German Tax Monthly

Information on the latest tax developments in Germany

July | 2018

CJEU Judgment on Final Losses in the Case "A/S Bevola and Jens W. Trock" (C-650/16)

In its judgment of 12 June 2018 the CJEU ruled in the case C-650/16 ("A/S Bevola and Jens W. Trock") on the transferability of a Finnish permanent establishment's (final) losses to the Danish head office in the light of the freedom of establishment within the meaning of Art. 49 TFEU. Although Danish Tax Law contains certain special arrangements, some of the general statements made by the CJEU on the continued applicability of the legal principle of "final losses" are notable.

We reported in the June 2017 edition of German Tax Monthly that the Federal Tax Court (BFH) changed its established case law of many years on claiming deductibility of so-called "final losses" (BFH I R 2/15). According to the understanding of the BFH, the CJEU had previously - in the "Timac Agro" judgment of 17 December 2015 (see January/February 2016 edition of German Tax Monthly) - de facto abolished final losses in any situation in which DTT exemption provisions apply. Since no domestic right of taxation existed in the first place for the income of the foreign permanent establishment exempt from tax at the national level, even the necessary comparability between a domestic and a cross-border situation was lacking.

Based on the "Timac Agro" decision it was generally understood that the CJEU had abandoned the legal principle of "final losses", but the CJEU now very much qualifies this in the current decision of 12 June 2018. According to the CJEU, the "Timac Agro" decision does not provide any foundation for the abstract statement that in situations in which DTT exemption provisions apply there was no comparability between domestic and foreign cases due to the outright non-recognition of the foreign income of the permanent establishment for domestic tax purposes. A restriction of the freedom of establishment under Community Law is thus not per se excluded. On the contrary, even in situations in which DTT exemption provisions apply, comparability may be given, because the objective of a tax exemption - i.e., the avoidance of double taxation

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of profits as well as the avoidance of double usage of losses - is precisely to establish comparability with the taxation of a purely domestic situation.

Following the most recent principles of interpretation of the CJEU it remains to be seen how the BFH will deal with the currently pending proceedings on foreign permanent establishment losses (I R 17/16, I R 48/17 and I R 49/17). In case I R 17/16, the BFH itself stayed the proceedings with explicit reference to the pending decision now rendered by the CJEU.

CJEU Judgment on the Compatibility of Income Correction Provision according to § 1 Foreign Transactions Tax Law (Previous Version) with Community Law

The case deals with the income correction provision pursuant to § 1 Foreign Transactions Tax Law (AStG) (arm's length principle) as amended and applicable in 2003. In its decision of 31 May 2018 the European Court of Justice (CJEU) ruled that the freedom of establishment pursuant to Article 43 EC (now Article 49 Treaty on the Functioning of the European Union) is infringed.

The CJEU reasoned that a provision that is only applicable to business relations with non-resident related companies such as § 1 AStG is essentially justified and compatible with Community Law for reasons of preserving the balanced allocation of the power to tax between the Member States. However, in the event of nonarm's length transactions, the taxpayer has to be given the possibility to present evidence of commercial justifications for the departure from the arm's length principle which results from its status as shareholder of the non-resident company.

The Applicant is a corporation resident in Germany which held an indirect shareholding of 100% in two companies established in the Netherlands. The Applicant provided two comfort letters to both companies without charging any remuneration (bank guarantee commissions). The local tax office increased the income of the Applicant in accordance with § 1 AStG by an amount corresponding to the presumed amount of the remuneration that an unrelated third party would have charged.

The judgment relates to the requests for a preliminary ruling from the Lower Tax Court Rhineland-Palatinate of 28 June 2016 (1 K 1472/13) whether the provision of § 1 AStG 2003 is compatible with Community Law, although in the event of non-arm's length business relations it does not allow for the presentation of evidence for a departure from the arm's length principle for commercial reasons based on the status of the taxpayer as shareholder (escape clause).

The CJEU states that the income correction provision of § 1 AStG must be regarded as a restriction on freedom of establishment as it is only applicable to cross-border business relations. But since this provision is suitable to ensure a balanced power to tax between the Member States it is justified under Community Law for compelling public interest reasons. As § 1 AStG prescribes an increase of taxable income for any departure from the arm's length principle, i.e., the scope of application is not limited to abusive tax arrangements, the provision - in order to ensure proportionality - has to provide the Applicant with the possibility of presenting evidence that the terms and conditions were agreed for commercial reasons derived from the status of the Applicant as shareholder of the non-resident companies. In the case at issue, the CJEU specifically emphasizes that none of the parties involved claimed that there had been any risk of tax evasion. Finally, the CJEU underlines that due to a lack of sufficient equity capital the provision of capital was required for the continuation and expansion of the business operations, and that it considers this to be a justified commercial reason for the gratuitous and non-arm's length provision of the letters of comfort which derived from the status as shareholder.

In concluding the CJEU emphasizes that it is for the national court to determine whether § 1 AStG is compatible with Community Law, i.e. whether it affords the Applicant the opportunity to provide evidence of commercial reasons resulting from its status under company law for transactions on non-arm's length terms. In addition, the Court will have to verify whether the asserted commercial reasons actually apply.

It is currently not foreseeable how the tax authorities and the legislator will respond to the judgment. It remains to be seen whether the legislator will amend the law to include an escape clause for commercial justifications and define them or whether the tax authorities will only respond to the CJEU judgment by issuing a corresponding administrative guidance.

Lower Tax Court of Munich (7 K 52/16): Notice of Liability against Foreign Remuneration Debtor because of Omission to Withhold Taxes for Artistic Performances

In a decision of 29 January 2018 (7 K 52/16), the Lower Tax Court of Munich ruled that for certain remunerations to non-resident

taxpayers an obligation to withhold taxes may exist even for remuneration debtors without a permanent establishment or other comparable place of business in Germany. The Court held that the non-resident tax liability of a remuneration debtor associated with a domestic activity establishes the domestic nexus required for the obligation to withhold tax.

Income tax on income of non-resident taxpayers is levied by way of withholding the tax. This includes, among others, income derived from artistic performances in Germany. At the point in time when the creditor is paid such remuneration the debtor is obliged to withhold tax on said remuneration on account of the creditor (tax debtor) and to remit the amounts withheld for tax purposes to the Federal Central Tax Office (BZSt). The debtor is in addition liable for withholding and remitting the tax.

The plaintiff is a corporation resident in Austria that does neither have a permanent establishment nor another place of business in Germany. In the years at issue (from 2000 to 2005) it operated a concert agency and engaged foreign music and theatre ensembles for guest performances in Germany. The plaintiff paid the artists a remuneration for their performances in Germany.

It was in particular controversial, whether the plaintiff should have withheld tax on account of the artists when paying the remuneration.

The plaintiff held the opinion that it did not have to withhold tax since it neither maintained a permanent establishment nor another place of business in Germany. The tax office, in contrast, confirmed the obligation to withhold tax and ultimately held the plaintiff liable for the income tax and solidarity surcharge owed by the foreign artists in the years at issue.

In the case at issue the Lower Tax Court also confirmed that tax would have had to be withheld. The obligation to withhold tax only requires taxable income of the creditor in the form of the remuneration in Germany. It is undisputed that this applies to the case at hand, since the performances of the artists took place in Germany. The Lower Tax Court explained in addition that withholding of the tax could not be omitted for the reason that the plaintiff did not maintain a permanent establishment or comparable place of business in Germany. The law does not contain a corresponding requirement. The non-resident tax liability of the remuneration debtor in connection with a domestic activity already creates the domestic nexus required for the obligation to withhold tax.

In conclusion the notices of liability to the plaintiff are lawful as a matter of principle.

Appeal proceedings against the decision are pending with the BFH (I R 8/18).

Obligation to report cross-border tax planning arrangements

The amended EU Council Directive in relation to mandatory reporting requirement for cross-border arrangements comes into force on 25 June 2018, 20 days after it was published in the Official Journal of the European Union. The German legislator is obliged to transpose the directive into German law by 31 December 2019 and to apply the rules from 1 July 2020. Arrangements must be reported to the competent tax authorities within 30 days beginning on the day after the arrangement is made available for implementation, or on the day after it is ready for implementation, or when the first step in its implementation has been made, whichever occurs first. Cross-border tax planning arrangements are already reportable according to the directive when it comes into force provided the first step of the arrangement was implemented in the period between 25 June 2018 (entry into force) and 1 July 2020. Information on reportable cross-border arrangements which were implemented during this transition phase are then to be submitted to the tax authorities by 31 August 2020.

For further details see German Tax Monthly April 2018.

Imprint

Published by
KPMG AG Wirtschafts-
prüfungsgesellschaft
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60549 Frankfurt/Main, Germany

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