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Important changes in law and regulations

21 November 2025

ECJ referral on the “switch-over” clause in Section 20(2) Foreign Tax Act

In its decision of 3 June 2025, (IX R 39/21 - published on 20 November 2025), the Supreme Tax Court referred the "switch-over" in Section 20 (2) Foreign Tax Act (“FTA”) to the ECJ: denial of DTA exemption for passive and low-taxed foreign permanent establishments and partnerships. The core question of the referral is whether it should be possible for the taxpayer – in the context of CFC taxation under Section 7 FTA et seq. – to provide "counter-evidence" in accordance with Section 8 (2) FTA.

The question has a long history, as the ECJ had already ruled in 2007 in the "Columbus Container" case (C-298/05) that the switch-over as such was in conformity with EU law, whereas the Supreme Tax Court (BFH) ruled in its final judgement that because of the provisions direct link to CFC taxation, the opportunity to provide counter-evidence analogous to Section 8(2) FTA must also be permitted in the context of Section 20(2) FTA.

The referral

For both the tax year 2007 and the tax year 2008, the Supreme Tax Court has expressed doubts as to whether the "switch-over" regulated in Section 20(2) Foreign Tax Act (FTA) is compatible with the freedom of establishment due to the reference contained therein to CFC taxation under Section 7 FTA et seq. This is because the opportunity to prove the existence of economic activity (motive test) in the host Member State (i.e. the country of permanent establishment) is not available to the taxpayer or has been expressly denied since 2008, whereas this option is otherwise provided for in the context of CFC taxation.

In the opinion of the Supreme Tax Court, these doubts are not contradicted by the fact that, in its decision in Columbus Container Services of 6 December 2007, the European Court of Justice – in C-298/05 – had already considered the switch-over from exemption method to the credit method in Section 20(2) of the FTA, to be acceptable under EU law. This is because the question referred to the ECJ at that time by the Münster Tax Court related exclusively to the legality under EU law of the switch-over from the exemption method to the credit method as set out in Section 20(2) FTA and therefore did not specifically deal with the reference in Section 20(2) FTA to CFC taxation under Section 7 FTA et seq..

Note: For this reason, the Supreme Tax Court (BFH) had already ruled in its final judgment in the Columbus Container case (I R 114/08) of 21 October 2009 – without referring the matter to the ECJ – that the ECJ's decision did not preclude a requirement that under EU law the taxpayer must be allowed to provide counter-evidence in the context of Section 20 (2) FTA.

In the version of Section 20(2) FTA applicable to the 2008 tax year, the application of Section 8(2) FTA was also expressly excluded by law.

In its referral, the Supreme Tax Court also tends to take the view that prohibiting the taxpayer from being able to provide counter-evidence could violate EU law.

Any questions?

For a deeper discussion of how this might affect your business, please reach out to your local PwC contact advisor or our following international tax experts:

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