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Cases
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Arbitration Committee agrees on Inheritance and Gift Tax Reform: Key Points

A draft bill for the amendment of the Inheritance and Gift tax Act - following a decision of the German Constitutional Court - has been in existence since 2015. On 24 June 2016 the Federal Parliament finally voted for the amendment after a long political process, only for the bill to be defeated in the *Bundesrat*, which called for the establishment of an arbitration committee. The committee has arrived at a compromise, which meanwhile was confirmed by both the *Bundestag* and the Bundesrat. Here a summary:

Valuation Reduction for Family Businesses: Many family businesses are subject to restrictions under the terms of the entity's statutes whether it be in relation to drawing profits, transferring the business interest or exiting the business. The new bill provides for a valuation reduction of up to 30%. According to the compromise, this valuation reduction will be applied to specific favoured assets and not to the fair market value of the relevant holding. Furthermore the relevant restriction must have been included in the entity's statute two years before the succession/gift and must continue 20 years thereafter. In addition the entity's statute must contain the provisions, which:

- Limit the drawings or distributions to a maximum of 37.5% of the profit for tax purposes after deduction of the income tax attributable to the relevant profit share or distribution. Drawings made to cover the income tax due on the profit share/distribution are not included in the restriction of the drawing/distribution.

- Restrict the power to dispose over an interest in the partnership or corporation to members of the entity, to relations or to family trusts.

- Provide that any compensation paid in the case of a withdrawal from the entity by a member is lower than the fair market value of the interest in the partnership or company.

Finally, the provisions must reflect the actual circumstances.

Adjustments to Valuations: The draft bill voted in by the *Bundestag* assumed that there would be an amendment to the Valuation Act. The basis interest rates foreseen therein – as at 31 December 2015 – would have resulted in a capitalisation factor for 2016 of between 10 and 12.5 (where it had previously been 17.86). The *Bundesrat* was concerned that this could mean that, taken with the valuation reduction for family businesses, the value of the transferred interest for tax purposes could be more than 50% lower than the fair market value of that interest. A compromise was reached by the committee so that the capitalisation factor will be fixed at 13.75. This should be achieved by allowing the Federal

Ministry of Finance to adjust the capitalisation factor in line with the interest rate structure.

Special Allowance for Property Transfers: According to the Constitutional Court, any special allowance for large property transfers must be specifically justifiable. According to the new rules, transfers of property in excess of a value of 26 million Euro may benefit from two alternative models. The so-called dwindling model provides for a declining basis treatment, according to which the deduction applied to large transfers will be gradually reduced by one percentage point for each 750,000 Euro the transfer exceeds 26 million Euro. The draft bill of the Bundestag does not provide for a basic allowance, so that the benefit may be reduced to nil. The *Bundesrat* had originally demanded a straight reduction and no allowance for transfers below 90 million Euro. According to the compromise, the draft bill has been accepted in this regard.

20 Per Cent Quota for full tax exemption: According to the compromise, the condition for the granting of an optional allowance, which is provided for in the current law, should also be included in the new law. However, a 20 per cent quota has been agreed upon. This means that the tax exemption will only be granted if less than 20% of the favoured property comprises so-called “management property” (such as, e.g., real property leased to third parties, shareholdings of 25% or less, works of art). The ratio of management property to business property is calculated on the basis of the fair market value of the management property in comparison to the fair market value of the business as a whole.

Financing Test: The basic allowance for financing in an amount of 15% of the fair market value of the business asset acquired will in future only be available, if the favoured asset is used mainly in a land and forestry business, a trade or profession or if it is a holding company. Furthermore, the previous administrative practice of applying the financing allowance to both assets held in common and special business assets in the case of trading partnerships will now become law.

Extension of the management property catalogue: An essential part of the original 2015 draft bill was the new definition of “favoured assets”. This “U-turn” has now been abandoned. The previous system of a negative catalogue remains in place, according to which “harmful” assets are listed, so that “favoured assets” and “harmful assets” are differentiated from each other. The *Bundesrat* wanted to exclude from the benefit interests in deemed commercial partnerships and similar corporations, because it could mean that private assets could be transferred in a preferential manner. The compromise provides that the preferential treatment will not be available on leisure or luxury assets – such as works of art, art collections, coins, precious metals and stones or other assets which are typically connected to an individual’s lifestyle – unless the trading, processing or leasing of these assets constitute the main purpose of the business.

Packet of measures against profit reduction and profit shifting

At a sitting on 23 September 2016, the Federal Assembly (*Bundesrat*) has responded to the draft of the Act to Implement the Amendments to the EU Mutual Assistance Directive and to Introduce Further Measures to Combat Profit Reduction and Profit Shifting (“the draft Act”) and proposed further measures. The packet of measures was confirmed by the Cabinet on 13 July 2016 and is intended to implement some of the recommendations of the *BEPS* (*Base Erosion and Profit Shifting*) Action Plan of the OECD and also to implement the amendments to the EU Mutual Assistance Directive. On 12 October 2016 the Federal Government gave its response to the *Bundesrat*. Among others the following suggestions of the *Bundesrat* were adopted:

- Reintroduction of the taxation of short selling for private transactions;
- Statutory definition of professional activity under Section 32d ITA to be defined further;
- Qualification of severance payments as remuneration for a previous employment activity for tax treaty purposes;
- Special Non-Business Expenditure Deduction for Limited Taxpayers

For a brief description of the most significant other recommendations please visit our *Tax & Legal News* site at http://blogs.pwc.de/german-tax-and-legal-news/2016/09/27/packet-of-measures-against-profit-reduction-and-profit-shifting-federal-assembly-bundesrat-responds/

Tax administration stresses the need for an effective Tax Compliance System

For the first time the German tax administration publicly raised the issue of an internal control system for tax purposes to ensure tax compliance. However, the corresponding Implementation Decree published on May 23, 2016 leaves many questions open and neglects to point out what the companies should be prepared for in the future.
For more detailed information please visit our *Tax & Legal News* site at http://blogs.pwc.de/german-tax-and-legal-news/2016/09/29/tax-administration-stresses-the-need-for-an-effective-tax-compliance-system/

Federal Ministry of Finance publishes draft bill to combat tax avoidance

The goal of the draft is to enable the tax authorities to obtain comprehensive information on business relationships between German taxpayers and offshore companies located in tax havens through the provision of new investigatory powers. The draft bill includes the following measures:

Disclosure requirement upon the acquisition of qualified investments: The existing legal requirement to disclose the acquisition of qualified investments in foreign entities is to be standardised for both direct and indirect holdings. In addition the draft provides for an extension of the deadline for the filing of the disclosure to the date of the filing of the income tax/corporation tax returns.

Disclosure requirement for directly or indirectly controlled partnerships, companies, associations and estates in third countries: In future a taxpayer will also be obliged to disclose any business relationships with a partnership, a company, an association or an estate located in a third country, which he controls either directly or indirectly. This will be regardless of whether the taxpayer formally holds an interest in the entity or not. Failure to disclose will lead to a delay of the commencement of the period in which the assessment of tax is permissible and thus the limitation period will be extended. In addition, a penalty of up to € 25,000 may be levied in cases of non-disclosure.

Liability of financial institutions for tax deficits: In future, under certain conditions, financial institutions will be obliged to inform the tax authorities about business relationships between domestic taxpayers and entities resident in third countries where the relevant financial institution has either set up the business relationship or has acted as a mediator. A failure to do so may result in the financial institute being held liable to make good any tax deficits arising therefrom. Furthermore a penalty of up to € 50,000 may be levied.

Repeal of the bank secrecy provision in tax matters: According to the draft bill the provision regarding the so-called bank secrecy in tax matters should be repealed. This expressly does not affect civil law bank secrecy, which protects the transmission of data by banks to, for example, other businesses. Whilst the existing bank secrecy rules did not give the banks a blanket right to refuse to provide the tax authorities with information, it certainly did encroach on the tax authorities' investigatory powers.

Extension of the automatic account data access procedure: The automatic account data access procedure for tax purposes should be extended. The new rules are intended to facilitate investigations in cases where a domestic taxpayer has the power to dispose over or is the economic beneficiary of an account or a deposit of an individual, a partnership, a company, an association or an estate, which has his/its residence, his/its customary place of abode, its registered office, its main branch or its place of management abroad. Furthermore the term during which credit institutes are obliged to keep data access on closed accounts available, should be extended to 10 years.

Collective disclosure requests: The options available to the tax authorities for making collective disclosure requests is to be codified on the basis of the settled case law of the Supreme Tax Court.

Collection and recording of identification for tax purposes: In the course of their identity checks, credit institutions should in future also collect and record the tax identification features of the account holder and any person with a power to dispose over the account. This information will be provided exclusively to the tax authorities through the account data access procedure. Previously the so-called identity check was limited to names and addresses.

New records retention requirements: A new records retention obligation should be imposed on taxpayers, who can alone or together with related persons, directly or indirectly exercise a controlling or decisive influence in commercial law matters or in financial or business matters on an entity resident in a third country. In future such taxpayers may be subject to a tax audit without the requirement of a special reason.

Inclusion in catalogue of particularly serious tax evasion offences: The evasion of tax through hidden business relationships with entities resident in third countries and controlled by the taxpayer should be included in the catalogue of particularly serious tax evasion offences. This would mean that the limitation period for criminal prosecution for this form of avoidance would be extended to 10 years.

Official Pronouncements

Schematic loan and return of securities

On August 18, 2016 the Supreme Tax Court rejected a scheme involving the loan of securities and held that – under certain circumstances – the economic ownership of the securities might remain with the lender. In the case before the Supreme Tax Court a German GmbH – under a general master agreement concluded with a UK company (lender) – received dividends from the transferred securities and was obliged to make compensation payments to the lender equal in time and amount. The GmbH received the dividend tax free and also claimed deduction of the compensation payments as business expense. The Supreme Tax Court refused and held that the economic ownership had not passed as it was not meant to generate income for the GmbH from the outset. Following this judgment the Federal Finance Ministry has now issued a decree elaborating on the principles of this judgment.

Short term ownership excludes transfer of economic ownership: Under the economic (beneficial) ownership concept the borrower must exercise effective control over the securities in such a way that he can, as a rule, economically exclude the owner (lender) from any influence on the securities and that he has the economic benefit from the transaction as a whole. On the other hand, the economic ownership will remain with the lender either if the stock is transferred for a period of less than 45 days following the dividend record date or if the ownership position of the borrower appears to be purely formal.

The Finance Ministry has further identified and listed some of the criteria under which an attribution to the borrower would be excluded from a tax point of view:

- There is a clear tax advantage for the parties involved or for third parties and the tax benefit is taken into account when setting the total fee for the securities transaction.
- There is no cash flow benefit for the borrower.
- There is only a limited voting right or voting rights were excluded from the outset and the borrower, therefore, had no benefits whatsoever under company law.
- The rights of the borrower from the securities transaction can be withdrawn at any time, given notice within three banking days.

Supreme Tax Court Cases

Tax neutral repayment of capital contributions by companies tax resident outside the EU also possible

The transfer of shares to German-resident shareholders as part of a US spin-off generally constitutes investment income under Section 20 (1) No. 1 of the Income Tax Act (ITA); Section 20 (1) No. 1 Sentence 3 ITA is to be interpreted in line with EU law, so that companies resident outside the EU may also repay capital contributions on a tax neutral basis, even though they do not maintain a contributions account for tax purposes under Section 27 of the Corporation Tax Act (CTA).

The taxpayers acquired shares in a US corporation ("A") in 2006. In 2008 they were issued with shares in another US company ("B"), which was a subsidiary of A, as part of a spin-off. The tax office treated the receipt as investment income taxable under Section 20 (1) No. 1 ITA. According to Section 20 (1) No. 1 Sentence 3 ITA receipts under this subsection will not be included in the tax base to the extent that they emanate from the distributing company's tax contributions account within the meaning of Section 27 CTA.

Section 27 CTA requires German corporate unlimited taxpayers to maintain a tax contribution account, which records changes in capital contributions, other than contributions to or repayments of share capital. Section 27 CTA further provides companies, which are unlimited taxpayers in other EU States, with a mechanism to maintain a tax contributions account. Section 27 makes no reference to companies, which are tax resident outside the EU.

As a result of this it has been unclear whether non-EU companies are able to make tax neutral repayments of capital contributions, as it is not possible to show that the receipt "emanates from the tax contributions account" (Section 20 (1) No. 1 Sentence 3 ITA) in such cases.

The Supreme Tax Court has now held that to restrict the application of the tax neutrality offered by Section 20 (1) No. 1 Sentence 3 ITA to receipts from German resident and EU resident companies would be a restriction to the right to free movement of capital and thus in contravention with Article 63 TFEU.

Further the Court stated that it could not recognise any reasons significant enough to justify a resident shareholder being refused the opportunity, ab initio, to prove that the distribution he received from a non-EU company was a repayment of capital contributions. The Court could not accept the argument that the restriction is justified because of the practical difficulties of establishing whether the receipt could be deemed to emanate from a tax contributions account, as these difficulties also exist in the case of EU resident companies.

Supreme Tax Court judgment VIII R 47/13 of 13 July 2016 published on October 12

Impact of tax treaty definitions on domestic law

The taxpayer, a GmbH, carried on business as an import agent; specifically it acted as the agent for another GmbH, sourcing all its goods from Turkey. The company had no other income source save for the provisions received. For this purpose, the taxpayer kept a purchasing office in Turkey.

In its trade tax returns for the years 2004 to 2008, the taxpayer deducted the income arising from the Turkish purchasing office from the trade tax base according to Section 9 No. 3 of the Trade Tax Act (TTA). This provision provides for the deduction of that part of the trade tax base, which emanates from a permanent establishment located outside Germany (as defined by the TTA). The tax office initially followed this treatment, but revised its view at a subsequent tax audit.

The basis for the tax office's revision was that under the terms of the German/Turkish tax treaty, a purchasing office was excluded expressly from the definition of a permanent establishment. The taxpayer argued, however, that the treaty did not apply in these circumstances and the relevant definition was the domestic one.

The Supreme Tax Court held that the domestic definition should indeed be applied to the term as set out in Sec. 9 No. 3 TTA and further stated that it was settled case law that tax treaties merely determined the extent to which the liability to tax under domestic law should be restricted. The definition of “permanent establishment” as set out in the individual tax treaties is, thus, generally only applicable within the framework of the tax treaty. This view is confirmed by the wording of the German/Turkish tax treaty itself, with such phrases as “For the application of this Treaty the following applies...” or (in Article 3 (1)) “Within the meaning of this Treaty...the expression ... shall mean”. In contrast questions such as whether earnings from abroad should be deducted when calculating income or to which cases such a deduction should apply, are ones of domestic law.

The concept of the “coexistence” of bilateral agreements as it concerns tax treaties and domestic tax rules presupposes a coexistence of the factual prerequisites with the result that terms defined in the treaty, which differ to the definition in domestic law, must be interpreted on a stand-alone basis according to treaty. It is open to the legislator to set aside this coexistence of the separate sets of rules but it has chosen not to in this case. No connection with treaty law is evident in the case of Section 9 No. 3 TTA.

Supreme Tax Court judgment I R 50/15 of 20 July 2016 published on October 19

Deadline for the filing of an application for recording at tax book values

The appellant, a limited partnership (“*KG*”) held the entire stock in a German limited company (*GmbH*). The special business assets (Sonderbetriebsvermögen) of the KG’s majority limited partner (“*A*”) included shares in a US corporation (“*A-Inc.*”) recorded with a tax book value of € 1. On 4 August 2008 *A* contributed the shares in *A-Inc.* into the GmbH and received new shares in the GmbH. In the statutory financial statements of the *GmbH* of 31 December 2008, the shares in *A-Inc.* were recorded at their fair market value (ca. € 2.6 million). The *GmbH* enclosed these statutory financial statements when submitting the tax returns to the tax authorities on 25 May 2009; also enclosed was a reconciliation to tax values (with higher depreciation from the supplementary balance sheets) and an attachment showing corrections according to Section 60 of the Income Tax Implementation Regulations. By a letter of 24 March 2010 the *GmbH* submitted to the tax office a separate tax balance sheet to 31 December 2008, according to which the value of the shares in *A-Inc.* was recorded at their original tax book value of € 1.

During tax audit the question was raised as to what extent the *GmbH* had properly applied its right to record book values. The tax office took the view that this subsequent election of the tax book values was not permissible. This view was shared by both the Tax Court at first instance and by the Supreme Tax Court.

The contribution constituted a qualifying share exchange, so that the *GmbH* had the option of recording the shares in *A-Inc.* at their tax book value or at a higher value not exceeding the fair market value. However, the *GmbH* had failed to exercise this option in time.

The relevant application must be submitted before the applicant files its “end-of-period tax balance sheet”. The term “end-of-period tax balance sheet” refers to the transferee’s end-of-period tax balance sheet for the period in which the date of the contribution fell; it does not refer to a balance sheet which is separate and independent from the end-of-period tax balance sheet.

<u>*Note:*</u> By submitting the 2008 statutory financial statements together with the reconciliation, the *GmbH* was treated as submitting a 2008 tax balance sheet and thus an “end-of-period tax balance sheet”. Section 60 of the Income Tax Implementation Regulations requires that a taxpayer, who is obliged to keep accounting records, attaches to his tax returns at least a statutory balance sheet and profit and loss account, which should be applicable for tax purposes. Where the balance sheet contains entries or amounts, which do not correspond to tax

regulations, these are to be adjusted through additions or annotations to correspond to the tax regulations. Alternatively, however, the taxpayer may also submit a tax balance sheet. Any one of these reporting alternatives (1. Statutory balance sheet with a statement that these are also the relevant basis for tax purposes; 2. Statutory balance sheet with additions or annotations relevant for tax purposes; 3. Tax balance sheet.), which the taxpayer submits to the tax office with his tax returns is- according to the Supreme Tax Court – to be regarded as an "end-of-period tax balance sheet" and thus constitutes the cut-off date for making the application.

Supreme Tax Court judgment I R 69/15 of 15 June 2016 published on October 26

From Europe

No automatic VAT liability solely because of missing VAT ID No

A German businessman took his car to Spain for business use. Nine months later he sold it to a Spanish business. He ignored the VAT implications of the move to Spain and issued a VAT-free invoice to the buyer as an intra-community supply from Germany. The German tax office saw the move to Spain and the later sale as separate transactions and – without informing the Spanish authorities – refused exemption from German VAT on the grounds that the German taxable event was the move to Spain. The liability arose from the failure of the taxpayer to provide a valid Spanish VAT registration number.

The ECJ held that in these circumstances the requirement on the taxpayer to document the move of the car to Spain with a Spanish registration number be treated as a purely formal requirement. There was no indication of an attempt to evade taxes and all the other conditions for exempting the sale to the ultimate buyer were fulfilled. Rather, the seller had misinterpreted the law, but – given the unrestricted right of both parties to deduct input tax borne – without endangering tax revenue in either member state.

The referring Lower Tax Court of Munich has also asked the ECJ on the implication of an earlier judgment from September 27, 2012 (C-587/10, *VSTR*) in which the ECJ found that the lack of the appropriate VAT ID No. is not a decisive criterion for the refusal of tax exemption where there is no question of bad faith *and* if the supplier took all reasonable, albeit unsuccessful steps to obtain the number from his customer and is, on the basis of other evidence, able to demonstrate that the recipient of the goods was a taxable person acting as such. Would the supplier – if he has not taken all the measures which can reasonably be required of him to provide the authorities with a VAT identification number – in general be refused an exemption from VAT? According to the opinion of the court responsible in the current case this requirement is only relevant to establish whether or not the supplier has participated in tax evasion. As a participation in tax evasion has in any event been ruled out in the present case the German businessman cannot be refused an exemption from VAT.

The ECJ case reference is C-24/15 *Plöckl* judgment of October 20, 2016

Supply of blood plasma to manufacturers of medicinal products not VAT exempt

The sale of blood plasma to customers in the EU is VAT-free as an intra-community supply. Exports outside the EU are "zero rated", that is, the charges to customers are also not subject to VAT. Both types of supplies would entitle a VAT recovery on the related inputs. However, the same sale would also have been VAT-free if delivery had been to a German customer. In such an instance, VAT would not be recoverable. The ECJ has ruled in the case C-240/05 *Eurodental* of December 7, 2006 that the exemption of a product by its nature takes precedence over exemption by destination. In consequence, the right to deduct input tax incurred in connection with the sale should be excluded, just as it would have been, had the sale been made on the home market.

The most recent case before the ECJ takes the issue a step further as it involved a German GmbH managing a blood donor center and which supplied plasma to various production facilities in other EU Member States for the preparation of medicinal products. The GmbH took the view that the plasma supplied to the manufacturers of medicinal products did not fall under the exemption for supplies of human blood and claimed the corresponding input VAT. The local tax office considered the supplies as falling under the local VAT exemption regulation and thus refused the input tax deduction. The ECJ sided with the company and held that only plasma actually intended for direct therapeutic use comes under the exemption laid down in Article 132(1)(d) of Directive 2006/112. The Directive does not include plasma which is used exclusively for the manufacture of medicinal products.

The ECJ pointed out that the relevant Article 132 concerns transactions directly linked to healthcare or those which have any therapeutic purpose. The tax exemption under Article 132 is meant to ensure that the supply of goods, which contributes to healthcare or which has a direct therapeutic connection, does not increase the costs and thus becomes inaccessible if their supply were subject to VAT. As a result, the German GmbH could now assume intra-community supplies and claim the underlying input VAT.

The ECJ case reference is C-412/15 *TMD* judgment of October 5, 2016

Formal invoicing errors may be corrected retroactively

The input tax deduction under the German VAT Act is conditional on possession of a supplier's invoice correctly drawn up. A deficient invoice can be corrected later, but the right to deduct the input tax can only be exercised after the correction. Thus, subsequent discovery, say on tax audit, of an invoicing error by the supplier can lead to deferral of the input tax deduction until the date of correction. This can trigger an interest charge for the intervening period.

The case brought before the ECJ by the Lower Tax Court of Lower Saxony concerned a trader (operating in the wholesale textile business) with defective suppliers' invoices (missing tax numbers). The ECJ ruled that the VAT Directive must be interpreted as requiring retroactive deduction where the error is merely formal and there is no suggestion of bad faith. The reasoning is based on the concept of VAT as a tax neutral system for traders. This requires an immediate right of deduction as soon as the VAT has been paid. Correction of a formal error later must not lead to an interest charge or other burden, since there has been no loss to the state. The court went on to add that the state should be entitled to enforce adherence to the formal requirements with penalties, but these must be proportionate. Charging interest up to the date of correction does not distinguish between innocent error and fraud and also ignores the fact that the error was – usually – made by the supplier and is therefore inherently out of proportion. Given that most cases of innocent error will not be discovered until audit, an acceptable time limit must allow for invoice correction for a reasonable period after the matter has come to the attention of the authorities. The local tax office, by the way, has stated from the outset that it accepts the corrected invoices as such and does not thus consider that the corrections were made belatedly.

The ECJ case reference is C- 518/14 *Senatex* judgment of September 15, 2016

German exclusion from withholding tax relief in conflict with EU law?

The German anti- treaty shopping rule denying full or partial relief from withholding tax, as otherwise prescribed under a double tax treaty or applicable EU directive, is questioned by the Lower Tax Court of Cologne as being in violation of community law. The question has therefore been referred to the ECJ.

The anti-treaty shopping rule: Section 50d sub-sec 3 of the German Income Tax (ITA) Act denies the foreign company full or partial relief from withholding tax otherwise applicable under a double tax regime to the extent (i) its own shareholders would not have been entitled to refund or exemption, had they received the income directly, and (ii) the gross income of the foreign company did not stem from its own genuine business activity. A foreign company does not exercise its own business activity where, inter alia, its gross earnings emanate from asset management or from significant activities outsourced to third parties. These rules were challenged by the Lower Tax Court of Cologne as violating the freedom of establishment because of its former "all or nothing"-approach for the years up to and including 2011 (the relief was factually subject to a 10% active earnings threshold). With effect from 1 January 2012 this was amended and somewhat moderated and replaced by a pro rata approach. The EU

Parent/Subsidiary Directive on the other hand, exempts qualifying dividend payments by a domestic company to another EU resident company, if certain holding requirements are fulfilled: A direct minimum holding of at least 10% (formerly 15%) and as a further condition the holding must exist for an uninterrupted period of at least 12 months.

The current case before the Lower Tax Court concerns repealed law, i. e. from the year 2007. A Dutch managing holding company held a 26.5% interest in a German subsidiary and claimed refund of the withholding tax deducted from dividends received from the latter. The sole shareholder of the Dutch company was a German private individual. The Dutch company had an office and staff but there were no business or other good reasons for its interpolation. In accordance with the legal requirements in Sec. 50d (3) ITA the Federal Central Tax Office refused the refund.

The Lower Tax Court takes the view that Sec. 50d sub-sec. 3 ITA infringes a company's freedom of establishment and has referred the case to the ECJ for further clarification. Holdings giving definite influence on another company's decisions and allowing to determine its activities are primarily governed by the provisions on freedom of establishment. The Lower Tax Court refers to an earlier ECJ judgment from May 10, 2007 (C-492/04, *Lasertec*) where such definite influence is given where the company has a substantial holding in the nominal capital of over 25%. Such a restriction of the freedom of establishment may only be justified in a case of abuse. But, as the court points out, the fact that the company was established in a Member State for the purpose of benefiting from more favourable tax legislation does not in itself suffice to constitute an abuse (ECJ judgment from September 12, 2006 (C-196/04, *Cadbury Schweppes*). In light of this the Lower Tax Court considers the requirements in Sec. 50d sub-sec. 3 ITA to be too strict and unjustified as such a restriction goes beyond its stated objective. Also, Sec. 50d sub-sec. 3 ITA denies exemption under certain scenarios although the requirements of the Parent/Subsidiary Directive are met.

Lower Tax Court of Cologne, decision of July 8, 2016 (2 K 2995/12)

From PwC

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