supra* n. 3, at p. 84.

60 OECD, *Corporate Loss Utilization*, *supra* n. 3, at p. 13.

as noted in the 2011 OECD Report.[61] The mentioned structures typically generate "artificial" capital losses, which can result in a total loss for the deducting entity, but not necessarily.

The branch reporters also present a wealth of different structures related to artificial losses, the detailed presentation of which would exceed the scope of this general report. The following information is therefore intended to provide the reader with an overview of the countries where artificial losses pose a problem and whether they can be effectively addressed through the application of anti-abuse provisions - be it GAARs or SAARs such as those based on BEPS Action 2 or article 9, 9a or 9b of the Anti-Tax Avoidance Directive (ATAD). For details on the tax planning models mentioned in this general report that generate artificial losses, reference should be made to the explanations in the branch reports. These explanations reflect personal views, which do not necessarily align with those of the tax authorities in respective countries. Neither the following summary nor the statements of the branch reporters claim to be exhaustive.

7.2. Country comparison

For several countries, artificial losses do not appear to be a problem. The Norwegian, Portuguese, Swedish, Turkish, and Uruguayan branch reporters report that they have not observed any arrangements leading to the claiming of artificial losses. The American branch reporters state that, as a result of the significant evolution of US income tax law to close tax loopholes, there are generally no broad arrangements that can create artificial losses for tax purposes without incurring any economic loss. Similarly, the Belgian branch reporter expresses that Belgium's existing system with GAARs and SAARs prevents arrangements that lead to artificial losses.

Liechtenstein, Singapore, South Africa, Spain, and Switzerland seem to have isolated cases where taxpayers were able to generate "artificial losses" in the past. The representative from Liechtenstein mentions the notional interest deduction, which can lead to artificial losses in certain financing structures with debt capital. However, the legislature has since addressed this issue by adopting a SAAR. In Singapore and Spain, there were financing structures that resulted in artificial interest expenses. In both countries, the tax authorities blocked these structures by applying the existing domestic GAAR. The branch reporter from South Africa mentions abusive capital market transactions that were carried out to generate artificial losses, but were subsequently stopped using a SAAR. In Chile and Chinese Taipei, attempts were made to create artificial losses through complex reorganizations. However, the tax authorities successfully stopped these attempts by invoking GAARs and the substance-over-form doctrine. In Switzerland, reorganizations and immigrations are mentioned as potential sources of artificial losses. The Swiss branch reporter, however, points out that their deduction can be denied by applying a SAAR or GAAR.

As far as can be seen from the branch reports, artificial losses were primarily a problem in Australia, Canada, Denmark, Luxembourg, the Netherlands, New Zealand, Poland, and Italy in the past, keeping the respective tax authorities busy. The focus was mainly on hybrid financing and financing through hybrid entities (Australia, Luxembourg, Italy), derivative financial instruments (Canada, Denmark, Netherlands), financing structures (Australia, Luxembourg, Netherlands, New Zealand, Poland, Italy), and complex reorganizations

61 OECD, *Corporate Loss Utilization*, *supra* n. 3, at p. 55 et seq.

(Denmark). The mentioned arrangements were largely and primarily stopped by the tax authorities using GAARs (Australia, Canada, Luxembourg, Denmark, New Zealand, Netherlands, Poland, and Italy), SAARs (Australia, Canada, Netherlands, and Italy), or transfer pricing principles. It is interesting to note that Poland introduced a schedular tax system in 2017 with different tax treatment for capital gains and other profits, among other reasons, to prevent abusive financing transactions and arrangements involving intangible assets. The term "capital gain" was deliberately defined broadly. The Australian branch reporter points out that the generation of artificial losses through hybrid financing instruments or financing through hybrid entities is no longer effective as a result of the introduction of hybrid mismatch rules. The same situation seems to generally apply in Italy, although apparently only when non-resident bondholders are involved.

Only a few countries seem to allow the deduction of artificial losses. India is mentioned, where hybrid financing, capital reduction structures, and loan assignments can result in deductible artificial losses. Panama also mentions examples where artificial losses can be generated, such as certain goodwill write-offs, reinsurance transactions, and financing transactions.

A particularly notable problem is reported by the Argentine branch reporters concerning artificial losses from foreign currency-denominated debts. Artificially created losses occurred in Argentina when a resident taxpayer had foreign currency debt with a foreign creditor. Due to the devaluation of the local currency, negative exchange differences were deductible in Argentina, while the foreign party did not have to recognize any taxable income. Since 2019, the inflation adjustment rules for tax purposes require resident companies to recognize a gain on foreign currency debt. This offsets the deduction created by the exchange difference with the gain created by inflation. However, currency losses can only be considered artificial losses if the debt is owed to a related entity.

7.3. Interim conclusion

The branch reports indicate that the issue of artificial losses varies across countries. Some countries, such as Norway, Portugal, Sweden, Türkiye, and Uruguay, have not observed any arrangements leading to artificial losses. In the United States and Belgium, existing anti-abuse provisions have effectively prevented the creation of artificial losses. Other countries, like Liechtenstein, Singapore, South Africa, Spain, and Switzerland have encountered isolated cases of artificial losses but have effectively addressed them through GAARs or SAARs. In contrast, countries like Australia, Canada, Denmark, Luxembourg, the Netherlands, New Zealand, Poland, and Italy have faced challenges related to artificial losses, primarily in the areas of hybrid financing, derivative financial instruments, financing structures, and complex reorganizations. However, the tax authorities in these countries have largely resolved the issue by implementing GAARs or SAARs. It is worth noting that, according to the branch reports, only India and Panama appear to allow certain arrangements that can lead to deductible artificial losses.

Part Eight: Mandatory disclosure rules and CbCR

8.1. Preliminary remarks

The OECD Report of 2011 emphasizes the importance of disclosure initiatives in uncovering corporate loss-shifting schemes. According to the 2011 OECD Report, disclosure initiatives, including mandatory disclosure rules, have proven to be very useful in helping tax administrations detect schemes involving losses in a timely manner. Given this background, the branch reporters were asked to examine whether their jurisdictions implemented the recommendations of BEPS Action 12 on mandatory domestic disclosure rules and – if so – whether the domestic implementation contain hallmarks involving loss transactions. The branch reporters also had to investigate whether the respective national legislations for the preparation of Country-by-Country Reports require specific information on losses, loss carryforwards, and intra-group reorganizations involving "loss-making companies".

BEPS Action 12 provides recommendations for designing rules that encourage taxpayers and advisors to disclose aggressive tax planning arrangements. One of the hallmarks outlined in BEPS Action 12 specifically addresses losses. The hallmark for loss schemes aims to capture schemes that create losses in order to generate a repayment or provide participants with losses that can be used to reduce their income tax or capital gains tax liabilities. Some jurisdictions may have introduced additional hallmarks to capture loss creation schemes. According to paragraphs 130 et seq. of the OECD/G20 Base Erosion and Profit Shifting Project Mandatory Disclosure Rules Action 12, a loss hallmark should target situations where a person incurs or acquires a loss that is transferred to another person to offset against other income and reduce their tax liability, where the loss is accelerated to reduce a person's current tax liability, or where the loss is part of a promoted scheme or transaction used by multiple people to reduce tax on their other income. When implementing BEPS Action 12 through the adoption of DAC 6, the EU legislature heavily relied on the hallmarks suggested by the OECD in the Final Report. Consequently, the hallmark related to arrangements involving losses mentioned in the report is also included in Annex IV. According to this hallmark, disclosure is mandatory if a particular arrangement satisfies the condition of achieving the so-called main benefit. In such an arrangement, a participant acquires a loss-making company, discontinues its main activity, and utilizes its losses to reduce tax liability, including through transferring losses to another jurisdiction or accelerating the use of those losses. It should be noted that BEPS Action 12 and DAC 6 only cover cross-border arrangements and structures.

Under BEPS Action 13, all large multinational enterprises (MNEs) are required to prepare a Country-by-Country Report (CbCR) containing aggregated data on the global allocation of income, profit, taxes paid, and economic activity among the tax jurisdictions in which they operate.

8.2. Country comparison

First, it should be noted that none of the examined states specifically require information on arrangements involving losses in relation to the documentation requirements under BEPS Action 13, particularly in connection with Country-by-Country Reporting. However, the Australian branch reporter points out that CbC Reports and local files are provided to the Australian Tax Office, and if loss-generating related party transactions are disclosed without corresponding tax payable in the foreign jurisdiction, indications of potential profit-shifting as well as loss-shifting schemes are reported. The Austrian branch report also states, "[c]onsidering the set of information to be reported, there is no doubt that the CbC-Report is quite suitable for identifying the schemes targeted at shifting of losses." It further emphasizes that the CbC Report, together with the local file, could be an additional source of information for local tax authorities to identify harmful tax practices related to loss utilization. Of the examined states, over 25 (including Australia, Argentina, Chinese Taipei, Chile, Germany, France, Finland, Denmark, India, Japan, Republic of Korea, New Zealand, Norway, Panama, Peru, Portugal, Singapore, South Africa, Spain, Switzerland, Türkiye, Uruguay, Ukraine, the United Kingdom, and the United States) have reported that they have implemented BEPS Action 13.

BEPS Action 12 or DAC 6, with the loss hallmark, has been introduced by the EU member states Denmark, Finland, France, Germany, Italy, Luxembourg, the Netherlands, Poland, Spain, and Sweden. Mandatory disclosure rules also exist in Canada, Mexico, and the United States. However, the Canadian branch reporters note that not all loss-shifting transactions are necessarily captured by the current reportable transaction rules or the tax shelter rules. In the United States, any tax avoidance transactions and transactions resulting in losses over USD 10 million in a single year or USD 20 million in any combination of years must be reported, including purely domestic transactions. Similarly, in Mexico, any tax planning models generating a tax benefit must be reported. Poland extended the territorial scope of the implementation of DAC 6 to purely domestic arrangements.

There is no mandatory obligation to report loss-shifting schemes in Brazil, Chinese Taipei, India, Israel, Japan, the Republic of Korea, Norway, Singapore, South Africa, Türkiye, Switzerland, Uruguay, and Ukraine.

8.3. Interim conclusion

The discussions demonstrate that the CbC Report, together with the local file, could indeed be an additional source of information for local tax authorities to identify harmful tax practices related to loss utilization, even though none of the participating states explicitly require the disclosure of specific information on losses, loss carryforwards, and intra-group reorganizations involving "loss-making companies" in the Country-by-Country Report. In the context of the Mandatory Disclosure Rules modelled after BEPS Action 12, loss schemes are covered, such as the acquisition of loss-making companies during a change of ownership and within the framework of reorganizations. However, it should be noted that the effectiveness of the Loss Hallmark found in BEPS Action 12 and in DAC 6 seems to be limited in most countries (but in Poland) in that it does not apply to purely domestic reorganizations.

Part Nine: Findings

The topic of corporate losses has been the subject of research over the years, both from a domestic and an international perspective. In times of economic downturn, the issue is of utmost relevance, not only from an academic but also from a practical standpoint. The reasons for this are evident. Corporations contribute a significant share to a state's tax revenues. Due to the possibility of carrying forward losses in most countries, an economic downturn can affect tax revenues for years, even after the economy has recovered and companies start generating profits again. It is therefore not surprising that numerous countries regulate the tax treatment of losses and restrict the offsetting of economically incurred losses in different ways to ensure the stability of tax revenues, which can be considered a fiscal-budgetary principle. In contrast, companies that are primarily accountable to their shareholders have an interest in being able to effectively compensate for economically incurred losses in accordance with the ability-to-pay principle and the total profit principle derived from it.

National legislators face the challenging task of balancing the ability-to-pay principle and the fiscal-budgetary principle of tax revenue stability. This balancing act is carried out differently in various countries, taking into account additional aspects. These include, amongst others, the tax policy principles of neutrality and practicability, as well as economic policy considerations, particularly in terms of location. EU member states also need to consider the freedom of establishment and the relevant case law of the European Court of Justice (ECJ) in this regard. The diverse aspects considered by national legislators in their decision-making process result in significant divergences in national regulations regarding the offsetting of losses. The more a legislator tries to restrict loss relief, the more it may become the subject of national and international tax planning by companies. In fact, in its 2011 report "Corporate Loss Utilization through Aggressive Planning," the OECD identified the following issues, in addition to transfer pricing abuses, as being of greatest concern to the tax administrations of OECD member states when it comes to tax planning with losses: the use of corporate reorganizations and group taxation regimes for loss trafficking purposes, tax planning schemes involving the use of foreign permanent establishments, hybrid arrangements, or financial instruments to deduct the same loss twice or multiple times, or to create artificial losses.

Subject 1 of the IFA Congress 2023 "Sharing and shifting of corporate losses – the new profit shifting?", to which 39 countries from all continents have contributed, examines in particular the following questions: To what extent can corporations actually claim economically incurred losses in the individual countries in accordance with the ability-to-pay principle and the total profit principle? What planning possibilities do reorganization rules, group taxation rules, hybrid arrangements and financial derivatives open up for shifting losses, the double or multiple use of losses or the creation of artificial losses? A central aspect of the IFA project is also to analyze the impact of the financial and economic crisis of 2007-2009, the Covid-19 crisis, and the adoption of the BEPS measures on the legislation and practice of individual countries regarding loss offset rules.

The following conclusions can be drawn from the 39 branch reports and the report on EU law:

1. When considering the regulations of the 39 countries examined regarding loss offsetting, it can be firmly stated that the loss offset regimes in all states lag far behind the ideal of the total profit principle. Due to budgetary considerations, states rely on loss carryforward rules and are reluctant to allow taxpayers to carry back losses. However, even the loss carryforward options are often limited in terms of time or amount, as the carryforward can frequently only be offset against a certain percentage of taxable profit before the offset. The deferral of loss offsetting proves problematic when the carryforward period expires or is no longer possible due to the liquidation of a company. If the elapsed carryforward could be covered by profits previously taxed, a definitive over-taxation conflicting with the total profit principle occurs. To make matters worse,

only a very few countries (Mexico, Uruguay and, to a limited extent, Australia) seem to provide for an inflation adjustment of loss carryforwards. The outlined over-taxations could be addressed by providing an inflation adjustment of previous year's losses and a carryback of otherwise expiring loss carryforwards to previously taxed profits. Alternatively, a tax credit system could be considered. With the ongoing digitization of tax authorities and the business world, the over-taxations occurring under current legal systems can likely no longer be justified by the lack of practicality of a loss carryback or loss carryback tax credit system.

2. Unlike the financial and economic crisis of 2007-2009, the Covid-19 crisis resulted in a significantly higher wave of temporary legislative changes. Of the 39 participating countries, approximately 40% have liberalized their loss offset regulations during the Covid-19 crisis. Most of these measures are of a temporary nature. They aim not only for temporary loss carryback, as recommended by the EU Commission, but also for a flexibilization of loss carryforward regulations.
3. As far as loss shifting in the framework of reorganizations is concerned, most of the 39 countries deny the transfer of loss carryforwards from one taxpayer to another one if there is a change in ownership (change of ownership test) and the previous loss generating activity is not continued (continuity of activity test) after the reorganization. Economic policy considerations play an important role in determining whether loss carryforwards can continue to be utilized in cases of ownership change and change of business. Countries that apply a generous continuity-of-business test create a favorable tax environment for businesses to adapt to constantly changing economic conditions, including technological advancements, digitization, and consumer behavior. In contrast, those countries that completely exclude loss transfer, such as Brazil, Peru, Panama, Mexico, and Uruguay, or make it dependent on meeting strict change of ownership tests (e.g., Argentina, Poland, and Finland) or strict continuity-of-business tests with stringent time constraints, are driven not only by fiscal and budgetary considerations but also by employment policy considerations, as exemplified by Italy, Japan, and the Republic of Korea. However, such strict regimes run the risk of inhibiting structural change, which ultimately led New Zealand and Australia to amend their legislation and administrative practices in recent years.
4. It is remarkable how widespread group taxation systems are nowadays. Out of the 23 OECD member states, 20 allow for intra-group loss offsetting. The possibility of offsetting losses within a group provides a significant alleviation of the absence of or only rudimentary loss carryback rules in most countries. From an economic standpoint, the question arises regarding which companies primarily derive the most benefits from these regimes and the extent to which SMEs can truly avail themselves of these advantages. The economic effects of group taxation regimes on different categories of companies should be examined more closely. Understanding the impact of group taxation regimes on SMEs is crucial since most countries either have no loss carryback mechanisms or only very limited ones, which ultimately constitute a central element for the taxation of corporations in line with the principle of total income. If it turns out that SMEs significantly benefit less from group taxation regimes, the loss carryback rules should be liberalized, at least for SMEs. Another notable, albeit not surprising, finding is the complete absence of South American countries among the countries with group taxation regimes. Together with the fact that losses in South America cannot be offset within a group or only with significant limitations during reorganizations, and that inflation adjustment is only possible in Uruguay, this serves as further evidence that

loss offsetting in the examined South American countries is handled more restrictively than in other regions of the world.

5. As far as the branch reports indicate, states are aware of the risks associated with group taxation regimes. Accordingly, specific provisions can be found in the various group taxation regimes to prevent the offsetting of pre-entry losses with group profits or profits of other group members. Regarding the exit from the group, the regimes also include specific provisions to prevent the double utilization of loss carryforwards.
6. The ability-to-pay principle requires that incurred losses from foreign branches are deducted from corporations' profits. This applies regardless of whether they occurred domestically or abroad. Both the credit method, which allows for the immediate deduction of foreign permanent establishment losses, and the exemption method with loss offset at the time the losses are realized by the foreign permanent establishment, respect the ability-to-pay principle. However, some countries' liberal approach of allowing the importation of foreign permanent establishment losses has been used in the past through various structures to deduct the same permanent establishment loss in different countries. Looking at the rules in the individual states, it is fair to say that the double use of permanent establishment losses is largely prevented today both when applying the credit method and the exemption method with loss offset. The anti-hybrid mismatch rules recommended in Action 2 of the BEPS project, which have been implemented in numerous states in recent years, are likely to prevent the double or multiple utilization of foreign permanent establishment losses in many states if this has not already been restricted earlier due to the adoption of other SAARs.
7. Against the background of the ability-to-pay principle and the total profit principle, the situation is unsatisfactory in those countries that do not allow foreign branch losses to be offset at all. This is particularly true in several South American countries, which exclude the offsetting of foreign branch losses even under the credit method. The situation has also worsened in the EU. The recent overturning of the ECJ's case law on final losses in the W. case (C-538/20) has created new challenges for companies, leaving them vulnerable to over-taxation if the final losses cannot be carried back due to the lack of provisions for loss carryback or offsetting against the profits of another group member within a group taxation regime.
8. The branch reports suggest that the dual or multiple use of the same loss in hybrid arrangements remains sporadic after 13 years since the 2011 OECD Report. South American countries have not implemented BEPS Action 2 recommendations, but their strict regulations limit tax planning with loss importation via hybrid mismatch arrangements. Hong Kong's and Singapore's territorial tax systems also prevent cross-border loss importation. In contrast, India seems to allow the double use of the same loss for foreign companies with dual residence. Challenges also persist with trusts. Meanwhile, most EU member states, Australia, the UK, and New Zealand have successfully addressed concerns about dual and multiple loss use in hybrid mismatch arrangements.
9. The branch reports indicate that the issue of artificial losses varies across countries. Some countries, such as Norway, Portugal, Sweden, Türkiye, and Uruguay, have not observed any arrangements leading to artificial losses. In the United States and Belgium, existing anti-abuse provisions have effectively prevented the creation of artificial losses. Other countries, like Liechtenstein, Singapore, South Africa, Spain, and Switzerland have encountered isolated cases of artificial losses but have effectively addressed them through GAARs or SAARs. In contrast, countries like Australia, Canada, Denmark,

> Luxembourg, the Netherlands, New Zealand, Poland, and Italy have faced challenges related to artificial losses, primarily in the areas of hybrid financing, derivative financial instruments, financing structures, and complex reorganizations. However, the tax authorities in these countries have largely resolved the issue by implementing GAARs or SAARs.

This report attempts to address the provocative question: Is corporate loss sharing and shifting the new profit shifting? The short answer is no. At least, the evidence from the branch reports does not support the view that corporate loss sharing and shifting is the new profit shifting.

International Fiscal Association

9 789083 087467