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Tax & Legal News

Supreme Tax Court Cases

ECJ to clarify invoice requirements for deduction of input VAT

In two cases the Supreme Tax Court has asked the ECJ to rule on the invoice requirements which allow the deduction of input VAT.

The input tax deduction under the German VAT Act is conditional on possession of a proper invoice from the supplier. Under the Sixth Directive provisions the invoice must only show the supplier's name and full address and VAT identification number. The German tax office refused an input tax deduction on the grounds that the supplier of cars "did not exist" or (in the second case) that there was merely a "letter box address".

The Supreme Tax Court sees its previous case law in contrast to a recent ECJ judgment of October 22, 2015 (C-277/14, *PPUH Stehcemp*) and has now referred the issue to the ECJ for clarification. In the case C-277/14 the ECJ held that – in general – a customer holding an apparently valid supplier's invoice cannot be refused an input tax deduction merely because of the supplier's irregularities. The deduction of input VAT may thus not be refused on the grounds that the invoice was issued by a non-existent trader and that it is further impossible to determine the identity of the actual supplier of the goods. The customer cannot be required to make checks that are not his responsibility. According to the Supreme Tax Court this could be interpreted to mean that not all of the formal invoice requirements must be fulfilled and that – at least – the address from which the taxpayer carries out business activities need not be shown in the invoice.

Supreme Tax Court decision V R 25/15 and XI R 20/14 of April 4, 2016 published on July 6

LLP partners to be taxed where they practise

An international law firm constituted as a US LLP maintained two offices in Germany with a total of four partners. Partners' remuneration was fixed centrally, based on the profits of the partnership. The German resident partners considered their partnership profit shares to be taxable in the USA under the US-German double tax treaty and obtained a binding ruling to that effect from the local German tax office. Unfortunately, they overlooked the reservation made in the ruling that it was subject to the US authorities' taking the same view. Rather, they argued before the IRS that their partnership profit shares were remuneration for professional services carried out in Germany and should not therefore be taxed in the USA. Effectively, their partnership profits became "white income", that is, income not taxed in either state as a result of clash of concept, or, in this case, presentation.

Later, however, the German tax office changed its mind about its ruling and assessed the German partners to income tax on their full profit shares on the assumption that they had operated solely from Germany. The partners protested that these profits were drawn from a US trade or business and pointed to the binding ruling. The tax office drew their attention to the reservation of the IRS' taking the same approach and the case went to court.

The Supreme Tax Court has now decided – effectively – in favour of the tax office. Partnerships were transparent vehicles from the point of view of income determination, but not from that of where it was earned. Rather, the earnings as partnership profits from professional services rendered were taxable in the hands of each individual partner where he or she carried out the work from a fixed place of business permanently at his or her disposal. Accordingly, the profits were only taxable in the USA, to the extent each partner had actually worked there from his or her own office. As regards the validity of the ruling, the court explained that the reservation made could only mean that it was conditional on actual taxation in the USA of the relevant income.

Supreme Tax Court judgment I R 50/14 of November 25, 2015 published on March 27, 2016

Ship charter trade tax privilege only if charterer mans ship himself

Profits earned in foreign permanent establishments are exempt from trade tax. Under a specific provision in the Trade Tax Act, 80% of the profits earned from shipping operations in international waters are deemed to have been earned in foreign permanent establishments. Accordingly, they are exempt. This exemption also applies to profits from ship charters, provided the charter is for a fully fitted-out and manned vessel. The Supreme Tax Court has now, however, held that it does not apply where equipment or crew are provided by another party. Thus it could not be claimed by a former shipping line that had sub-let a ship that it had received fully manned on a charter from the owners.

The Supreme Tax Court arrived at this decision largely through analogy with the tonnage tax provisions of the Income Tax Act. These carry the same restriction, but also make clear that the legislative intentionally distinguished between the different forms of ship's charter. The analogy is justified by the references in the Trade Tax Act to the Income Tax Act. The effect is that the trade tax privilege can only be granted on ship charters to a single claimant apart from the actual operator. Income from bare-boat charters or, as in this case, from intermediaries who merely act as agents or brokers, is therefore chargeable to trade tax in full.

Supreme Tax Court judgment I R 40/15 of December 22, 2015 published on May 11, 2016

No de minimis exclusion for negative interest deduction for trade tax

One-quarter of interest expense including interest costs implicit in leasing and royalty expenses is disallowed for trade tax. However, the first €100.000 in each year is allowed in full. The profit share falling to a silent partner ranks as interest for this purpose. Thus, the interest add-back can be negative, i.e. can increase the trade tax loss for the year, wherever a silent partner is required to assume a loss from operations.

In a case involving small amounts, the tax office refused to accept a net "negative interest" claim on the grounds that it was lower than €100.000. In the view of the tax office, the de minimis amount of €100.000 applied to both positive and negative sums and thus reduced both positive and negative add-backs. However, the Supreme Tax Court has now held in favour of the taxpayer that the exclusion applies to positive sums only. The official explanation of the provision laid before Parliament at the time of its enactment described the amount as an "allowance for the relief of smaller and medium-sized businesses". This wording implies application of the provision to positive amounts only, both because an "allowance" necessarily reduces taxable income rather than increasing it, and because refusing the negative interest add-back for smaller amounts would burden rather than relieve the smaller business in particular.

Supreme Tax Court judgment I R 15/15 of January 28, 2016 published on May 18

No royalty charge for assumption of group name by subsidiary

A German business was active in a field of patented technology associated with its own firm name, “B”. It allowed its Polish subsidiaries to register in that name, “B Sp.z.o.o.”, but made an appropriate charge for the use of the technology. It also did not authorise the Polish companies to use its logo, but left it up to them to design their own. The tax office maintained that the group name was a valuable intangible and demanded an income adjustment to reflect its use by foreign subsidiaries. However, the Supreme Tax Court has now confirmed its previous case law in holding that the mere use of the group name in the company registration of a subsidiary – including the right to trade under that name – does not give rise to a royalty entitlement of the parent. Such entitlement only arises in connection with other associated rights, such as the use of a logo or technology, in which case, the benefit from the use of intangibles should be seen as a package. However, this did not arise in the case at issue, as the rights to the logo had not been assigned and the rights to the technology had been charged for separately.

Supreme Tax Court judgment I R 22/14 of January 21, 2016 published on May 18

VAT rate for providing parking space separate from hotel accommodation

The Supreme Tax Court has applied the ECJ case law which allows for the application of the reduced VAT rate to concrete and specific aspects of the supply of services. In Germany, hotel accommodation services are subject to the reduced VAT rate, however, this does not apply to services which do not immediately contribute to the letting of rooms. In this respect, the court held (case XI R 11/14) that the provision of parking for hotel guests must be taxed at the standard VAT rate of (currently) 19%. This also applies if this is not charged separately by the hotel. In an earlier judgment of April 24, 2013 on a similar issue (case XI R 3/11, published on December 4, 2013) the Supreme Tax Court decided that breakfast services are subject to the standard VAT rate. Although the breakfast may be considered to be an ancillary supply to the accommodation, it would be necessary to split the VAT treatment with respect to the VAT rate.

Even though in both cases the claimants provided both the accommodation and the breakfast / the parking at a single price, this could not alter the court’s decision.

Supreme Tax Court judgment XI R 11/14 of March 1, 2016 published on June 29

From Europe

No extension of inheritance tax privilege for repeated transfers to transfers taxable abroad

According to the German Inheritance Tax Act a provision for partial credit for the tax previously paid on a prior transfer of the same estate during the previous ten years is available. The credit declines with time, is only available for transfers between spouses or relatives in the direct line and is calculated on the basis of the current transfer, but may not be higher than the proportional amount of the previous charge. Transfers of estates previously taxed abroad are therefore excluded from credit.

A mother living with her daughter in Austria inherited on the latter’s decease. The transfer was charged to Austrian inheritance tax. The mother then moved to Germany and died shortly afterwards, leaving her estate to her German resident son. The latter claimed the privilege based on the legislative intent of avoiding double taxation and cited the free movement of capital when the tax office refused to grant it.

The ECJ advocate general on the case was of the opinion that the free movement of capital would not be restricted because the two situations – a previously foreign estate taxed abroad and a home estate taxed at home – are not comparable and has suggested the court rule accordingly (opinion of March 17, 2016). The ECJ followed the approach taken by the advocate general: The German legislative intent was to partially relieve a double charge to tax on transfer within the immediate family within a short period of time. However, there was no obligation on Germany to relieve Austrian taxation. Rather, the German relief remained a wholly German matter. The court goes on to add that, in addition, the resulting restriction on the freedom of capital movement can be justified on the basis of the coherence of the German tax system, which credits a German tax previously paid by in effect the same taxpayer from a German liability now to be borne.

The ECJ case reference is C-123/15 *Feilen* - judgment of June 30, 2016

Commission clarifies scope of EU State aid rules to facilitate public investment

The EU Commission has published guidance when or whether public spending falls within, and outside, the scope of EU State aid control. This guidance will help public authorities and companies to identify when public support measures can be granted without needing approval under EU State aid rules.

The Notion of Aid Notice is the last part of the Commission's State Aid Modernisation initiative, launched in 2012. As part of its State Aid Modernisation, the Commission has already updated all major State aid guidelines and simplified the rules so that unproblematic aid measures can be implemented without prior Commission scrutiny. The overall purpose is to provide legal certainty and cut red tape for public authorities and companies, and focus the Commission's resources on enforcing State aid rules in cases with the biggest impact on the Single Market.

More details (the full text) of the Commission Notice on the notion of State aid to be found on the website of the Commission under http://ec.europa.eu/competition/state_aid/modernisation/notice_of_aid_en.pdf

From PwC

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