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By PwC Deutschland | 03 September 2015

No EU objection to German tax rules on EU branch losses?

An ECJ advocate general has suggested that neither the German refusal to allow a deduction for branch losses incurred in other member states, nor the recapture provision in the event of disposal of the branch offend against community law.

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Up to 1998, German companies were able to deduct foreign branch losses, notwithstanding double tax treaty provisions for taxation solely in the country of source. However, this deduction was ultimately only temporary inasmuch as it was recaptured on future branch profits, or when the branch was disposed of, wound up or incorporated. A German subsidiary of a French group operated a consistently loss-making Austrian branch from 1997 to 2004. In 2005, the branch made a trading profit before transferring its assets and business to the Austrian subsidiary of the same group. The German tax office refused a deduction for the losses incurred from 1999 onwards and added the 1997/98 deductions back to income in 2005 under the recapture provisions, which remained (and remain) in force. The company objected to both adjustments as a restriction on its freedom of establishment, given that it would have been able to permanently deduct corresponding losses from a German branch.

The ECJ advocate general on the case has suggested the court rule that the refusal to continue to allow a deduction for foreign branch losses from EEA countries after 1998 is not a restriction on the company's freedom of establishment. The company's Austrian losses could be carried forward in Austria and were therefore not permanent. The Austrian branch was not in a comparable position to a German one and thus the loss deduction possibility in Austria as opposed to Germany was not a restriction on the freedom of establishment. Even if it were, it could still be justified by the need to preserve the internationally agreed allocation of taxing rights between treaty partner countries. By contrast, the advocate general agrees with the taxpaying company that the 2005 deduction recapture is a restriction on its freedom of establishment. However, he sees that restriction to be justified by the need to preserve the allocation of taxing rights, the coherence of the German taxation system and by the need to prevent the abuse of offsetting the same loss in both countries. He also points out that the losses were not final in the year they were incurred.

The ECJ case reference is C- 388/14 *Timac Agro* opinion of September 3, 2015.

Keywords

Foreign branch, branch losses, recapture