



Euro Tax Flash

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Hornbach-Baumarkt case (C-382/16) referral to the CJEU

Freedom of establishment – Transfer pricing rules – Tax on cross border transactions only

On June 28, 2016, the Finance Court of Rhineland-Palatia (FCR) in Germany referred a case to the Court of Justice of the European Union (CJEU) regarding German transfer pricing rules. KPMG in Germany will be representing the taxpayer, a German stock corporation, in the CJEU proceedings. The Claimant is a German parent company which had given guarantees and letters of comfort to banks, in relation to loans to its foreign subsidiaries, without requiring any payment. The referred case concerns whether the imputation of income under the German transfer pricing rules in relation to these transactions is compatible with the freedom of establishment under EU law (Article 49 of the Treaty on the Functioning of the European Union (TFEU)), in particular as regards the possibility for the taxpayer to present evidence of commercial justifications.

Background

German transfer pricing rules mandate an adjustment to the taxable base of a German resident taxpayer, based on arm's length principles, if that taxpayer's base has been reduced as a result of a transaction / business relationship with a non-German related party on terms that

would not have been agreed between independent parties in similar circumstances. For transactions between German entities, no such adjustment is required.

In a previous similar case (*Société de Gestion Industrielle SA (SGI) v État Belge (the Belgian State)*, Case C-311/08) decided by the CJEU, involving Belgian transfer pricing rules with similar adjustment provisions, it was held that the applicable rules did amount to a restriction on the right to freedom of establishment, but were justified on the grounds of preserving the allocation of taxing rights between Member States and combating tax avoidance. The CJEU also held that the Belgian rules were proportional since they allowed taxpayers the opportunity to provide evidence of any commercial justification for the arrangements, without being subject to undue administrative constraints.

In the present case, the Claimant had guaranteed loans made by banks to some of its non-German subsidiaries, some of which were resident in other EU countries, former Accession States and some of which were resident in third countries, and provided comfort letters to those banks. The Claimant did not charge its subsidiaries any fees for these guarantees. The German tax authorities adjusted the Claimant's taxable income based on the German transfer pricing rules.

The question referred to the CJEU

The Bundesfinanzhof (the German Federal Tax Court) (in Case I R 88/12 from June 25, 2014), has previously found that the German transfer pricing rules are compatible with EU law, being a suitable measure to safeguard the balanced allocation of taxing rights and is not disproportionate, and did not see the need to refer the issue to the CJEU.

However, in the Hornbach-Baumarkt case, the FCR notes that the German rules do not have an explicit mechanism for taxpayers to provide any exception based on commercial justifications to prevent the transfer pricing adjustment, which raised the question as to whether the rules were in fact compatible with Article 49 TFEU.

In addition, the FCR pointed out that, although in some cases taxpayers can provide commercial justifications based on a similar transaction between independent parties (e.g. the supply of goods at below market rates might be agreed between independent parties if there was some other intangible benefit to the transaction), which the taxpayer could use as a defense under general tax principles in Germany to prevent the transfer pricing adjustment, there is no corresponding independent situation for the Claimant to possibly compare their transaction against. This is due to the very nature of the relationship – as an ultimate beneficiary of its subsidiaries' successes, the Claimant will always have economic justifications in the success of those subsidiaries that an independent party would not have. Therefore, there are additional economic justifications that the Claimant could claim for the transactions, which have nothing to do with eroding the taxable base in Germany or for tax avoidance. However, the German transfer pricing legislation does not allow for the Claimant to use any such justification and so, as indicated above, may go too far in achieving its aims. Therefore, the case is referred to the CJEU to clarify whether the transfer pricing legislation constitutes a restriction on the freedom of establishment, given the different treatment for cross-border arrangements to wholly domestic situations.

EU Tax Centre comment

Given the previously decided case law by the German Federal Tax Court that the transfer pricing rules there are wholly compatible with EU law, the referral of this case to the CJEU can be viewed as ground-breaking. However, KPMG believes that there is a strong possibility that the CJEU will hold, given the facts and circumstances of the case, that the German transfer pricing rules do infringe the freedom of establishment without justification.

Finally, although the FCR referred to the SGI case outlined above, in which the restriction was held to be justified, there was one significant difference not explicitly mentioned in the FCR's referral to the CJEU. In the SGI case, domestic transactions could still be caught by the applicable Belgian transfer pricing rule at the level of the parent if the granted benefit was not taxed at the level of the related entity which benefitted from the transaction. In the present case, there is no such condition in Germany. Therefore, in our view the German rules cannot be justified on the grounds of preserving the allocation of taxing rights between Member States and combating tax avoidance in the same way as was held in the SGI case.

KPMG's EU Tax Centre will be liaising closely with the team from KPMG in Germany, who will be representing the Claimant before the CJEU, in order to provide prompt continued updates via our Euro Tax Flash and E-News publications as appropriate.

Should you have any queries, please do not hesitate to contact [KPMG's EU Tax Centre](#), or, as appropriate, your local KPMG tax advisor.



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