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By PwC Deutschland | 28 May 2018

ECJ decision German CFC regulations to be published on 31 May 2018

The publication of the decision of the European Court for Justice (ECJ) in the Hornbach-Baumarkt case is scheduled for 31 May 2018.

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The case revolves around the question whether Section 1 of the Foreign Transaction Tax Act ("FTTA" - in the version in force in 2003) violates the freedom of establishment. The section in question calls for income corrections to be made on related party transactions which are not considered to have been concluded at arm's length.

Background

According to the provision under review, income of a German resident taxpayer derived from business relations with a company established in another Member State in which that taxpayer has a direct or indirect shareholding of at least 25 % and with which that taxpayer has agreed terms that depart from those that would have been agreed on by unrelated third parties under the same or similar circumstances must be calculated as if that income had been earned pursuant to terms agreed on between unrelated third parties. One of the questions put to the ECJ by the Rheinland-Pfalz, was whether such a rule was in line with EU law as it did not give the taxpayer any chance to provide evidence of a commercial reason for the transaction.

Hornbach provided comfort letters to banks and creditors guaranteeing that the liabilities of some of its foreign subsidiaries would be met. It did not receive any remuneration from the subsidiaries for the comfort letters. Following a tax assessment, the tax office held that the comfort letters had not been granted on arm's-length terms. The Tax Office therefore increased Hornbach's tax base to reflect the notional remuneration that it considered would normally have been paid to Hornbach by an unconnected third party in consideration for the comfort letters.

The Tax Court Rhineland Palatinate considered that this may constitute a violation of the freedom of establishment, because, inter alia, the provision did not provide the taxpayer the opportunity of providing evidence that there were non-tax commercial reasons for the agreement. The Advocate General, however, in his opinion of 14 December 2017, did not share this view. On 31 May 2018 we will see which view the ECJ will confirm.

ECJ. C-382/16, Hornbach-Baumarkt

Interesting to note in this regard:

- In its decision of 26 January 2016 the Tax Court of Saxony (3 K 653/11), referring to earlier Supreme Tax Court case law, decided that Section 1 FTTA in the version in force from 2003 did not contravene EU law. An appeal was made to the Supreme Tax Court (I R 14/16) which in turn referred the matter to the ECJ (C-382/16).
- In its decision **(I R 88/12) of 25 June 2014** the Supreme Tax Court saw, in a case involving the grant of an interest-free loan to a Belgian subsidiary (in 2001), no breach of EU law. The reason given for this was that the income correction was but a measure to ensure a balanced allocation of taxing rights which could not be considered to be disproportionate. Hence it could not be considered to be contrary to EU law.

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Keywords

CFC, allocation of taxing rights, freedom of establishment