Deloitte.

URL: http://www.deloitte-tax-news.de/german-tax-legal-news/cjeu-concludes-germanys-pre-2012-anti-treaty-shopping-rules-violate-eu-law.html

27.12.2017

German Tax and Legal News

CJEU concludes Germany's pre-2012 anti-treaty shopping rules violate EU law

The Court of Justice of the European Union (CJEU) issued a decision on 20 December 2017, concluding that the pre-2012 version of Germany's anti-treaty-shopping rules in section 50d (3) EStG violate EU law (combined cases C-504/16 (Deister Holding) and C-613/16 (Juhler Holding). The court held that the rules violate both the EU parent-subsidiary directive (PSD) and the freedom of establishment principle in article 49 of the Treaty on the Functioning of the European Union (TFEU).

Under the anti-treaty shopping rules, a payment that is subject to German withholding tax will be denied the benefits under the PSD or an applicable tax treaty in cases where the payer entity's shareholders would not be entitled to similar benefits, or the recipient is unable to demonstrate that it earns sufficient active business income. If both tests are failed, relief will be granted only if both a business purpose test and a substance test can be met. The rules were substantially revised following an investigation by the European Commission launch in 2010 that that measures imposed disproportionate requirements on foreign companies to demonstrate, in particular, that they were engaged in an active business. The revised rules apply to payments made on or after January 1 2012.

Facts of the cases

In the two cases before the CJEU, the applicants (recipients of German dividends) were holding companies established in other EU members state. The applicants claimed that, based on the PSD, they were entitled to a withholding tax exemption on the dividends received from the entities in the other member states.

The Deister case involved a Dutch resident entity that had shareholdings in several companies established in EU and non-EU countries and provided financing to its subsidiaries. The Dutch company held 26.5% in the German dividend-paying entity. The Dutch entity rented office space in the Netherlands and had two Dutch-based employees in the years 2007 and 2008. Its sole shareholder was an individual resident in Germany. The German tax authorities denied the withholding tax exemption under the PSD because the individual shareholder would not qualify for benefits under the PSD if it held the participation directly and the Dutch holding entity lacked sufficient substance in terms of earnings from an active trade or business.

In the Juhler case, the dividend recipient in the other case was resident in Denmark. The company had shareholdings in more than 25 subsidiaries, some of which also had registered offices in Denmark and it held 100% of a German GmbH. The sole shareholder of the Danish company was an individual resident in Singapore. The German tax authorities denied the withholding tax exemption on the same grounds as in the first case.

The Fiscal Court of Cologne referred the cases to the CJEU because it had doubts regarding the compatibility of the German rules with EU law.

Decision of the CJEU

The CJEU held that the pre-2012 German anti-treaty-shopping rules violate both the PSD and the freedom of establishment principle in the TFEU.

Parent-subsidiary directive

The PSD requires member states to grant a withholding tax exemption for dividend payments between a subsidiary and its parent company provided both entities are resident in different EU member states and they meet a minimum holding requirement (15% until 2008, and 10% thereafter). The PSD does allow member states to introduce rules to prevent fraud and abuse of the directive; according to article 1(2), the "Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse." The question referred to the CJEU was whether the German anti-abuse rules are in line with that provision.

In its decision, the CJEU first emphasized the objective of the PSD, which is to avoid double

taxation by prohibiting the levy of withholding tax on qualifying dividends. The court also reiterated the principle that article 1(2) provides for an exception to the withholding tax exemption based on the "general rules laid down by the directive" and thus article 1(2) "must be subject to strict interpretation." Accordingly, "its specific objective must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, the purpose of which is unduly to obtain a tax advantage."

The CJEU stated that the German anti-treaty shopping rules are "not specifically designed to exclude from the benefit of a tax advantage wholly artificial arrangements the purpose of which is unduly to obtain that advantage," and that "the mere fact that … persons [who would not have been entitled to such an exemption] have such holdings does not in itself indicate the existence of a wholly artificial arrangement." Specifically, the court held that the German rules include a "general presumption of fraud or abuse and thus undermines the objective pursued by the Parent-Subsidiary Directive" and, further, the "directive does not contain any requirement as to the nature of the economic activity of companies falling within its scope or the amount of turnover resulting from those companies' own economic activity."

Consequently, the CJEU found that the PSD precludes national tax legislation, such as the German anti-treaty-shopping rules.

Freedom of establishment

The CJEU also tested the German ant-treaty shopping rules against the fundamental freedoms in the TFEU, concluding that the rules could fall within the scope of both the freedom of establishment and the free movement of capital. Since the dividend recipients in both cases were resident in the EU, it was necessary to take into account the facts of the case, and because both holding percentages were sufficient to grant the holding company a definite influence over the decisions of the German subsidiary, allowing it to determine its activities, the freedom of establishment was applicable. The fact that the shareholder in the second case was resident in a non-EU country does not affect the right of the holding companies to rely on the freedom of establishment.

Given that the withholding tax exemption granted to nonresident shareholders was subject to the anti-treaty-shopping rules, while a resident shareholder would have received dividends tax exempt, the CJEU found that the German rules constitute a restriction of the freedom of establishment, which cannot be justified by the objective of combating tax evasion and avoidance.

Consequently, the CJEU found that the freedom of establishment precludes national tax legislation such as the German anti-treaty-shopping rules.

Implications for taxpayers

The CJEU decision only affects dividend payments made by a German entity to its EU parent company for periods before 2012. To the extent a withholding tax exemption was denied based on German's anti-treaty-shopping rules, taxpayers should be entitled to a refund provided the statute of limitations has not expired.

The revised anti-treaty-shopping rules apply to payments made as from 1 January 2012, although these rules also have been challenged and a preliminary ruling requested from the CJEU (C-440/17, GS), see GTLN. In light of the 20 December decision, it seems likely that the CJEU will apply the same principles and conclude that the revised anti-treaty shopping rules also are incompatible with EU law. Potentially affected taxpayers should object to any decisions made by the German tax authorities in which they deny a withholding tax exemption under the PSD based on the anti-treaty shopping rules.

Although not specifically mentioned in the CJEU decision (and not specifically covered in the pending case), the anti-treaty-shopping rules also may violate the free movement of capital principle in third-country situations. For example, an entity in a third country that relies on a tax treaty to reduce (or eliminate) German withholding tax on dividends could fall within the scope of the free movement of capital if the withholding tax reduction is denied based on the anti-treaty-shopping rules. In a third-country scenario, the principle can come into play even where there is a 100% shareholding if the rule as such also would target shareholdings below the threshold of a controlling shareholding. Taxpayers should continue to monitor developments if they did not rely on the PSD but rather on an applicable tax treaty.

Ihr Ansprechpartner

Dr. Alexander Linn
Partner
allinn@deloitte.de
Tel.: 089 29036-8558

www.deloitte-tax-news.de

Diese Mandanteninformation enthält ausschließlich allgemeine Informationen, die nicht geeignet sind, den besonderen Umständen eines Einzelfalles gerecht zu werden. Sie hat nicht den Sinn, Grundlage für wirtschaftliche oder sonstige Entscheidungen jedweder Art zu sein. Sie stellt keine Beratung, Auskunft oder ein rechtsverbindliches Angebot dar und ist auch nicht geeignet, eine persönliche Beratung zu ersetzen. Sollte jemand Entscheidungen jedweder Art auf Inhalte dieser Mandanteninformation oder Teile davon stützen, handelt dieser ausschließlich auf eigenes Risiko. Deloitte GmbH übernimmt keinerlei Garantie oder Gewährleistung noch haftet sie in irgendeiner anderen Weise für den Inhalt dieser Mandanteninformation. Aus diesem Grunde empfehlen wir stets, eine persönliche Beratung einzuholen.

This client information exclusively contains general information not suitable for addressing the particular circumstances of any individual case. Its purpose is not to be used as a basis for commercial decisions or decisions of any other kind. This client information does neither constitute any advice nor any legally binding information or offer and shall not be deemed suitable for substituting personal advice under any circumstances. Should you base decisions of any kind on the contents of this client information or extracts therefrom, you act solely at your own risk. Deloitte GmbH will not assume any guarantee nor warranty and will not be liable in any other form for the content of this client information. Therefore, we always recommend to obtain personal advice.