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Tax & Legal News

Official Pronouncements

Tax authorities' circular on VAT liability of operators of an electronic market place

The tax authorities have published a circular setting out the official view of the application of the new rules on the VAT liability of operators of electronic market places introduced by the Finance Act 2018.

The full name of the statute often referred to as the Finance Act 2018 is the "Act on the Avoidance of VAT Shortfalls in the Electronic Market Place and on Other Tax Provisions". As its name suggests the Act has introduced into the VAT Act a provision imposing specific obligations on operators of electronic market places and a provision allocating a liability for the VAT shortfall to them. The new rules came into force on 1 January 2019.

According to the new provisions, operators of an electronic market place are obliged to keep information on potentially VATable supplies in Germany made by the users of their platform. The information – provided in the form of a certificate issued by the supplier's local tax office – includes the name and address of the supplier using the platform, his tax number/VAT ID; in addition, details must be collected about the relevant supplies. Failure to meet these obligations can under certain conditions lead to the operator himself becoming liable for unreported VAT due on supplies provided using his/its platform.

The obligation to keep records arises even where no VAT registration has taken place. In such cases, details of the tax number and the VAT ID are not required. The records must be stored for ten years.

The certificates issued by the supplier's local tax office will initially be issued in paper form until an electronic system has been set up. A standard form issued by the tax authorities is available (on the Finance Ministry's website) to make the

application for such a certificate but the application may also be made form-free, provided the required information is included. The period of validity of certificates will currently not extend beyond 31 December 2021. The certificate will serve the platform operator as proof that the supplier is subject to VAT but is not proof that he meets all his VAT obligations. Small traders also receive a certificate upon application.

Suppliers who do not make any domestic supplies and who are not subject to VAT are not required to provide a certificate.

Where the platform operator has doubts as to the authenticity of the certificate, he should approach the issuing tax office. Failure to do so could lead to the platform operator being held liable for any unpaid VAT.

The circular sets out the circumstances in which the platform operator may become liable for the VAT shortfall and considers the definition of an electronic market place (making the distinction between electronic market places and bulletin boards/agency forums).

Where the platform operator has a valid certificate he should not generally become liable for any VAT shortfall unless it is evident that he was aware of the failure of the supplier to meet his VAT obligations in full or he did not exercise reasonable care in ascertaining whether this was the case.

The platform operator is considered to have the relevant knowledge or not exercised reasonable care, where he ignores obvious or known facts, which would lead to the conclusion that the supplier was not meeting his VAT obligations.

A liability for the VAT shortfall may also arise where the platform operator fails to produce a certificate. In such cases, knowledge of the supplier's failure to meet his VAT obligations will not be relevant.

A liability for the VAT shortfall should not arise where the platform operator can show that the supplier did not register on his platform as an entrepreneur (so no certificate was provided) but the platform operator had otherwise met with his obligations to record and retain information.

Whilst according to the statute, the new rules came into effect on 1 January 2019, the circular provides a period of grace allowing for the platform operators until 1 October 2019 to collect information on resident and EU/EEA- resident entrepreneurs and one until 1 March 2019 to collect information on other non-resident entrepreneurs.

Source: Federal Ministry of Finance circular of 28 January 2019 (III C 5 – S 7420/19/10002 :002)

Tax Court Cases

Deduction of final branch losses – a change of track?

The Lower Tax Court of Hesse, with reference to the ECJ case Bevola und Jens W. Trock, decided that final losses of a foreign (UK) permanent establishment are deductible in Germany.

The plaintiff is a German stock corporation, who realized losses through its UK branch. Those losses were exempt in Germany according to the Germany-UK double tax treaty. The activities of the PE were discontinued in 2007. The plaintiff applied for a deduction of the final losses in Germany at the time of closing the PE on grounds of EU Law.

The competent tax office refused the deduction of the final foreign losses. In the Bevola case (C-650/16), the ECJ decided that final losses of a foreign PE were deductible in Denmark (as head office state) under the freedom of establishment. Therefore, the Bevola case brought new life into the tax treatment of final PE losses after the negative ECJ judgment in the case Timac Agro (C-388/14).

Applying the Bevola case, the Lower Tax Court of Hesse decided that the freedom of establishment requires the deduction of the final losses accrued at the level of the German parent company for corporate tax and trade tax purposes. Not deducting the losses in the country of head office would be disproportionate as the plaintiff lost the possibility of deducting foreign losses from future foreign gains in the UK by closing the PE.

Source: Lower Tax Court of Hesse, judgment of September 4, 2018 (8 K 1279/16); appeal is pending before the Supreme Tax Court (case I R 32/18).

Trade tax: Dividend income exemption in case of double residence

According to the Lower Tax Court of Hesse, the dividend income exemption for trade tax on qualifying shareholdings is also available for distributions of companies of foreign legal form – provided the foreign company is comparable to a German corporation, has its place of management and thus a permanent establishment in Germany.

Sec. 9 no. 2 a of the Trade Tax Act (TTA) protects profit distributions on shares in non-tax exempt domestic companies (...) from trade tax. The investment – at the beginning of the tax period – must at least be 15 per cent and the distributions be included in the trading profit (which is the starting point to determine the final and overall trading income subject to trade tax).

The plaintiff (a GmbH) was the sole shareholder of a Belgian partnership (BVBA). The sole managing director of BVBA was a natural person (A) with sole residence in Germany. BVBA is undisputedly similar to a corporation for German tax purposes. It did not engage in any active business and otherwise held a 14 % stake in a Mexican corporation (CV). In 2009, the latter made a profit distribution to BVBA in respect of its 2008 earnings and BVBA further distributed these profits to the GmbH. The tax office included 95 per cent of the dividend from BVBA to the plaintiff's trading income subject to trade income tax.

The Hesse tax court concluded that the conditions for a trade income tax exemption are met. The term "domestic company" includes not only corporations with domestic management established in Germany, but also legal entities established abroad with a place of management in Germany. That is true here, since A (the managing director of BVBA) was a German resident individual.

BVBA – through A – has a German domestic place of management and is per se the subject of trade tax in accordance with Sec. 2 (1) sentence 3 TTA (permanent establishment by way of domestic management). According to the Lower Tax Court, denial of the trade tax exemption would lead to double trade tax burden on the distribution in Germany.

Source: Lower Tax Court of Hesse, judgment of October 19, 2018 (8 K 1279/16); appeal is pending before the Supreme Tax Court (case I R 43/18)

Double tax treaties: recognition of losses from a Belgian permanent establishment

Section 50d (9) Income Tax Act (ITA) excludes a tax exemption in Germany under a double tax treaty where, inter alia, the income is not taxed in the other treaty state. The Supreme Tax Court held that the term "income" in this context applied to both positive and negative income. Thus, provided that the other conditions set out in Section 50d (9) have been met, losses, which were originally excluded as tax-free treaty income, could be deducted from domestic taxable income, regardless of the treaty.

The German-resident law firm of the appellant, an unlimited German taxpayer, rented offices in Brussels from 1991 to 2010 and from October 1992 onwards, a lawyer was to some extent present in the offices constantly, offering various services, including the provision of advice, information or opinions, which could be invoiced under the federal fee regulations for legal services. Between 1994 and 2004, a lawyer was employed, who also used the office for representative activities. Following a tax audit, the Belgian tax authorities issued certificates, which stated, inter alia, that the law firm was not regarded as a Belgian tax resident for the purposes of the Belgian/German tax treaty, was not liable to income tax for the

fiscal years 1991 to 2007, and that for these periods no loss carry-forward was available. The appellant applied to set off the Belgian losses against his taxable income in Germany.

The question before the Court revolved around whether the expenses incurred by the law firm for the rental of an office in Brussels were to be recognised for German tax purposes in the hands of the appellant. Were the costs deductible as business expenses or were they merely to be considered for the purposes of calculating the tax rate under the progression provisions?

Section 50d (9) No.1 ITA deals with the situation where income is not taxed as a result of a conflict as to how the provisions of a tax treaty are applied/interpreted by the participating treaty states. This may be the case where the designation as to the type of income conflicts, or where facts and circumstances are interpreted differently or where the domestic legislation of the different states leads to a divergent interpretation of the treaty provisions. In these circumstances, Section 50d (9) No.1 ITA allows Germany to tax the income, in that it prohibits the treaty tax exemption.

According to the decision of the Supreme Tax Court, this prohibition applies not only to income/profits but also to losses incurred, so that not only income untaxed in the other state will be taxable in Germany but also losses not recognised in the other state will be available for set off in Germany.
In the circumstances before the Court, Article 14 of the Belgian/German treaty gave the right to tax the income (both positive and negative) of the Brussels office to Belgium. The Supreme Tax Court referred the matter back to the lower tax court to decide whether the requirements of Section 50d (9) ITA had been actually met in the circumstances and whether there was an actual conflict of qualification.

The lower tax court had allowed the appellant's appeal and confirmed that that the appellant could deduct the Belgian losses. However, this decision had solely been based on the fact that the Belgian tax authorities had issued the above-mentioned certificates. The Supreme Tax Court held that it was necessary to look into the matter in greater detail and establish whether the income/losses were excluded from taxable income in Belgium because of Belgian domestic tax legislation or whether this exclusion was a result of a conflict of qualification in tax treaty law.

According to the Supreme Tax Court, if it is subsequently established that the exclusion of the income from the Belgian tax base results from Belgian domestic tax legislation, Section 50d (9) No. 1 ITA will not be applicable.

Source: Supreme Tax Court judgment of 11 July 2018 (I R 52/16), published on 19 December 2018

From Europe

European Court of Justice: RETT exemption on conversions not illegal State Aid

Back in June 2017 we informed you of the Supreme Tax Court's referral to the European Court of Justice of the question as to whether the RETT exemption on conversions(Section 6a Real Estate Transfer Tax Act) constitutes illicit State Aid. On 19 December 2018, the European Court of Justice held in A-Brauerei (C-374/17) that the RETT exemption granted in the case before it of an upstream merger did not infringe the State Aid rules.

In the case in question the taxpayer, A-Brauerei, a public limited company/stock corporation, had, for a period of more than 5 years, been the sole shareholder of a subsidiary which was the owner of certain real estate. In the relevant period the subsidiary was merged upwards into the taxpayer. As the subsidiary held real estate the merger would have given rise to a transfer subject to RETT, unless the exemption on conversions under Section 6a Real Estate Transfer Tax Act was available.

The Supreme Tax Court referred the question as to whether the RETT exemption on conversions (here the merger) constitutes illicit State Aid. Illicit State Aid in this context is state aid that distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, i.e. inter alia, provisions which are considered "selective".

Section 6a Real Estate Transfer Tax Act applies to:

(i) Restructurings/conversions regulated by the German Restructuring Act or any equivalent (company) law of a Member State of the EU or the European Economic Area;

(ii) Entities involved in the restructuring must form part of the same group (i.e. there must be a common parent, which – directly or indirectly – holds at least 95% of the shares in all entities involved; the parent itself may also be part of the restructuring);

(iii) Restructurings where the participation(s) of at least 95% exist during the five years before and after the transaction.

All requirements must be met cumulatively. The German tax authorities disputed A-Brauerei's compliance with the conditions, and the case went eventually up to the Supreme Tax Court. The Supreme Tax decided that the benefits of the RETT exemption had to be granted to A-Brauerei unless the rule constituted illegal State Aid. In the view of the Court the provision may give rise to a "selective advantage". so on 30 May 2017, the Supreme Tax Court referred the case to the ECJ expressing doubts in respect of Section 6a RETT and its compatibility with EU State Aid rules.

The ECJ examined the selectivity of Section 6a RETT Act, and held that the general rule ("the reference framework") in this case was, in principle, that all transfers of ownership in German real estate triggered RETT. The ECJ concluded that Section 6a RETT Act is a derogation from this reference framework as it exempts group restructurings from the RETT levy even if another entity acquires the property. The ECJ noted that both entities involved in group restructurings covered by Section 6a RETT Act and other entities which perform other types of ownership transfers or do not form part of a group can be considered to be in a comparable situation in the light of the objective of the general rule. The provision was, therefore, found to be a priori selective.

However, the ECJ found that the derogation could be justified by the nature or general scheme of the German tax system and the intention of the German provision to prevent double taxation. The ECJ held that in an upstream merger case like the one at hand it can be assumed that the taxpayer (parent) had already paid RETT when it integrated the subsidiary with the property into the group because the parent owned more than 95% of the shares in the subsidiary (i.e. the acquisition of such amount of shares in a property owning company is an event triggering German RETT). Exempting such a parent from the second RETT levy is therefore justified by the objective to prevent double taxation. As regards requirement (iii) relating to the duration of the holding, the Court found it to be justified by the objective to prevent abuse. The ECJ did not comment on requirement (i).

Source: Decision of the European Court of Justice on 19 December 2018 in A-Brauerei (C-374/17)

News in brief	
European Court of Justice: Deductible input VAT of a branch located in another Member State	In its judgment in Morgan Stanley (C-165/17) on 24 January 2019, the ECJ ruled on the ratio of deductible input tax in relation to the internal supplies of a French branch to its head office, a financial service provider in the UK. *https://blogs.pwc.de/german-tax-and-legal-news/2019/02/08/european-court-of-justice-deductible-input-vat-of-a-branch-located-in-another-member-state/*
The Italian Budget Law 2019	The last version of the Italian Budget Law 2019 has been published in the Gazzetta Ufficiale from the 31. December 2018 and entered into force on the 1st of January 2019. The provisions include interesting innovations on the tax environment for taxpayers, both legal entities and natural persons. *https://blogs.pwc.de/german-tax-and-legal-news/2019/02/12/the-italian-budget-law-2019/*
Information to be provided by applicants for authorised economic status under the Union Customs Code	The ECJ held that certain information required by the customs authorities from legal persons applying for authorised economic status under the Union Customs Code was lawful within the ambit of Directive 95/46/EC and Regulation (EU) 2016/679 governing the protection of individuals with regard to the processing of personal data and on the free movement of such data. *https://blogs.pwc.de/german-tax-and-legal-news/2019/01/17/european-court-of-justice-information-to-be-provided-by-applicants-for-authorised-economic-status-under-the-union-customs-code/*
Free movement of capital in cases of shareholdings of at least 10%	The Supreme Tax Court held that with regard to national provisions with a requirement of a minimum shareholding of at least 10%, the principle of the free movement of capital is not blocked by the principle of freedom of establishment. Whilst the judgement specifically related to a legal provision, which is no longer applicable, it represents a departure by the Supreme Tax Court from its previous view on this issue. *https://blogs.pwc.de/german-tax-and-legal-news/2019/02/01/free-movement-of-capital-in-cases-of-shareholdings-in-excess-of-10/*
Trade tax: foreign passive income attribution	Two decisions of the Baden-Württemberg Tax Court have been published in connection with the attribution of foreign passive income for trade tax purposes. In these decisions the Court also raises doubts as to whether the add-back of this type of foreign income is compatible with EU law. *https://blogs.pwc.de/german-tax-and-legal-news/2019/01/18/trade-tax-foreign-passive-income-attribution/*

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From PwC

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