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From PwC

US tax reform legislation signed by President Trump

Congress on December 20, 2017 gave final approval to the House and Senate conference committee agreement on tax reform legislation that lowers business and individual tax rates, modernize US international tax rules, and provide the most significant overhaul of the US tax code in more than 30 years. President Trump signed the tax bill on 22 December 2017.

The US federal corporate income tax rate will be reduced from 35 percent to 21 percent. Also, the current 39.6-percent top individual income tax rate will be reduced to 37 percent and other individual income tax rates and brackets be revised. Both the new corporate tax rate and revised individual tax rates will be effective for tax years beginning after December 31, 2017.

The US tax reform provides the most significant overhaul of US international tax rules in more than 50 years by moving the United States from a ‘worldwide’ system to a 100-percent dividend exemption ‘territorial’ system. As part of this change, two minimum taxes are included aimed at safeguarding the US tax base from erosion, along with other international tax provisions.

More details of the tax reform – as laid down in the final conference committee agreement - to be found here.

Commission announces new guidelines to improve withholding tax procedure

On 11 December 2017 the European Commission put forward new guidelines on withholding taxes to help Member States reduce costs and simplify procedures for cross-border investors in the EU.

The recommendations, developed alongside national experts, form part of the EU’s Capital Markets Union Action Plan and should improve the system for investors and Member States alike. In particular, the Code of Conduct – which is envisaged to apply on cross-border dividend, interest and royalty income – aims to reduce the challenges faced by smaller investors when doing business cross-border. It should result in quick, simplified and standardised procedures for refunding withholding taxes where appropriate. Implementation of the Code of Conduct is voluntary for Member States. It provides a snapshot of the problems faced by cross-border investors and explains how more efficient tax procedures can be put in place. The Code outlines a range of practical ways for Member States to address key issues, including:

Submit refund claims or apply for relief: Possibility of beneficial owners, non-resident financial institutions and other representatives to submit refund claims or apply for relief. For instance, beneficial owners, including those with a low value portfolio, are able to claim refund or apply for relief on their own behalf, without any intermediary; non-resident intermediaries are allowed to claim refund and apply for relief on behalf of their clients in a non-discriminatory manner.

Efficient and user-friendly digital WHT procedures: Digitalisation of the reclaim process. Digitalisation can be defined as the adoption or increase in use of digital or computer technology by an organization. It takes time, demands resources and can be carried out with various degrees of maturity (in the case of WHT processes, it can range from using emails and /or publishing forms online to full online processes).

Efficient internal IT systems: Tax administrations to use IT systems for efficiently processing reclaims and refunds, as well as, when applicable, a relief at source system.

Effective reliefs and provision of refunds in a short period: Provide relief and refunds in an appropriate period of time and normally within 6 months of receipt of a fully documented and valid claim for refund or application for relief by the relevant tax authority.

User-friendly forms and user-friendly documentation requirements: The tax administrations should make the forms for the submission of refund claims or application for relief as user-friendly as possible. In addition, tax administrations should provide clear requirements in relation to which supporting documents taxpayers have to provide in order to substantiate their claims for refund or applications for relief vis à vis tax administrations Document requirements are published online in at least one language customary to the sphere of international finance. Documents requested are relevant and necessary.

Set up a single point of contact: Tax administrations should have a single point of contact for all aspects concerning the WHT procedures. The single point of contact should be easily found, i.e. on the website of the tax administration.

Relief at source: Carrying out relief at source requires the assumption of important responsibilities and obligations by financial intermediaries which can be held liable for failures to comply with their obligations.

As set out in the Capital Markets Union Action Plan, the European Commission encourages Member States to adopt systems of relief-at-source from withholding taxes and to put in place better refund procedures. The Commission went on to note that whereas some of the suggestions may be carried out relatively quickly and cheaply, others may take longer and involve substantial investments, in particular when it comes to IT systems.

European Commission – Press release of 11 December 2017

Official Pronouncements

Final circular published by Federal Ministry of Finance on application of loss forfeiture rules

On 30 November 2017, the Federal Ministry of Finance published the final version of its circular on the application of the loss forfeiture rules according to Section 8c of the Corporation Tax Act (CTA), including comments on the Hidden Reserve Clause and the Group Clause. This circular replaces the circular on this subject from 4 July 2008.

More details to be found on our *Tax & Legal* site under

https://blogs.pwc.de/german-tax-and-legal-news/2017/12/06/tax-legal-newsflash-5-december-2017/

Ministry of Finance clarifies questions on the Investment Tax Act 2018

In a circular the Federal Ministry of Finance clarified a number of urgent questions raised by the German Banking Industry Committee and the Federal Association of Investment and Asset Management with regard the application of the Investment Tax Act in the version applicable from 1 January 2018.

The German Banking Industry Committee and the Federal Association of Investment and Asset Management asked the Federal Ministry of Finance to clarify certain issues in relation to a number of different areas of the Investment Tax Act in the version applicable from 1 January 2018. The Finance Ministry answered these questions in the circular after conferring with the chief tax authorities of the Federal States. The areas addressed in the circular include the determination of the level of equity holdings for funds of funds, (Section 2 (6) & (7) Investment Tax Act 2018), the definition of other domestic income (Section 6 (5) Investment Tax Act 2018) and the application of the conditions of Section 36a Income Tax Act to investment funds (Section 10 Investment Tax Act 2018).

Federal Ministry of Finance Circular of 24 November 2017 (IV C 1 – S 1980-1/16/10010:010)

Limited taxpayers: withholding tax on cross-border licensing of software

The Federal Finance Ministry published the long-awaited circular on its intended application of the rules (Section 50a Income Tax Act) applying to limited taxpayers and withholding tax on cross-border licensing of software and databanks.

The Federal Finance Ministry circular provides a detailed evaluation of software and databank licences supplied by non-resident providers to resident customers and the potentially resultant limited liability to German tax under Section 50a (1) No. 3 Income Tax Act ("ITA") by way of withholding. The limited liability to German tax arises where income is realised from licensing rights, which are exploited in a domestic branch or other establishment.

The German tax liability arises where the user is given extensive rights to (economically) exploit the software (this could for example be the right to duplicate, to adapt, to disseminate or to publish) and that this exploitation occurs in a domestic branch or other establishment. The term "exploitation" means targeted activities intended to achieve an economic benefit from the licensed rights. No limited tax liability will arise for example where the licence of the software functions is the prime purpose of the contract.

Withholding Tax will only be withheld under Section 50a (1) No. 3 ITA where the non-resident provider of the cross-border software licence is a limited taxpayer.

Example

A German resident company obtains a licence from "Software Ltd.", a Singapore resident company, containing the right to disseminate, duplicate, publish and adapt a special photo software in order to make it suitable for the German market and to incorporate it in software package containing separate programme features, which package the German company markets. The royalties paid by the German company constitute the domestic income of a limited taxpayer in the hands of Software Ltd, to the extent the latter company does not have a domestic branch or a permanent representative in Germany.

Withholding tax under Section 50a (1) No. 3 ITA only applies to temporary licences. A licensing of patented software is generally to be viewed as a temporary licence of rights, as a full transfer of patented rights is not permissible.

Income from the licensing of rights will be subject to a limited tax liability where extensive rights are granted which allow for further economic exploitation. This would be the case, for example, where a foreign entity, which had neither a domestic branch nor a permanent representative in Germany, allowed its German resident subsidiary to further develop and commercially market the parent's original software products in Germany and - for the payment of a royalty - granted the German company extensive rights (duplication adaptation and dissemination rights). In such a case the German subsidiary would not only be entitled to use of the software in a conventional manner but also to exploit it through development and dissemination of the adapted form.

Domestic income does not arise where the licence simply allows a conventional use of the software. This evaluation applies regardless of whether the relevant software is so-called "standard software" or whether it is specially developed "individual" software. Conventional use also includes adaptations and duplications which are necessary for conventional use in so far as no economic exploitation is involved. No domestic income will arise where the cross-border licence is limited to the onward transfer of the software and its conventional use within a group of companies within the meaning of Section 18 of the Stock Corporation Act; this will apply whether or not the onward transfer is on a cost-covering basis or whether an additional payment is made.

Internet-based software licences: In addition to the transfer of software through disk or download, the use of software can be facilitated over the internet server of the supplier. This applies particularly to Application Service Providing ("ASP") and Software as a Service ("SaaS"). In addition to the transfer of software, the end-user is regularly supplied with further technical services (data retention, data processing, support, maintenance and advice). Again in this situation, domestic income will only arise to the extent that extensive rights for economic exploitation are granted.

Transfer of software copies to intermediary suppliers: No taxable transfer will arise, where the licence is limited to the domestic dissemination of certain copies (reproductions) of software, without the intermediary supplier being granted extensive rights in the software itself. The transfer by the foreign software provider can occur through the provision of a disk or by way of a download (provision of a licence key for the download of the software).

Mixed contracts: No tax liability will arise where the transfer of rights is insignificant (i.e. no more than 10%) compared to the supply as a whole or where the consideration cannot be allocated where an apportionment is required.

Use of the Read/Print function of a databank: According to the Finance Ministry's interpretation, no domestic income should arise where the licensee uses the Host Access Functionality or the Read- Print - Functions of a databank in a standard (conventional) manner. This is in contrast to the commercial use of the databank or of information contained in the databank (for example rights to public reproduction, the right to sub-license to a third party or the right to publish patented analyses).

No economic exploitation of data use in higher education institutes and in public libraries: As mentioned above domestic income will only arise where the rights are exploited in a domestic branch or other establishment. According to the Finance Ministry the expression "other establishment" also includes universities and public authorities. However, it cannot be assumed that an institute of higher education or a library can carry on a targeted activity ("exploitation") within the framework of its public duties. Hence foreign suppliers who license the use of their academic databanks to institutes of higher education or a libraries are not subject to the limited tax liability where the commercial use of the databank is excluded in the contract between the institute of higher education/ library and the databank supplier.

The circular is to be applied to all open cases.

Federal Ministry of Finance circular of 27 October 2017 (IV C 5 S 2300/12/10003: 004) published on 2 November 2017.

Tax Court Cases

VAT treatment of call-off stocks

The Supreme Tax Court (V R 31/15) rejected the tax administrations opinion on the VAT treatment of call-off stocks as opposed to consignment stock.

Many subcontractors supply their goods by means of so-called call-off stock. If the stock is supplied from another EU member state, the German tax authorities – in the past – treated the corresponding movement of the goods as intra-Community transfer followed by a domestic supply of goods. The Supreme Tax Court has now rejected this approach – however, only under certain conditions.

The appellant supplied his customer from Spain. The goods were put into consignment stock in Germany. The supplies were carried out based on supply contracts. The specific quantities of goods as well as the supply dates were determined by binding delivery schedule plans. The customer had the right of unrestricted access to the supplied goods. It was established that some 95 % of the goods were dispatched from Spain based on such delivery schedule plans.

The Supreme Tax Court held that the supplies were considered to be direct supplies of goods from Spain to Germany, since the customer was already fixed at the very start (beginning) of dispatch from Spain. The court went on to say that, under circumstances of the case at hand, a short break in a stock would not be harmful, i.e. if the goods are stored in the warehouse for a short time It would not be sufficient, though, if the dispatch of goods were to a person who is only likely to be the customer.

Assignment of players as gift to a football club

The Supreme Tax Court held that where a third party provides his employees to a football club to serve as players, trainers or counsellors without receiving adequate consideration, the waiver of such compensation is to be considered as a taxable gift of the third party to the football club.

In the case a former sponsor of a football club employed players, trainers and counsellors as commercial staff and paid them. However the players/trainers/counsellors did not work for the sponsor but rather played football for the club. The sponsor received no payment from the club for the assignment of the athletes. The tax office imposed gift tax on the club based upon the sponsor's salary payments to the athletes. The club's appeal to the tax office was unsuccessful.

The Supreme Tax Court shared the view of the lower court, that the sponsor's gratuitous assignment of the players to the club was subject to gift tax. Generally where an employer assigns his staff an adequate compensation will be paid. However, if the parties agree that the players will be employed and remunerated by a third party, but will in fact solely play football for the football club, and if that club is not required to pay an adequate compensation to the third party, the waiver of compensation by that third part will be deemed to be a gift to the football club.

This judgement could also be of significance to other types of sport.

Supreme Tax Court judgement of 30 August 2017 (II R 46/15) published on 22 November 2017

Input VAT refund: transmission of scanned invoice copies

Under the German VAT Implementation Regulations (Regulation 61 (2) 3rd Sentence – in the version valid until 29 December 2014), the condition that a "copy" of an invoice is to be attached to the input VAT refund application in electronic form, is met when the document which has been electronically transmitted is a faithful replication of the invoice.

The appellant, a resident of Poland, submitted with his electronic application for an input VAT refund an electronic copy of an invoice which was stamped with the word "Copy". The scanned original of this invoice was sent to the Federal Tax Office (FTO) with a later application for a different input VAT refund period. The FTO refused the refund application because, within the application deadline period, the invoice had only been submitted as a scanned copy of the original but not as a scanned original. An input VAT refund solely on the basis of a scanned copy of an existing (i.e. not lost) original invoice was not permissible. The Supreme Tax Court rejected this proposition and accepted the appellant's arguments with reference to the most recent case law.

The requirement in Regulation 61 (2) 3rd Sentence VAT Implementation Regulations (old version) "to attach electronically invoices and import documents in copy" is also met with, where the document transmitted is not a scanned original but a scanned copy of the original, a scanned copy of a duplicate invoice or a scanned copy of a second copy of the invoice. In its judgement of 17 May 2017 (V R 54/16) the Court stated that "A copy of an invoice copy is a copy within the meaning of Regulation 61 (2) 3rd Sentence VAT Implementation Regulations (old version)"

Note: Regulation 61 (2) 3rd Sentence VAT Implementation Regulations (old version) directs that "invoices and import documents in copy are to be electronically attached" to the refund application. This rule corresponded to the wording of Article 10 of Directive 2008/9/EC (laying down detailed rules for the refund of value added tax provided for in Directive 2006/112/EC, to taxable persons not established in the Member State of refund but established in another Member State), which wording is still prevailing.

With effect from 30 December 2014 Regulation 61 (2) 3rd Sentence VAT Implementation Regulations was amended to the extent that invoices were no longer to be transmitted "in copy" but rather "as scanned originals". According to the tax authorities this amendment serves only as a clarification of Article 10.

Supreme Tax Court decision of 30 August 2017 (XI R 24/16), published on 22 November 2017

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

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 number of cases.

In its ruling of 7 September 2017 (C-16/16 *Eqiom SAS and Enke SA*) the European Court of Justice decided that a treaty/directive-shopping provision in French tax law – which is similar to the German rule in Section 50d (3) ITA – is not compatible with EU law (Parent/Subsidiary Directive ("PSD") and the fundamental freedom of establishment).The French tax authorities refused an application for an exemption from French withholding tax on the basis that the exemption in question did not apply to dividends received by a legal person, which was directly/indirectly controlled by one or more persons resident in a third country (i.e. outside the EU), unless the parent company can prove that the main purpose or one of the main purposes for the chain of interests was not to take advantage of the tax exemption. The Court held that both the PSD and Article 49 TFEU (freedom of establishment) precluded such a rule. The ultimate shareholder of the company making the claim in this case was a Swiss company.

More details on the issue to be found on our *Tax & Legal* site under

https://blogs.pwc.de/german-tax-and-legal-news/2017/11/24/german-exclusion-from-withholding-tax-relief-in-conflict-with-eu-law/

Commercial transactions between friends and recognition of losses

The Supreme Tax Court decided on a case involving a gratuitous share transfer between friends, where the transferor had significant acquisition costs. The Court held that the presumption of a commercial transaction is not rebutted purely because a friendship exists between the contracting parties.

The case related to a decision of the lower court relating to an agreement, where the lower court held that the contracting parties had agreed and economically executed a gratuitous transfer; the lower tax court's decision was principally based on the fact that the contracting parties had a long-standing friendship originally arising from their relations as neighbours. According to the Supreme Tax Court, however, the lower tax court was wrong to characterise a relationship between friends as equal to a relationship between relatives and thus rebutting the presumption of a share transfer for a valuable consideration.

The existing presumption that third parties tend not to give away anything in the course of normal business, can be refuted by the relevant parties through either direct proof or with the support of circumstantial evidence. However, the lower tax court should recognise that the higher the economic value of the shareholding is between the parties, the harder the presumption will be to rebut.

Supreme Tax Court decision of 9 May 2017 (IX R 1/16) published on 8 November 2017.

Expatriate exit taxation in violation of the Agreement for the Free Movement of Persons?

The lower tax court of Baden-Württemberg released a press bulletin stating that by a notice dated 14 June 2017 (2K 2413/15), it had referred a question to the European Court of Justice ("ECJ") with regard to Section 6 Foreign Transactions Act ("FTA") – expatriate exit taxation. The question referred was whether the expatriate exit tax rule under Section 6 FTA contravened the principle of non-discrimination contained in the Agreement for the Free Movement of Persons between the EU and Switzerland.

The lower tax court of Baden-Württemberg takes the view that the appellant is entitled to rely on the principle of non-discrimination contained in the Agreement for the Free Movement of Persons between the EU and Switzerland. A person who wishes to move to Switzerland may be subject to expatriate exit tax, whereas a person who moves inside Germany would not be. According to ECJ case law, the principle of non-discrimination contained in the Swiss Agreement is comparable to the Fundamental Freedoms of the EU. The principles of freedom of establishment and free movement of labour (and the freedoms in general) prohibit every measure which is aimed at impeding the exercise of a freedom or making it less attractive. According to the Tax Court the charge to expatriate exit tax had "at least a dissuasive effect" on the move from Germany to Switzerland.

Since 2008, the appellant, a German citizen, has been the managing director of a company resident in Switzerland, in which company he holds a 50% interest. In 2011 he moved his (habitual) residence from Germany to Switzerland. The German tax office charged him to expatriate exit tax on the increase in value attributable to his shareholding (so-called hidden reserves). According to the tax office, the removal to Switzerland led to an earlier realisation of income tax on a (potential) sale of his shareholding. No option for a deferral of the tax payment was available in respect of a removal to Switzerland, even though in the case of a removal within the EU, such a deferral should be possible.

Press release No. 11/2017 of the Tax Court of Baden-Württemberg, dated 2 November 2017.

Tax consolidation groups: Compensation payments and failure to amend "old agreements" following Sec. 302 (4) Stock Corporation Act

According to a decision of the Supreme Tax Court published on 9 November 2017 a profit pooling agreement will not be recognised for tax purposes where the compensation agreement with the external shareholder contains both the right to a variable compensation payment calculated on the basis of the profits of the subsidiary/controlled company/"Organgesellschaft" ("subsidiary") and a fixed amount. This also applies to subsidiaries in the form of a GmbH (i.e. limited companies as well as to public limited/stock companies (AGs)). The Supreme Tax Court also ruled that the requirement of Section 17 2nd Sentence No. 2 Corporation Tax Act (old version), according to which the assumption of losses was to be expressly agreed in the profit pooling agreement of a GmbH in accordance with Section 302 (4) Stock Corporation Act, was not only to be complied with at the time of conclusion of the agreement but also in each of the following years. It followed that those parts of the Section 302 regulation which had not entered into force at the time of the conclusion of the contract were also to be taken into consideration. Thus where a loss assumption agreement is not inserted into an "old" profit pooling agreement, (i.e. one concluded prior to the entry into force of Section 302 (4) Stock Corporation Act), in order to meet the requirements of the amended section and where this omission was not subsequently redressed under the amnesty rule, the Organschaft was no longer to be recognised for income tax purposes.

More details to be found on our *Tax & Legal* site under

https://blogs.pwc.de/german-tax-and-legal-news/2017/11/10/tax-consolidation-groups-organschaft-for-income-tax-purposes-compensation-payments-to-minority-shareholders-failure-to-amend-to-old-agreements-of-a-gmbh-followi/

Limited taxpayers: no add-back of fictitious business expenses without domestic branch

The Supreme Tax Court has ruled that where a limited taxpayer has no permanent establishment (branch/permanent representative) located in Germany, the add-back of fictitious business expenses cannot be applied.

Gains arising from the sale of shares in a company are exempt from tax where the seller is a company. However, 5% of the gain is to be added back as a fictitious non-deductible business expense. The question before the Court was whether this fictitious non-deductible business expense could also be attributed to a foreign company as a limited taxpayer, where that foreign company had no permanent establishment (i.e. no branch or permanent representative) located in Germany.

The appellant, a limited company, was tax resident of Bermuda and thus did not benefit from a tax treaty. The appellant argued that the rule concerning fictitious non-deductible business expenses could only be applied where the taxpayer actually carried on a business in Germany or at least had a domestic permanent establishment (i.e. to have business expenses you should have a domestic business). The lower tax court of Hessen had refused the appeal, following the tax office's argument that the sale of shares (with a shareholding of more than 1%) in a German resident company gives rise in principle to a limited obligation to pay tax. If the limited taxpayer is a company, the gain on disposal is tax free and correspondingly 5% of the gain on disposal is a non-deductible fictitious business expense.

The fiction of lump-sum business expenses cannot apply in this situation because the appellant, due to the fact that it does not operate a domestic branch nor does it have permanent representative in Germany, does not earn any domestic income which such business expense could be set off against. Whilst the relevant provision creates a fictitious business expense and directs its non-deductibility, it does not provide the German tax authorities with a mechanism to tax the fictitious business expense. This mechanism would therefore have to be provided for in other tax provisions. The appellant realised domestic income from a deemed business. To determine this "business income", however, no calculation of profits allowing for a deduction of the business expense needed to be carried out. The appellant's limited obligation to pay tax arose exclusively from the gain on the disposal. The difference between the disposal proceeds and the acquisition costs including any costs of sale was qualified as "business income" by virtue of a statutory fiction so that to this extent neither an accrual basis accounting nor a cash base accounting became necessary.

Supreme Tax Court judgment of 31 May 2017 (I R 37/15), published on 25 October 2017.

Full forfeiture of loss relief where more than 50% of the shares are transferred also unconstitutional?

On 29 August 2017, the lower tax court of Hamburg referred a further request 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, namely where more than 50% of the shares in the loss making company are transferred (second alternative of Sec. 8c Corporation Tax Act). The Lower Tax Court is convinced that this rule is also unconstitutional.

Share transfers of more than 25 % but no more than 50 % are unconstitutional: On 29 March 2017 the Constitutional Court held (case ref. 2 BvL 6/11) that Sec. 8c sub-sec. 1 sentence 1 of the Corporation Tax Act (CTA) – dealing with changes of more than 25% and up to 50% of the shares in a company within a period of five years – is unconstitutional as there is no justification for the unequal (different) treatment of companies in cases of a harmful change of ownership, i. e. where more than 25% but no more than 50% are transferred (alternative 1 of Sec. 8c CTA) and the loss carry forward is then reduced in proportion to the transfer. The case was referred by the Lower Tax Court of Hamburg. In the opinion of the Constitutional Court there was no plausible reason to assume a (harmful) change of identity of the company without taking further into account the business assets and / or the type of business of the company. In its judgment at the time the court left it open whether this should be judged differently in situations where more than 50% of the shares are transferred (alternative 2 of Sec. 8c CTA).

Further referral to Constitutional Court regarding share transfers of more than 50 %: Most recently, though, the lower tax court of Hamburg referred to the Constitutional Court questions with regard to the rules on the full forfeiture of loss relief under Section 8c 2nd Sentence CTA, specifically where in a five year period more than 50 per cent of the shares change ownership. The lower tax court is convinced that this rule is also unconstitutional.

In its resolution the court follows in full the earlier judgment 2 BvL 6/11 of the Constitutional Court on alternative 1 of Sec. 8c CTA. The curtailment of loss relief is solely dependent on the situation of the shareholder and does not sufficiently take into account the company's personal ability to pay. In other words: The court sees no plausible reason to assume a (harmful) change of identity of the company without taking further into account the business assets and / or the type of business of the company. The court does not see any justification for this. Even more so, as Sec. 8c CTA is not a pure anti-abuse restriction but also covers "normal" changes of shareholders and thus is more of a general restriction. The effects of Sec. 8c CTA are felt to be too far reaching, as the rules come into play as a consequence of any form of share transfer. Typically, the identity of the company is not lost solely if more than 50 % of the shares are transferred. Moreover, it cannot be assumed from the outset that the influence of the acquirer of the shares would equally result in a change of the company as such. The reasons for a change of shareholders are manifold and a change of identity can ultimately only be judged on the basis of the measures actually taken by the shareholders.

Lower tax court of Hamburg, resolution of 29 August 2017 (2 K 245/17); official press release of 18 October 2017

Standard actuarial interest rate for pension provisions of 6 %: unconstitutional?

The Cologne Tax Court considers the standard actuarial interest rate of 6 % applied for the calculation of pension provisions under Section 6a of the Income Tax Act in 2015 to be unconstitutional. It has suspended the appeal and referred the matter to the Constitutional Court for that Court to consider the constitutionality of the standard rate.

Whilst parliament is entitled to set a standard actuarial interest rate, it must, at regular intervals, review whether the standard rate is still realistic. The actuarial interest rate has remained unchanged since 1982. The statutory interest rate is so unrealistic in the current interest rate environment that parliament must be obliged to review it. The judges took the view that the failure to review and adjust amounted to a constitutional breach. All available parameters, such as bond yields or corporate bond returns, would have shown that, over the years, there was an ongoing downward tendency and that the interest rates lay well below 6%.

The higher the standard actuarial interest rate is, the less a business is entitled to allocate to its pension provision. This results in a much higher tax burden.

Note: Affected tax assessments should be kept open until the Constitutional Court decides.

Cologne Tax Court, Decision of 12 October 2017 (case reference: 10 K 977/17) and Press report of 16 October 2017

From Europe

German Anti-Treaty-Shopping Rule infringes EU law

The European Court of Justice (ECJ) issued its decision on two cases referred to it by the lower tax court of Cologne on the compatibility of the anti-abuse rule in Section 50d Income Tax Act (ITA) with EU law. According to Section 50d (3) ITA certain intermediary foreign companies are not entitled to a (full or partial) refund of German withholding tax. Without a preceding oral hearing the ECJ took the view that the section was incompatible with both the Parent-Subsidiary Directive and the freedom of establishment.

Both referrals of the Cologne Tax Court related to the so-called anti-treaty shopping regulation in Section 50d (3) ITA (in the 2007 version), according to which a foreign company was refused relief under a directive or tax treaty to the extent that persons had holdings in it who would not be entitled to the relief if they earned the income directly, and

(1) there were no economic or other substantial reasons for the involvement of the foreign company; or
(2) the foreign company did not earn more than 10% of its entire gross income for the financial year in question from its own economic activity; or
(3) the foreign company did not take part in general economic commerce with a business establishment suitably equipped for its business purpose.

In this regard the circumstances of the non-resident company were the sole decisive factor; organisational, economic or other substantial features of undertakings that were affiliated with the foreign company were not to be considered. The questions referred by the lower tax court indicated a concern about a potential restriction of the freedom of establishment and a violation of the Parent-Subsidiary Directive (Directive 90/435/EEC – "PSD").

Facts and Decision: In case C-507/16, the appellant, Deister Holding, had its registered office in the Netherlands and had holdings in several companies established in various States; it financed those companies, inter alia, by making loans to the companies of the group in question. The appellant held at least 26.5% of the capital of a company incorporated under German law. The appellant had a rented office in the Netherlands and two employees. Deister Holding's sole shareholder was resident in Germany. In case C-613/16, the appellant, Juhler Holding, was a holding company with its registered office in Denmark. Its sole shareholder was a company incorporated under Cypriot law without its own economic activity. The sole shareholder of the Cypriot company was an individual resident in Singapore, who would not have been entitled to a refund of the dividend withholding tax, had he received the dividend directly. Juhler Holding had holdings in more than 25 subsidiaries and a property portfolio; it exercised financial control within the group so as to optimise the group's interest costs, was responsible for supervising and monitoring the performance of the individual subsidiaries and had a phone line and an email address. However, it did not have its own offices.

Infringement of the Parent-Subsidiary Directive: The ECJ considered the German provision to be too one sided and restrictive. The aim of the PSD is to eliminate any (tax) disadvantages arising from the distribution of profits between companies of different Member States and to facilitate the grouping together of companies at EU level. The judges pointed out that whilst the PSD did provide the Member States with the right to introduce rules to prevent abuse, the measures must be appropriate for attaining that objective and must not go beyond what is necessary to attain it. The German provision does not meet this criteria.

A general tax measure which automatically excludes certain categories of taxable person from the tax advantage, without the tax authorities being required to provide even prima facie evidence of fraud and abuse, goes further than is necessary for preventing fraud and abuse. The Court has previously stated that, the specific objective of any national measures must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, and the purpose of which is to obtain an undue tax advantage. In the view of the ECJ, Section 50d (3) introduced a general presumption of abuse. However, national authorities may not confine themselves to applying predetermined general criteria, but must carry out an individual examination of the whole operation at issue. Further the applicant should be entitled to provide evidence to the contrary. The situation should be examined on a case-by-case basis, with an overall assessment being made of the relevant situation, based on factors including the organisational, economic or other substantial features of the group of companies to which the parent company in question belongs and the structures and strategies of that group.

The ECJ also noted that the PSD itself did not contain any requirement as to the nature of the economic activity of companies falling within its scope or the amount of turnover resulting from those companies' own economic activity

Impediment to the freedom of establishment: The ECJ took the view that Section 50d (3) ITA leads to a difference in treatment, likely to dissuade a non-resident parent company from carrying on an economic activity in Germany through a German subsidiary and therefore constitutes an impediment to the freedom of establishment. The Court was unable to establish any justification for this restriction. This could be the case where situations are not objectively comparable or where it can be justified by overriding reasons in the public interest recognised by EU law. Such justifications could not be demonstrated here.

The non-resident parent company is in a situation which is comparable to that of a German resident parent, as Germany has chosen to exercise its tax jurisdiction over the profits distributed by the resident subsidiary to the non-resident parent company. Thus it had to be concluded that the non-resident parent company is, vis-à-vis those dividends, in a situation comparable to that of a resident parent company. As regards the justification for and the proportionality of the impediment, Germany argued that the provision could be justified, inter alia, by its objective to safeguard the balanced allocation of taxation powers between the Member States. However, the ECJ noted in this regard, that the PSD itself governs the issue of that allocation, in that it prohibited Member States from levying WHT on profits distributed by a resident subsidiary to its non-resident parent.

Note: The Cologne Tax Court has also expressed its doubts in relation to the current version of Section 50d (3) ITA (applicable from 2012) and referred the question to the ECJ on 17 May 2017 (2K 773/16). The case is pending under the ECJ reference C-440/17.

The ECJ joint case reference is C-504/16, *Deister Holding* and C-613/16, *Juhler Holding* judgment of December 20, 2017

Exemption of loss forfeiture for troubled businesses illicit state aid?

The exception of the German loss restriction rules for acquisitions in the course of a rescue operation to save a troubled business was held by the European General Court as a selective measure as it favours certain companies – those in financial difficulties – over their competitors in the marketplace. Two cases were brought to the ECJ for final clarification. The advocate general in one of the cases now proposes that the ECJ overturn the judgment of the General Court to the extent that it dismissed the action as unfounded.
More details can be found on our *Tax & Legal* site under

https://blogs.pwc.de/german-tax-and-legal-news/2018/01/02/exemption-of-loss-forfeiture-for-troubled-businesses-illicit-state-aid/

VAT: Divergent treatment of discounts on medicinal products violates EU law

On 20 December 2017 the European Court of Justice (ECJ) held that the divergent VAT treatment of discounts granted by pharmaceutical companies (i.e. trader/entrepreneur for VAT purposes) to statutory (public) health insurance funds and private health insurance funds constitutes an infringement of EU law. The ECJ followed the Advocate General's opinion and confirmed the doubts of the German Supreme Tax Court which had referred the question to the ECJ.

The case related to the discounts which pharma companies are obliged to grant private health insurance funds under the provisions of the Medicinal Products' Discounts Act. In the past these discounts – in contrast to the discounts granted to the state health insurance funds – could not reduce the taxable amount of the relevant pharma company, because - according to the view of the tax authorities - the private health insurance fund (as trader/entrepreneur) was not included in the supply chain as the medicinal product was not acquired by the private health insurance fund itself but rather the fund had refunded the costs of the insured person.

The General Advocate saw an infringement of the principle of equal treatment in relation to the reduction of the taxable amount. Hence a taxable person is not required to be directly contractually bound with the beneficiary of the discount in order to be able to consider the discount in the calculation of the taxable amount.
The ECJ followed this view, considering the discount to the private health insurance fund to be a reduction in price for VAT purposes. This was based, inter alia, on Articles 73 and 90 of the VAT Directive. The value of the consideration is everything which the supplier receives from the customer. Further, in line with Article 90, the taxable amount must always be reduced, where the taxable person does not receive the whole consideration after the time at which the supply took place.

In addition, the ECJ referred to its earlier judgment in *Elida Gibbs* (judgment of 24 October 1996, C-317/94). noting that one of the principles on which the VAT system is based is neutrality, in the sense that within each country similar goods should bear the same tax burden whatever the length of the production and distribution chain.

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

Foreign Tax Act: Income adjustment in accordance with community law?

The lower tax court of Rhineland Palatinate has asked the ECJ to rule on the income adjustment provision of the Foreign Tax Act as amended in 2003 as it might not be in accordance with EU-law. The focus of the judicial review is on the tax consequences of a business relationship with a related party and where the terms do not meet the third party comparison test. The ECJ advocate general has suggested the court decide that the German rules for profit adjustment under Sec. 1 Foreign Tax Act are not in violation of the freedom of establishment.

Can a Member State prevent companies from shifting profits out of its jurisdiction by requiring income to be declared on the basis of 'arm's-length conditions'? Can it impose such a requirement only in relation to cross-border transactions and not domestic ones (that is, between two resident companies) without falling foul of the Treaty rules on freedom of establishment?

The ECJ advocate general says yes to both points. He does not consider that the German rules in question give rise to any restriction on the freedom of establishment. However, to the extent that they do, they are, in his view, justified.

The case involved a German AG which issued letters of comfort for its foreign subsidiaries for which no fee had been agreed and charged. The tax office increased the income of the AG for the notional remuneration. According to the Lower Tax Court such treatment (i. e. giving rise to a higher tax burden) may be an infringement of freedom of establishment as it would prevent taxpayers from establishing a subsidiary in another member state. Under an arm's length review the taxpayer may present valid reasons as to why the conditions agreed with the foreign related company correspond to those which would have been agreed between mutually independent third parties. However, under the regime of Sec. 1 Foreign Tax Act (FTA) the taxpayer is not given an opportunity to provide evidence of any commercial justification for the transaction being below market while considering the specific shareholder relationship of the parties involved. Thus, the provision in the FTA does not sufficiently take account of the fact that the shareholder might have a personal interest in "his" company being successful as he then would participate by higher profit distributions.

The advocate general considers this latter argument – in his own words – clearly incorrect. Because otherwise, the notion of arm's-length transaction would no longer have any bearing. It would effectively mean a full exclusion of any business transactions with subsidiaries from the application of the principle, because a parent will always have an interest in seeing its subsidiary prosper. There would thus always be, by definition, a justification.

The ECJ case reference C-382/16 *Hornbach-Baumarkt* opinion of 14 December 2017

Compulsory content of invoices for purpose of deduction of input VAT

The European Court of Justice (ECJ) published its decision in the joined cases of Geissel and Butin ruling that Directive 2006/112/EC of 28 November 2006 on the common system of value added tax ("the VAT Directive") – Articles 168(a) and 178 (a) together with Article 226(5) – must be interpreted as precluding national legislation, which makes the exercise of the right to deduct input VAT subject to the condition that the address where the issuer of an invoice carries out its economic activity must be indicated on the invoice.

In two separate cases, the German Supreme Tax Court referred to the ECJ the question as to whether, in order for a taxable person to be entitled to deduct input VAT, the relevant invoice should be considered to contain a "full address" within the meaning of the VAT Directive (Articles 168(a) and 178 (a) together with Article 226(5) "the relevant Articles") where, the invoice issued by the supplier only provides an address where the supplier may be reached by post but where he does not carry out any economic activity. The cases related to two traders in motor vehicles who claimed input VAT on the basis of invoices issued, in the first case, by a "ghost company" which did not have any establishment at the address on its invoices and, in the second case, by a supplier with no fixed establishment in Germany, who used a "letterbox address" on his invoices.

Article 226 of the VAT Directive lists the details which must appear on such an invoice. Article 226(5) lays down, in particular, the requirement to indicate the full name and address of the taxable person and of the customer. The ECJ noted that the ordinary meaning of the term 'address' is broad and - referring to the Opinion of the Advocate General - the usual meaning of that term covers any type of address, including a 'letterbox address', provided that the person may be contacted at that address.

Moreover, so the ECJ, Article 226 of the VAT Directive states that only the details mentioned in that article are required for VAT purposes on invoices issued pursuant to Article 220 of the VAT Directive. It followed therefore that the requirements relating to those details must be interpreted in a strict manner since it is not possible for Member States to lay down more stringent requirements than those under the VAT Directive nor is it open to Member States to make the exercise of the right to deduct VAT dependent on compliance with conditions relating to the content of invoices which are not expressly laid down by the provisions of the VAT Directive (the Court also referred to the judgment of 15 September 2016, *Barlis 06 - Investimentos Imobiliários e Turísticos*, C-516/14).

Further referring to the earlier ECJ judgment of 15 September 2016, in *Senatex*, (C-518/14), the Court noted that the right to deduct VAT may not, in principle, be limited. According to that decision the deduction of input VAT must be allowed if the substantive requirements are satisfied, even if the taxable persons have failed to comply with certain formal conditions. Against this background, so the Court in the present cases, it must follow that the detailed rules regarding the indication of the address of the issuer of the invoice cannot be a decisive condition for the purposes of the deduction of VAT.

In addition consideration could be given to the purpose of the provision. The aim of indicating the address, name and VAT identification number of the issuer of the invoice is to make it possible for the tax authorities to establish a link between a particular economic transaction and a specific economic operator, i.e. the issuer of the invoice, and thus establish the tax due and the existence of a right to deduct input VAT. The Court pointed out that the VAT identification number of the supplier of the goods or services is also an essential piece of information in that identification and that number is easily accessible and verifiable by the tax authorities. (Here the Court also made reference to the fact that in order to obtain a VAT identification number, undertakings must complete a registration process in which they are required to submit a VAT registration form, along with supporting documentation.)

Additionally, the Court took the view that such an interpretation was confirmed by the judgment of 22 October 2015, *PPUH Stehcemp* (C-277/14), in which the Court ruled that it was possible to deduct input VAT in a case where the national court made the finding that the building designated in the commercial register as being the supplier's registered office was in a dilapidated state. The Court held that the fact that no economic activity could be carried out at the supplier's registered office did not mean that that activity could not be conducted elsewhere in particular when those activities are carried out remotely through the use of new computer technologies.

It follows, therefore, that for the purposes of the exercise of the right to deduct VAT by the recipient of goods or services, it is not a requirement that the economic activities of the supplier be carried out at the address indicated on the invoice issued by that supplier.

The ECJ joint case reference is C-374/16, *Geisel* and C-375/16, *Butin* judgment of November 15, 2017

VAT: Supply of goods – Finance lease with option to purchase

The European Court of Justice decided that a finance lease with an option to purchase should be qualified as a "supply of goods" where the exercise of the option appears to be the only economically rational choice that the lessee could make at the appropriate time. As a result the whole of the VAT becomes due when the object to be leased is handed over.

The plaintiff, Mercedes-Benz Financial Services Ltd, a subsidiary of Daimler AG, offers three types of standard contract for financing the use of motor vehicles: a standard hire agreement known as “Leasing”, a “Hire Purchase” agreement, and a leasing agreement with an option to purchase called “Agility”, which combines certain features of the first two types of agreement and which allows customers to postpone choosing between leasing and purchase until after the vehicle has been handed over. The ‘Leasing’ agreement excludes any transfer of ownership and, moreover, sets a maximum mileage beyond which the customer is liable to pay a penalty. In the case it was not disputed that this type of agreement falls within the category “supply of services”, with VAT falling due on the monthly instalments. The “Hire Purchase” and “Agility” agreements, on the other hand, both provide for a transfer of ownership, but on different terms. Under the “Hire Purchase” agreement, the total monthly payments made over the term of the agreement generally represent the total sale price of the vehicle, including the cost of financing. A small additional fee is to be paid in order to acquire ownership of the vehicle at the end of the contract. That final payment is provided for in the agreement and does not depend on the option being exercised. Again it was not disputed that this type of agreement falls within the category “supply of goods”, with VAT falling due upon the handing over of the vehicle. This dispute arose in respect of the “Agility” agreement, under which the monthly instalments are generally lower than under a ‘Hire Purchase’ agreement, with total instalments (including the financing costs) representing approximately 60% of the vehicle sale price. If the user wishes to exercise the option to purchase the vehicle, he must therefore pay approximately 40% of the sale price. That “balloon” payment represents the estimated average residual value of the vehicle at contract maturity. The customer is asked, three months before the end of the contract, whether he wishes to exercise the option.

The plaintiff argued that the “Agility” agreement should fall into the category “supply of services”, with VAT falling due on the monthly instalments, as the agreement did not necessarily provide for the transfer of ownership. The question was how the words ‘*contract for hire which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment*’, used in Article 14(2)(b) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (Article 14 providing the definition of the “supply of goods”), should be interpreted.

The Court decided that they should be interpreted as applying to a leasing contract with an option to purchase if it can be inferred from the financial terms of the contract that exercising the option appears to be the only economically rational choice that the lessee will be able to make at the appropriate time if the contract is performed for its full term. As an example the Court mentioned a situation where at the end of the contract term the lessee would not be obliged to pay a substantial “balloon” payment as the market value of the vehicle was not substantially higher than the instalments already paid.

The ECJ case reference is C-164/16, *Mercedes-Benz Financial Services* judgment of October 4, 2017

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