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Forfeiture of Loss relief: further referral to Constitutional Court

On 29 August 2017, the Hamburg Tax Court referred a question to the Constitutional Court on the constitutionality of the rules on the full forfeiture of loss relief under Section 8c 2nd Sentence of the Corporation Tax Act “CTA” (as amended by the Business Tax Reform Act of 2008 - now Section 8c (1) 2nd Sentence CTA). The referring court is convinced that the rule is unconstitutional.

The referred question relates to the rule according to which a company’s loss carry-forward is fully forfeited, where in a five year period more than 50 per cent of the shares change ownership. This is a further examination of the constitutionality of the highly criticised loss relief forfeiture rules. We will provide you with more detailed information on the referral as soon as the written document is available.

Section 8c CTA has already been subjected to the review of the Constitutional Court; on 29 March 2017 that Court held that Section 8c 1st Sentence CTA (now Section 8c (1) 1st Sentence CTA) contravened the German Constitution. The scrutinised rule (also a referral of the Hamburg Tax Court), which related to the partial forfeiture of loss carry-forwards where in a five year period more than 25 per cent but less than 50 per cent of the shares changed ownership, was held by the Constitutional Court to be incompatible to the principle of equality. The legislature was given until 31 December 2018 to repair the infringement retroactively for the period 1 January 2008 to 31 December 2015.

More details on the resolution dealing with the partial forfeiture of loss carry-forwards can be found under

http://blogs.pwc.de/german-tax-and-legal-news/2017/05/16/curtailment-of-loss-relief-for-companies-in-part-unconstitutional/

Trade tax on profits from disposal of partnership interest unconstitutional?

The First Senate of the Federal Constitutional Court heard arguments on the constitutionality of a provision in the Trade Tax Act, according to which trade tax was levied on the sale of business interests. The case has opened up a question of principle with regard to trade tax.

Since 2002 trade tax has been payable on profits arising from certain disposals of partnership interests. The intention of the legislature at the time was close a loophole. Prior to the new rule companies had to pay trade tax on profits arising from the sale of business interests but this could be avoided by inserting a partnership. The background to this is that where the seller is an individual no trade tax arises. In the instant case of a brewery effected by the new rule, interests in a GmbH & Co. KG (a limited partnership with a company as its unlimited partner) had been sold by various companies, partnerships and a foundation. In addition the business from Bremen filed a complaint on the basis of an abuse of the constitutional prohibition of retroactivity, as its members sold their interests before the provision came into force but were charged to tax. As a matter of fact the relevant disposal of the business interests occurred in the middle of legislative process. The sales contract was signed before the law came into force, but after the government introduced a draft bill to the Bundesrat (Federal Council/upper house). The question is therefore how long one can rely on the continuity of applicable tax laws. We will have to wait and see, as the Constitutional Court will probably take a couple of months to issue its decision.

Case reference: Constitutional Court 1 BvR 1236/11

European Commission proposes far-reaching reform of the EU VAT system

Despite many reforms, the VAT system has been unable to keep pace with the challenges of today's global, digital and mobile economy. The Commission estimates that – overall – over €150 billion of VAT is lost every year, meaning that Member States miss out on revenue that could be used for schools, roads and healthcare. On 4 October 2017 the Commission proposed to fundamentally change the current VAT system by taxing sales of goods from one EU country to another in the same way as goods are sold within individual Member States. This will create a new and definitive VAT system for the EU.

More details to be found on our *Tax & Legal* site under
https://blogs.pwc.de/german-tax-and-legal-news/2017/10/17/european-commission-proposes-far-reaching-reform-of-the-eu-vat-system/

Bundesrat reacts positively to exchange of information for tax-saving schemes

At its sitting on 22 September 2017 the Bundesrat (Federal Council/upper house) expressly welcomed the proposal for an amendment of Council Directive 2011/16/EU on administrative cooperation in the field of taxation to impose a reporting obligation on cross-border schemes. It has long been a demand of the Bundesrat that rules on reporting obligations be introduced.

The planned adjustments propose that Directive 2011/16/EU should in future generally oblige national tax authorities to automatically exchange information with other EU tax authorities. Primarily among the matters to be reported are all unjustified reductions in tax revenues in a Member State or any tax savings arising from artificial profit shifting amongst group companies. Also being considered is extending the obligation to disclose information to auditing bodies (e.g. during the audit of the annual financial statements). These bodies have sight of enormous amounts of data and could come across examples of aggressive tax planning practices. Furthermore the Member States should ensure that their tax authorities are expressly required to disclose potential tax planning schemes of an aggressive nature and to make certain that such information is automatically exchanged between the tax authorities of the Member States. This should occur within the framework of a mechanism still to be agreed. One concept is an exchange through a common communication network (CCN). The amended directive would include both detailed mechanisms and sanctions, which the Member States would be obliged to implement into national law.

In its sitting on 22 September 2017, the Bundesrat expressly welcomed the European Commission's approach and noted that not only was there a need to address cross-border tax avoidance schemes but also similar domestic avoidance practices. It therefore recommended the introduction of a reporting obligation for domestic institutions. The Bundesrat's only criticisms related to the application of the Directive.

In this connection the Bundesrat suggested the following improvements:

- The reporting obligation should also apply where "a significant purpose" of a scheme is to gain a tax advantage and not only where this is the "main purpose" of the scheme.
- The reporting deadline of five days is too short and should be extended.
- Intermediaries should be given the opportunity to explain the reported schemes and its motives, including its background and possibly its plausibility. The extended reporting deadline would also make sense here.
- Certain minimum and maximum standards should be introduced as a reaction to tax planning schemes which are proven to be aggressive. This would ensure a unified European approach.

Reference: Comments of the Bundesrat on 22 September 2017, BR-Drs.524/17.

Automatic exchange of financial account information has commenced

The first automatic exchange of financial accounts information between Germany and 49 other states according to the OECD Common Reporting Standard commenced on 30 September 2017.

According to the OECD Common Reporting Standard for the automatic exchange of information on financial accounts data, the accounts of not only individuals but also of legal persons and other legal entities (including trusts and foundations) are subject to reporting. The standard also includes the obligation to review passive non-financial entities and the reporting of individuals who actually control these entities (i.e. the reporting of the beneficial owners).

The commencement of the automatic exchange of information in September 2017 applies to the reporting period 2016. Compliance with the Standard will be monitored by the Global Forum on Transparency and Exchange of Information for Tax Purposes. One hundred and twenty states belong to the Global Forum.

For more information see:
http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/

Transparency Register: registration obligations from 1 October 2017

The Transparency Register – as defined in Section 18 of the Money Laundering Act – is a legally prescribed register, which records beneficial interests in companies, partnerships and foundations, which themselves operate on the financial markets. The register became effective on 1 October 2017.

Further details can be found under
https://blogs.pwc.de/german-tax-and-legal-news/2017/10/13/transparency-register-registration-obligations-from-1-october-2017/

New US tax reform framework released

The Trump Administration and Congressional Republican leaders released on September 27, 2017 a nine-page “unified framework for fixing our broken tax code” (the Framework) that includes specific goals for lower business and individual tax rates.

The Framework statement is the latest product of tax reform discussions (business tax reform and individual tax reform) by a working group known as the “Big 6” – consisting of Treasury Secretary Steven Mnuchin, White House National Economic Council Director Gary Cohn, House Speaker Paul Ryan (R-WI), Senate Majority Leader Mitch McConnell (R-KY), House Ways and Means Committee Chairman Kevin Brady (R-TX), and Senate Finance Committee Chairman Orrin Hatch (R-UT) – and builds off an earlier July 27th joint statement.

The Framework calls for a 20-percent corporate tax rate, a new 25-percent rate for certain passthrough business income, and international reforms that include a territorial tax system and a one-time mandatory repatriation tax. The Framework also would replace the current seven individual tax brackets with three brackets with rates set at 12 percent, 25 percent, and 35 percent, while leaving open the possibility of providing a fourth higher tax bracket for upper-income individuals to meet President Trump’s goal of ensuring that tax reform benefits the middle class and not “the wealthy.”

More details to be found on our US tax site under
https://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-trump-rep-congressional-leaders-release-new-tax-reform-framework.pdf

Official Pronouncements

VAT grouping and input VAT deduction for holding companies

Following decisions of the European Court of Justice and the German Supreme Tax Court the Federal Finance Ministry has issued guidelines on the VAT grouping and the input VAT deduction for holding companies. In a special VAT Newsflash our tax experts take a closer look on the situation as a whole.

More details to be found under
https://blogs.pwc.de/german-tax-and-legal-news/2017/06/29/vat-grouping-and-input-vat-deduction-for-holding-companies/

Country-by-Country Reports: German Ministry of Finance releases circular

On 20 December 2016 legislation was passed introducing measures to combat base erosion and profit shifting. A part of this legislation – introduced in the new Section 138a of the General Tax Code – imposed an obligation on multinational enterprises to report annually for each tax jurisdiction in which they do business, so-called Country-by-Country (CbC) reports. On 11 July 2017 the German Ministry of Finance released a circular, which provides some guidelines on the completion of the CbC reports.

The new Section 138a of the General Tax Code (GTC) sets out the rules for the exchange between the tax authorities of the participating states of country-specific reports to document the appropriateness of the relevant transfer pricing. According to Section 138a GTC, multinational enterprises, which produce consolidated financial statements, are obliged at the end of each financial year to complete a country-specific report (CbC report) for the group and file it with the Federal Tax Office.

The obligation to file a CbC report arises for financial years beginning after 31 December 2015. The transmission to the Federal Tax Office is to be made according to an OECD standardised electronic XML format.

In its circular the Ministry of Finance makes reference to the fact that the relevant information in the CbC reports must be made in the specified formats. Furthermore the circular contains various appendices specifying the concrete requirements.

The circular also contains a link to the OECD user guide:
http://www.oecd.org/tax/country-by-country-reporting-xml-schema-user-guide-for-tax-administrations-and-taxpayers.htm

Ministry of Finance Circular of 11 July 2017 (IV B 5 – S 1300/16/10010 :002)

Tax Court Cases

5-year tax deferral on transfer of roll-over relief provision also applied retroactively

Under a provision in the Income Tax Act, businesses may defer the tax charge on the capital gain from the sale of certain business assets (mostly land and buildings) by deducting the gain from the cost of a replacement asset. This reduces the basis for amortisation of the replacement asset and also its base acquisition cost for computing any gain on a future sale. The replacement must be acquired within a set time limit (basically four years for the purchase or commencement of construction) and must be held as a fixed asset of a domestic permanent establishment. In the meantime the ECJ has confirmed that charging a gain to tax before it is realised is a hindrance on the taxpayer's freedom of establishment, but has also held that that hindrance is justified by the need to preserve the balance of taxing rights between Member States. A ten-year deferral of the burden is sufficient to alleviate undue hardship, particularly in view of the increasing risk of taxpayer default with the passage of time (ECJ case reference C-657/13, *Verder Lab Tec* Judgment of May 21, 2015).

The German tax administration implemented the ECJ guidelines in the course of the Tax Amendment Act 2015: As an alternative, taxation on the gain reinvested in another member state may be deferred and spread over 5 years. This new option was applicable retroactively in all open cases.

The appellant owned an agriculture and forestry business which he took over from his parents in 2006. The business assets included a roll-over relief provision stemming from a sale of real estate in 2005/2006. In 2010 the provision was partially released and transferred to real estate located in Hungary as part of the business of a local partnership half-owned by the appellant himself. The Hungarian property thus no longer belonged to a domestic permanent establishment of the appellant and, as a consequence, the tax office treated the release amount as taxable income.

The Supreme Tax Court confirmed this approach in principle and held the German right to taxation to be undisputed. Following recent ECJ case law the court went on to say that the German business reinvesting the gain on the sale of a German asset in a replacement asset in another Member State at least be allowed the option of deferring payment of the tax liability over a period of five years. Although the application for deferral must be made in the year of sale, the Supreme Tax Court held that a subsequent application is sufficient. Since the sale of real estate took place prior to the enactment of the new rules and the respective tax return was also filed before the enactment date (6 November 2015) the taxpayer must be treated as if he had submitted the application in time.

Supreme Tax Court judgment VI R 84/14 of June 22, 2017 published on August 23, 2017

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 been referred to the ECJ in three cases.

The anti-treaty shopping rule: Section 50d sub-sec 3 of the German Income Tax 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. Two cases before the Lower Tax Court concern 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 took 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.

On the same subject, but in the case of a Danish holding company, the Lower Tax Court of Cologne took the opportunity to make an additional referral to the ECJ (case 2 K 721/13). Contrary to the previous referral the holding did not employ staff and did not have its own business premises. Nevertheless, the court believes that Sec. 50d sub-sec. 3 ITA does not sufficiently take into account the functions of the holding company within the whole group (i. e. organizational or economic aspects and all other relevant features and functions of the foreign related companies).

Note: The Lower Tax Court of Cologne continues to maintain its concerns also for years from 2012 under the amended rules of Sec. 50d sub-sec. 3 German Income Tax Act and has referred a third case involving dividend payments to a Dutch company to the ECJ. On the one hand, with regard to a possible violation of the freedom of establishment and the EU Parent/Subsidiary Directive. Secondly and in particular the judges criticize that under the anti-abuse provisions there is no possibility for the claimant to provide evidence to the contrary, especially if the foreign company maintains a business establishment suitably equipped for its business purposes. Lastly, the judges doubt whether it is compatible with EU law if the burden of proof lies with the applicant.

Sources:
Lower Tax Court of Cologne, decision of July 8, 2016 (2 K 2995/12); the ECJ case reference is C-504/16, Deister Holding (years up to 2011)
Lower Tax Court of Cologne, resolution of August 31, 2016 (2 K 721/13); the ECJ case reference is C-613/16, Juhler Holding (years up to 2011)
Lower Tax Court of Cologne, resolution of May 17, 2017 (2 K 773/16); the ECJ case reference is C-440/17 (years from 2012)

Imputed VAT taxation and margin-scheme taxation before ECJ

Supreme Tax Court judges have expressed doubt both upon the previously uncontested obligation of entrepreneurs subject to the so-called imputed taxation ("Sollbesteuerung) to pre-finance VAT and upon the exclusion of the reduced VAT rate on the provision of holiday apartment rentals according to the so-called margin-scheme taxation. The Supreme Tax Court has therefore referred two cases to the European Court of Justice.

The first case (21 June 2017: V R 51/16) relates to a plaintiff, who worked as an agent for professional football players. She was subject to the imputed taxation procedure, according to which the entrepreneur is obliged to pay over the VAT as soon as the service is supplied regardless of whether the related remuneration has been received. The plaintiff earned provisions from the various football clubs for procuring professional players; the provision was actually only paid after the player had signed the employment contract and received a playing permit from the German Football Association (the "DFL" as licensor). The provision was paid in instalments based on the length of the employment contract. The due dates of the provision instalments and the right to claim them were conditional upon the continuing existence of the contract between the player and the club. The tax authorities considered that the plaintiff was obliged to pay the VAT on the full provision in 2012 when the agency service had been provided, even though she could contractually only claim parts of the provision from the clubs in 2015.

Doubt expressed about the usual tax procedure: The approach of the tax authorities reflects a tax procedure which has been practised for decades. The Supreme Tax Court has now raised doubts about whether this approach is compatible with the binding provisions of European law set out in the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax. The question referred to the ECJ is whether the taxpayer is obliged to pre-finance the VAT due on the services provided for a period of 2 years, where he can (partially) only receive the remuneration for the services 2 years after the chargeable event.

The referral is also relevant to instalment purchases and leasing arrangements:
The questions referred to the ECJ have significant importance for the practice. At first sight they relate to certain claims for remuneration but they can also have significance for fixed-term payment claims such as instalment purchases in retail or for leasing arrangements. Here too according to the current practice a taxpayer subject to imputed taxation is obliged pay the tax on the supply of the goods as soon as the goods have been handed over. Following the hitherto existing practice this even applies where the taxpayer will only be able to receive the individual instalment payments over a period of a number of years.

Holiday apartments: In the second case (3 August 2017: V R 60/16) the ECJ has been asked to decide whether it continues to follow its previous decision, according to which the rental of holiday apartments by a travel agency on its own behalf (and not as an agent) is subject to margin-scheme taxation and whether – in the case of an affirmative answer – the margin is to be taxed at the reduced rate applicable to accommodation in holiday homes.

Sources: Supreme Tax Court referrals of 21 June 2017 (V R 51/16) and 3 August 2017 (V R 60/16) published on 20 September 2017

No pro-rata reduction of tax-free allowance for non-resident beneficiaries

The ECJ has previously held that the German inheritance and gift tax option according to which a higher exempt amount is available where one beneficiary is resident does not fully resolve the conflict with EU law arising from the lower personal allowances for non-residents. In consequence and considering the relevant ECJ case law the Supreme Tax Court ruled in favour of a Swiss-resident widow and granted the full higher tax-free allowance for spouses of €500,000 irrespective of the total inheritance transferred which also included foreign property not subject to German tax.

German inheritance (and gift) tax personal allowances vary by degree of kinship between €500,000 (spouses) and €20,000 (unrelated persons). The allowance drops to €2,000 regardless of kinship in all cases where both testator (donor) and heir (beneficiary) are not resident in Germany (Sec. 16 sub-sec. 1 and 2 German Inheritance and Gift Tax Act). A Swiss-resident widow objected to this distinction in respect of her inheritance of a German property along with certain other Swiss assets from her deceased Swiss-resident husband. In 2010 the widow inherited German property of some €377,000 and also Swiss property of €5,200,000 and Swiss bank deposits and investments in Switzerland of €1,100,000. Initially the German tax office assessed the inheritance tax on the value of the German property by taking into account the lower personal allowance of €2,000 but then reversed its decision in light of the judgment of 17 October 2013 (C-181/12, *Welte*), in which the ECJ has held that the principle of freedom of capital movement prohibits the German system of granting higher personal allowances on capital transfers where at least one of the parties is resident. In its amended assessment, however, the tax office reduced the tax in part by granting the higher tax-free allowance for spouses only proportionally, i. e. in the ratio of the German property to the total assets inherited (including the Swiss assets). This treatment was now also rejected by the Supreme Tax Court. The higher tax free allowance must be granted in full and the inheritance of German property was thus tax free altogether.

Although the German tax administration in 2011 introduced in the Inheritance and Gift Tax Act an option for taxation as a resident the ECJ – in a subsequent judgment of 8 June 2016 (C-479/14, *Hünnebeck*) – held that this option for taxation as a resident does not fully resolve the conflict with EU law from the lower personal allowances for non-residents.

Taking all this into account the Supreme Tax Court concluded that the higher tax-free allowance of €500,000 be available in full according to the strict wording of Sec. 16 sub-sec. 2 of the Inheritance and Gift Tax Act. A broader interpretation that the exemption must be granted on a pro rata basis is not justified. Any amendment to that effect would be a matter for the German legislator.

Note: In the course of the legislation to combat tax avoidance which the government introduced at the end of last year Sec. 16 sub-sec. 2 was indeed amended to the effect that the tax-free allowance be reduced by a partial amount to be determined in detail and thus taking into account to a certain extent the transfers abroad as being not subject to German tax.

Supreme Tax Court judgment II R 53/14 of May 10, 2017 published on August 17, 2017

From Europe

Profit participation rights at fixed rate is interest under German-Austrian tax treaty

The dispute before the European Court of Justice (ECJ) concerned the interpretation and application of Article 11 of the double tax treaty between Austria and Germany as regards the right of taxation of interest from registered participation certificates (profit participation certificates – 'Genussscheine') acquired by UniCredit Bank Austria AG (Bank Austria) from the German Westdeutsche Landesbank (WestLB) as the issuer of the certificates.

According to Art. 11 (1) of the treaty "interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State". Apart from this general rule Art. 11 (2) states "that income from rights or debt-claims with participation in profits (...) or income from profit-participating loans and profit-sharing bonds, may also be taxed in the State in which it arises, in accordance with the laws of that State". Interest is defined as income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, Art. 11 (3) of the treaty.

Under the terms of issue, the amount of the annual payment was a percentage of the nominal value of the certificate ranging from 4.4% to 7.4%. Since the issuer had made profits over the entire holding period of the certificates the interest has always been paid at the fixed annual rate as provided for in the terms of issue. Austria claimed that the remuneration from the certificates is not a "participation in profits" within the meaning of Article 11 (2). Germany took the contrary view and claimed the right to tax the interest as well. It supported its claim by a judgment of the Supreme Tax Court from August 2010 where it was held that a contractual profitability condition in the certificates at issue rendered the interest profit-dependent and thus entitled Germany to withhold tax on the interest paid to the Austrian recipient (creditor). Since a mutual agreement procedure initiated by Austria failed in 2011 the case was brought before the ECJ.

The ECJ is of the opinion that the context in which the phrase "income from ... debt-claims with participation in profits" is used and the objective and meaning of Article 11 of the German-Austrian treaty calls for a strict interpretation and be limited to situations in which the remuneration from the debt-claim varies and depends – at least partially – on the amount of the debtor's profits. In the case at hand, though, the certificates granted an entitlement to the payment of annual interest at a fixed predetermined rate calculated on the basis of the nominal value of those certificates. The terms of issue did not provide that the interest rate be supplemented, at the very least, by a variable element representing a part or a share of the profits made by the debtor. Thus, irrespective of the amount of profit of the debtor, the interest rate was based solely on the nominal value of the certificates.

The claim made by Austria was thus granted. The ECJ conceded that the interest rate may be reduced to zero where the debtor incurs losses. However, if no losses are incurred in subsequent years, the creditor would be entitled to payment of arrears during those years and therefore this was more a suspension of interest until the bank returned to profitability than a clause for participation in profits. To the ECJ this only implied that the annual payment of interest was affected by the presence of sufficient net profit for that financial year, and not that, in addition to annual interest, the certificates gave rise to an entitlement to a share in those profits.

The ECJ case reference is C-648/15 *Austria v Germany* judgment of September 12, 2017

Disallowance of discount on delivery of pharmaceuticals in breach of EU VAT law?

In Germany pharmacies issue the pharmaceutical products to persons with statutory (public) health insurance pursuant to a framework agreement concluded with the National Association of Public Health Insurance Funds. The pharmaceutical products are supplied to the public health insurance funds and the latter delivers them to persons insured by them. The pharmacies grant the public health insurance funds a discount on the price of the medicinal products. In consequence the pharmaceutical company is legally required to reimburse the pharmacies — or wholesalers as the case may be – for this discount. For the purposes of turnover tax the German tax authorities treat this discount as a reduction of the VAT turnover base. In contrast, the pharmacies issue – from a contractual point of view – pharmaceutical products directly to the individuals with the private health insurance pursuant to individual contracts with them. Unlike the public health insurance funds, private health insurance funds are not themselves the customer for the pharmaceutical products, but merely reimburse the persons insured by it for the costs incurred when they purchase pharmaceutical products. Pharmaceutical companies are then bound, pursuant to legal regulation, to grant the private health insurance funds a discount on the price of the medicinal product. In contrast to the treatment under the auspices of the statutory health insurance rules, the German tax office does not regard this discount as a reduction of the VAT base.

On the basis of ECJ case-law (ECJ judgment of 24 October 1996 *Elida Gibbs*, C-317/94) and also with regard to the principle of equal treatment under EU law the Advocate General (AG) has proposed that the court should rule that a pharmaceutical company which supplies pharmaceutical products is entitled to reduce its VAT basis under Article 90 of Council Directive 2006/112/EC of 28

November 2006 on the common system of value added tax also in cases where it supplies those pharmaceutical products to pharmacies via wholesalers, where the pharmacies supply those taxable products to persons covered by private health insurance, where the private health insurance company reimburses the persons insured by it for the costs of purchasing the medicinal products, and where the pharmaceutical company is required to pay a 'discount' to the private health insurance company pursuant to a statutory provision. The AG is of the opinion that the answer to the questions raised by the Supreme Tax Court must respect the fundamental principles of VAT, namely that the basis of VAT assessment is the consideration actually received.

The AG also points out that the pharmaceutical company does not have at its free disposal the full amount of the price received at first sale of its products to pharmacies or wholesalers. At most but importantly so, it is a 'mere temporary custodian' of the part of the amount received that it is bound to pay later to public and private health funds as a rebate and which is indexed to the price of the pharmaceutical products supplied. Lastly, the AG takes the view that treatment of pharmaceutical supplies to publicly and privately insured persons are comparable situations that are being treated differently for no apparent objective justification.

The ECJ case reference is C-462/16 *Boehringer Ingelheim Pharma* opinion of July 11, 2017.

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 VAT 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 VAT 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 thinks that its previous case law – namely requiring the address in the invoice to be the place where the issuer exercises its economic activity – may not be in line to a recent ECJ judgment of October 22, 2015 (C-277/14, *PPUH Stehcemp*) and has therefore referred the issue to the ECJ for clarification on 6 April 2016. In the case C-277/14 the ECJ has held that – in general – a customer holding an apparently valid supplier's invoice cannot be refused an input VAT deduction merely because of irregularities brought about by the supplier. The customer cannot be required to make checks that are not his responsibility. The question thus to be answered is whether (i) all formal invoice requirements must be fulfilled and (ii) the address from which the taxpayer carries out business activities need not be shown in the invoice. In other words: Is it sufficient that the taxable person making the supply gives an address by which he may be reached by post but where he does not carry out any economic activity?

The ECJ advocate general on the case has now suggested the court rule that Article 226 (5) of the VAT Directive precludes national legislation making the right to deduct input VAT dependent on an invoice indicating the address where the issuer carries out its economic activity; any type of address, including a so called "letter-box address" would be sufficient, provided that the person can in fact be contacted at that address. In order to correctly identify the issuer of the invoice it should not be necessary that the place of economic activities or the presence of the trader's business must be shown as the address in the invoice. In particular with regard to recent economic developments such as e. g. e-commerce, office sharing and teleworking. In light of this it is sometimes difficult to maintain that an economic activity is carried out from one particular place. For example, it is nowadays possible to run a business buying and selling goods on an internet platform from nearly anywhere in the world.

If the ECJ should nevertheless have a contrary view and hold that the formal invoice requirements are not fulfilled, the question of good faith arises, namely whether the deduction of input VAT is only possible when the taxable person has taken every measure that could reasonably be required of him in order to satisfy himself that the content of the invoice was correct. In this case the advocate general suggests that such an interpretation would not be in line with EU VAT rules as it would, de facto, introduce a significant limitation of the right of deduction, which the VAT rules do not support.

The ECJ case reference is joint cases C-374/16 *Geissel* and C-375/16 *Butin* opinion of July 7, 2017.

Refusal to deduct French social security contributions not compatible with EU law

A French tax official (appellant) lived in Germany with her German civil service husband. Under the terms of the double tax treaty, her salary was excluded from German taxation, but taken into account when establishing the rate to be applied to the rest of the couple's income (principally the husband's pay and allowances). However, the German tax office refused to take the French social security contributions into account – as a deduction because they were directly connected with tax-free income and in the rate calculation (special tax rate) because they were in the nature of a personal relief rather than a cost of earning income. The net result was that the contributions at issue were unrelieved in Germany, whereas a full deduction would have been available had the same amounts been paid under a German scheme. The ECJ now held that this is indeed a discrimination and in violation of Article 45 of the Treaty on the Functioning of the European Union (TFEU).

The refusal to calculate the special tax rate without deducting the social security contribution might discourage resident workers from looking for or accepting employment in another Member State. Such restriction under Article 45 TFEU would only be permissible if it related to a situation which is not objectively comparable or if it is justified by an overriding reason in the public interest. Both alternatives do not apply in the case at hand. The appellant and her husband were taxed jointly and thus Germany would be in position to grant her the advantages resulting from her personal or family circumstances, despite the fact that the appellant did not have a significant German source income. That puts her in a situation comparable to that of a resident taxpayer receiving income in his State of residence.

Moreover, the restriction can also not be justified by overriding reasons in the public interest. The German government had argued that the refusal to allow the deduction is justified to secure a balanced allocation of the power of taxation between Germany and France and the consistency of the national tax system. The ECJ objected. First, the right of taxation in this instance is clearly and specifically dealt with in the double tax treaty concluded between France and Germany (taxation of salaries and wages in the country of source on the one hand and corresponding tax exemption in the country of residence, without limiting the right – in this instance – of Germany to take the exempt income into account in setting the rate to be applied to the couple's other income). This leads the ECJ to conclude that, whilst Germany agreed in the double tax treaty that income received in France is solely taxed in that State, it cannot now assert that the disadvantage arising from the refusal to deduct the social security contributions is offset by the fact that that income is not taxed in Germany. Such an argument would, according to the ECJ, undermine the allocation of powers of taxation freely agreed by Germany in the double tax treaty.

The ECJ case reference is C-20/16 *Bechtel* judgment of June 22, 2017

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