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Foreign branch loss recapture provision confirmed

The ECJ has confirmed a German provision for the recapture of foreign branch losses previously deducted on sale of the foreign permanent establishment.

Up to 1998, German law allowed a resident business to deduct the losses incurred in its foreign permanent establishment, even where the foreign branch profits were excluded by treaty from German taxation. As of 1999, the provision was abolished except for its recapture rule for foreign losses previously deducted. This rule provides for an add-back to taxable income of the previous deduction when that loss is covered by profits in the country of establishment, or where the establishment is sold or wound up.

A German company deducted its Austrian branch losses in 1997 and 1998. From then on, the branch continued to make losses in all years except for 2005 when its assets and business were sold to an Austrian group company. In that year, the German tax office insisted on adding the loss deduction from 1997/98 back to income because the Austrian permanent establishment had ceased trading, whereas the company demanded a further deduction for the losses 1999-2004 because there was no longer any effective deduction in the country in which they had been incurred.

The ECJ has now sided with the tax office on both points. The recapture provision is an essential balance in the coherence of the German tax system, given that the double tax treaty allocates to Austria the sole right to tax Austrian business profits. The original deduction was a privilege to help the German company until it could realise an effective deduction in Austria. Accordingly, its withdrawal was justified once it was no longer needed. This latter could be either through actual recovery from realised profits or through effective abandonment by the company through the disposal of its branch business.

The ECJ case reference is C-388/14 *Timac Agro* judgment of December 17, 2005

Keywords

Foreign branch, losses, permanent establishment (PE), recapture