By PwC Deutschland | 06 June 2017

No deduction of final branch losses following EU law.

Payments made to a purchaser to compensate for a poor economic position following the transfer of an interest in a partnership may not be deducted from the domestic tax base to the extent they are attributable to a foreign branch (i.e. a permanent establishment for tax treaty purposes) of the partnership. In its decision the Supreme Tax Court cited a decision of the European Court of Justice (ECJ) from 2015.

In 1999 the appellant, a GmbH, assigned its interest in a limited partnership (“the KG”) to the second limited partner. The KG held an Italian branch. The Italian branch had incurred losses in the years 1996 to 1998, which were separately assessed under Section 2a (3) Income Tax Act. Due to the expected losses of the KG, the plaintiff agreed in the course of the transfer to pay a compensation payment. This compensation payment was partially attributable to the Italian branch.

The tax office treated that part of the compensation payment attributable to the Italian branch as a non-deductible expense. Further it took the view that the relevant conditions had been met to reincorporate the Italian branch losses, which had been deducted in earlier tax years.

The tax court allowed the appellant’s appeal with regard to the deductibility of the expense. However the Supreme Tax Court reversed this decision. The compensation payment could neither be deducted as business expense nor could it be deducted as a so-called “final” loss. The decisive issue was the so-called “symmetry thesis”, according to which the tax treaty exemption of foreign income was attached to both positive and negative income. ECJ and Supreme Tax Court case law has ruled up to now that, due to the freedom of establishment rule, a loss deduction from the corporation tax base should be possible if and to the extent that the taxpayer can prove that the losses are “final” losses, namely they cannot, under any circumstances, be utilized by the foreign branch for a tax set-off. The Supreme Tax Court applied this rule not only to circumstances where the losses could no longer actually be utilized in the source state but also to circumstances where, whilst the loss utilisation was theoretically still possible in the other state, in reality it could just about be excluded and where such a loss deduction abroad became available contrary to expectations, it would, from an administrative law point of view, still be open to the German tax authorities to make a subsequent adjustment.

The ECJ has, however, in the meantime revised this case law. In its decision of 17 December 2015 (C-388/14 Timac Agro Deutschland), the ECJ held that, where there was no objectively comparable domestic situation, no concerns should arise from an EU law point of view, where a Member State, in the event of a transfer by a resident company of a permanent establishment situated in another Member State, excludes the possibility, for the resident company, of taking into account in its tax base the losses of the establishment transferred where, under a double taxation convention, the exclusive power to tax the profits of that establishment lies with the Member State in which the establishment is situated.

Whilst the Supreme Tax Court sees dogmatic doubt in the Timac Agro Deutschland decision, in the instant case it followed the view of the ECJ and refused a further referral to that court.

Citation: Supreme Tax Court decision of 22 February 2017 (I R 2/15), published on 17 May 2017

Keywords

EU Law, Final PE losses, International Tax