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By PwC Deutschland | 05 April 2016

No conflict between Foreign Tax Act and tax treaty definition of arm’s length dealing

The finance ministry has decreed that Supreme Tax Court judgments limiting the income adjustments under the Foreign Tax Act to questions of amount are not to be followed as precedents prohibiting adjustments by reason of the nature of the transaction under review.

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The Foreign Tax Act provides for adjustment of income to the level that would have been achieved had the given transaction been conducted at arm's length. It thus provides for adjustment both in respect of pricing as well as in respect of the nature of a transaction. Accordingly, transactions that a third party would not have entered into in the given form can also lead to adjustment (disallowance of the expense, imputation of income) even if their pricing is not in dispute. However, the Supreme Tax Court has seen this conclusion as being in conflict with the arm's length clauses of the tax treaties (on the lines of the OECD model) and thus sought to restrict application of the income adjustment provision to pricing disputes only (judgments I R 23/13 of December 17, 2014 and I R 29/14 of June 24, 2015). The finance ministry does not share this view and has issued a decree directing tax offices not to follow the two judgments in other similar cases. Rather, they should continue to apply the existing statutes and extra-statutory instruments as they stand.

Keywords

Foreign Taxes Act, arm's length, income adjustment