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URL: http://www.deloitte-tax-news.de/german-tax-legal-news/federal-tax-court-confirms-ruling-of-lower-tax-court-regarding-the-pre-2021-anti-treaty-shopping-rules.html

26.10.2021

German Tax and Legal News

Federal tax court confirms ruling of lower tax court regarding the pre-2021 anti-treaty shopping rules

Court rejects tax authorities' arguments in light of CJEU case law.

The German federal tax court in a decision dated 9 June 2021 and published on 21 October 2021 confirmed a 2020 decision of the lower tax court of Cologne (see GTLN dated 10 December 2020) ruling that the interposition of certain entities within a corporate structure was not abusive for purposes of the former anti-treaty shopping rules under section 50d (3) of the Income Tax Code (ITC).

The federal tax court's ruling came as a result of a complaint filed by the federal tax authorities against the lower tax court's denial of leave to appeal. The lower tax court did not allow for an appeals procedure because, in its opinion, the tax technical issue already had been decided by the Court of Justice of the European Union (CJEU).

The decisions of the federal tax court and the lower tax court are of relevance primarily in regard to the version of the anti-treaty shopping rules that were in place until 8 June 2021. As from 9 June 2021, the former anti-treaty shopping rules were replaced by updated and amended anti-treaty shopping rules (see GTLN dated 24 March 2021).

Background
he CJEU held in two December 2017 (combined cases C-504/16 and C-613/16, see GTLN dated 27 December 2017) that the pre-2012 German anti-treaty shopping rules violate both the parent-subsidiary directive (PSD) and the freedom of establishment principle in article 49 of the Treaty on the Functioning of the European Union (TFEU). The CJEU then ruled on 14 June 2018 (case C-440/17, see GTLN dated 7 August 2018) that the post-2011 German anti-treaty shopping rules in section 50d (3) ITC also violate the PSD and the freedom of establishment principle.

The Ministry of Finance set forth its interpretation of the CJEU decisions in a decree dated 4 April 2018 (see GTLN dated 11 April 2018), in which it limited the application of the rulings to claims for a reduced dividend withholding tax rate that are based on the PSD.

Broadly, both the pre-2012 and the post-2011 versions of the anti-treaty shopping rules (which also apply to withholding tax relief sought under an EU directive) provide that a nonresident company that receives a payment subject to German withholding tax must meet certain requirements to be entitled to withholding tax relief. Although there are variations in the pre-2012 and the post-2011 requirements, both sets of rules provide alternative tests relating to ownership, business activities, business purpose, and substance requirements that companies must meet to qualify for such relief.

Lower tax court case
In the case decided by the lower tax court of Cologne, a Dutch BV held all of the shares in a German GmbH. A French entity held 51% of the shares in the Dutch BV and, in turn, the French entity was held by a French listed entity. The other 49% of the shares in the Dutch BV were held by a German GmbH through a Dutch CV (a partnership); the German GmbH was, in turn, held by the French listed entity. The Dutch BV had two managing directors but no other personnel or office space. The Dutch BV was not engaged in activities other than holding the shares in the German GmbH.

The federal tax authorities rejected both the application for a dividend withholding tax exemption certificate and a withholding tax refund application with regard to the 49% indirect ownership of the German GmbH. The rejection was based on the argument that the substance and activity conditions of section 50d (3) ITC were not fulfilled at the level of the Dutch BV. The federal tax authorities further argued that because of the interposition of the Dutch CV (a transparent partnership) with the German GmbH as a partner, the French listed entity could not be part of the analysis since the interposed German GmbH is not entitled to benefits under a double tax treaty or the PSD. The applicant's argument that the purpose of the Dutch BV was to avoid immediate French taxation of dividends from the German GmbH

was seen as an abusive purpose under the PSD by the federal tax authorities.

In its decision, the lower tax court referred to the anti-treaty shopping rules and the CJEU decisions and stated that, although the anti-treaty shopping rules violate EU law, this does not automatically result in the rules being void and no longer applicable. The court concluded that the rules generally remain applicable but must be interpreted and applied in light of EU law. The CJEU decisions focused on whether a structure chosen by a taxpayer was an artificial arrangement used to obtain a tax advantage, which the CJEU stated must be the basis for any domestic anti-abuse legislation. The CJEU concluded that a set of rules that is based on irrebuttable presumptions without giving the taxpayer the chance to demonstrate the opposite does not comply with these principles.

The lower tax court evaluated the anti-treaty shopping rules in light of these principles and concluded that the interposition of the German GmbH was not abusive or artificial since it did not result in a tax advantage.The German GmbH would have been eligible for a full credit (or refund) of the German withholding tax if it held the German GmbH subsidiary directly. Furthermore, the court stated that the interposition of a transparent partnership (i.e., the Dutch CV) is not considered abusive for purposes of the anti-treaty shopping rules.

The lower tax court also considered the intended French tax savings as not being abusive per se as the intention of taxpayers to minimize their tax burden cannot be seen as abusive. Only in scenarios where this goal is being reached by using purely artificial structures that have no economic justification an abusive character might be given.

Finally, the lower tax court referred to established CJEU case law (e.g., cases C-565/11 and C-234/10) according to which tax refunds that are based on claims resulting from the violation of EU law are subject to interest. Due to the lack of more specific rules in EU law, the court applied the German interest rules for tax claims and used 0.5% interest per month for such refunds.

Comments

The federal tax court's decision is brief and rejects entirely the federal tax authorities' arguments. As a result, the ruling of the lower tax court is final. The federal tax court denied the complaint as there was no new argument that was brought forward and the original issue had been decided by the CJEU. As the federal tax authorities did not raise any arguments regarding the interest on refunds, the federal tax court did not rule on this issue.

As the anti-treaty shopping rules have been amended for all open cases with effect as from 9 June 2021, the federal tax court's ruling will have limited benefit for taxpayers on a going forward basis. Whether the amended anti-treaty shopping rules are in line with EU law and fulfill the conditions as prescribed by the CJEU in its decisions regarding the previous versions of the anti-treaty shopping rules remain doubtful, and the new rules likely will be subject to tax court proceedings again.

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