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By PwC Deutschland | 06. August 2021

Penalties due to incomplete cross border documentation in breach of EU law?

In its referral to the European Court of Justice (ECJ) for a preliminary ruling, the Regional Tax Court of Bremen raises doubts as to whether the penalty surcharge under Section 162 (4) Fiscal Code due on failure to present proper documentation in cross border business relations is in line with the freedom of establishment in Art. 49 TFEU and the freedom to provide services (Art. 56 TFEU).

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Background

In the course of an amendment in 2003, the German legislator introduced extended documentation obligations and duties for the taxpayer to cooperate on cross border matters in conjunction with Section 90 (3) Fiscal Code. At the same time, violation of this obligation was punished by imposing penalty surcharges (Sec. 162 (4) Fiscal Code). This penalty may be due if the taxpayer fails to submit certain records of foreign business transactions and relations or if he submits them in an insufficient form. The penalty amount paid is not a deductible expense.

Particular duties to record and furnish

The taxpayer is under duty to record the type and scope of his cross-border business dealings with related parties. (Sec. 90 (3) sent.1 Fiscal Code together with Sec. 1 (4) Foreign Tax Act regarding the adjustment of income from a foreign business relationship), documenting the facts as well as their economic and legal basis. As a rule, the tax authorities shall require the submission of records only for the purpose of conducting a tax audit.

Consequences of failure to cooperate

If the taxpayer fails, wholly or partially, in his duties of cooperation under Sec. 90 (3) Fiscal Code, he can suffer disadvantageous consequences, i. a. the imposition of penalties according to Sec. 164 (4) Fiscal Code. The penalty charge will be levied – at the discretion of the tax authority - if the taxpayer fails to produce records or provides largely unusable records and the penalty ranges from at least 5% and at the most 10% of the additional income from business dealings with related parties, however minimum of €5,000 (in the case of failure to produce records at all or only unusable records). In the case of delayed production of usable records, the penalty is to be at least €500 for each full day of delay but is not to exceed a total of €1,000,000 for all cases of delayed submission of usable records and for each period of assessment.

Facts of the case

The business purpose of the plaintiff, a domestic limited partnership (KG), was the holding and management of investments, in particular in companies domiciled in Germany, and the provision of service, consulting, and management services to affiliated companies and third parties. In the years in dispute, it held 100% of the shares in a subsidiary GmbH (limited liability company), which in turn held 100% of the shares in four other German GmbHs. The sole limited partner was a Dutch B.V., which was fully held by Y N.V., which was also domiciled in the Netherlands.

During the years in dispute, Y N.V. provided services to the plaintiff's subsidiaries based on separate contracts between Y N.V. and the general partner of the plaintiff, a GmbH and between Y N.V. and the plaintiff. Compensation should be based on the actual costs incurred on a full cost basis (in particular: salaries). Shareholder's costs of Y N.V. should not be charged. During a tax audit for the years 2007-2010, submission of the financial statements according to Section 90 (3) Fiscal Code was requested by the tax office. Especially, possible double entries of expenses and other items, the determination of shareholder's

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costs and the calculation of costs of staff could not be furnished in a sufficient manner by the plaintiff. In addition, the tax auditors imposed a surcharge pursuant to Sec. 162 (4) Fiscal Code in the amount of 5% of the amount to be adjusted (corrected), i. e. €20,000 per tax assessment period, since the documentation submitted was not suitable and of no use. This penalty charge was contested by the plaintiff as to violate the freedom of establishment in Article 49 of the Treaty on the Functioning of the European Union (TFEU).

Decision (reasons for referral to the ECJ)

In its referral to the ECJ, the Regional Tax Court of Bremen raises doubts as to whether the penalty surcharge under Section 162 (4) Fiscal Code is in line with the freedom of establishment in Art. 49 TFEU and the freedom to provide services (Art. 56 TFEU). In the opinion of the court, there is a restriction because the record-keeping and documentation requirements and the associated penalty surcharge only apply to taxpayers engaged in business relationships with related parties abroad, but not to domestic business relationships . Furthermore, a justification of this restriction was doubtful. It is true that the surcharge is suitable to safeguard the powers of taxation between the Member States and to combat tax avoidance. However, it was not necessary to impose such a surcharge. The legislator had already provided the tax authorities with sufficient other means to enforce the documentation requirements with the alternative under Sec. 162 (3) Fiscal Code to issue an unfavorable assessment by way of an estimation: In this estimate it was to be assumed that the taxable income of the taxpayer in Germany – which the records described in section 90 (3) should serve to figure out – is higher than the income he declared. An (additional) surcharge would therefore no longer contribute to prevent tax evasion.

In addition, the regulations regarding the amount of the surcharge also led the court to believe that it was not necessary. In particular, the surcharge is not directly linked to the tax effect of the findings but rather to the additional amount of income and may therefore amount to €5,000 even if no additional amount of income is determined.

Source:

Regional Tax Court of Bremen, decision of 7 July 2021 - case ref. 2 K 187/17 (3)

Schlagwörter

cross border transactions, incomplete documentation, penalty surcharge