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By PwC Deutschland | 26 June 2018

Current version of German anti-treaty shopping legislation is also incompatible with EU law

On 25 June 2018, the European Court of Justice published its decision of 14 June 2018 concerning the current version of the German anti-treaty /anti-directive shopping legislation.

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Again, the ECJ found that the provision both contravened the Parent/Subsidiary Directive and constituted a restriction of the freedom of establishment.

Background

On 20 December 2017 the European Court of Justice (ECJ) issued its **decision** on two cases referred to it by the Cologne Tax Court on the compatibility of the anti-abuse rule in Section 50d Income Tax Act (ITA) in the version of the 2007 Finance Act (***old version***) with EU law. The Cologne Tax Court – ***in a second referral*** – submitted another case (2 K 773/16) to the ECJ which concerned ***the current version of the anti-treaty shopping rule*** (Section 50d (3) Income Tax Act "ITA"), which applies to periods of assessment from 2012 onwards. The current Section 50d (3) ITA generally applies to situations where the shareholders of a foreign resident parent company would not be entitled to the same tax relief available to the parent company if they received the income directly and where the parent company in question does not earn income from its own economic activity in the relevant financial year.

In the case before the ECJ, the question was raised whether the appellant was entitled to a refund of withholding tax deducted from a dividend paid to it in 2013 by its German resident subsidiary. The Dutch parent company ("GS") exercised three types of business functions, namely, as a financing and administrative holding company, as well as the financing of companies resident outside Germany and the trading in commodities in its own name and for its own account. For the purpose of these activities, GS used two technically equipped rented rooms and employed three people. The ECJ judges considered the concerns of the Cologne Tax Court justified and in giving the reasons for their decision, referred to their decisions in Deister Holding (C-504/16) and Juhler Holding (C-613/16) on 20 December 2017, which related to the version of the provision applicable to periods up to and including 2011.

Parent-Subsidiary Directive („PSD")

According to the Court, the PSD neither prescribes what kind of economic activities a company must carry on, nor what level of income the relevant company must earn from its own economic activities.

The German provision at issue establishes a general presumption of tax evasion or abuse thereby compromising the aim of the PSD to reduce – at EU level – double taxation on profit distributions made by subsidiaries to their parents.

In the opinion of the ECJ a case-by-case examination of the particular situation must be possible, so that, in particular, account can be taken of organisational, economic and other important aspects of the business group, to which the parent company belongs, as well as consodering the group's structures and strategies

Freedom of establishment

In the case before the Court, GS, the Dutch parent held a 90% shareholding in the German subsidiary and could therefore influence its decisions. As a result freedom of establishment also became an issue. The ECJ held that the current provision also restricts the freedom of establishment. Such restriction is only permissible only if it relates to situations, which are not objectively comparable or if it is justified by

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overriding reasons in the public interest recognised by EU law (such as combating tax evasion). This was not the case here.

Source

ECJ decision of 14 June 2018 (C-440/17), GS

Note:, On 4 April 2018 the Federal Ministry of Finance issued a circular on how Section 50d (3) ITA should be applied in practice to PSD-relevant applications following the decisions of *Deister Holding* and *Juhler Holding*. **See our blog**

Keywords

Parent/Subsidiary Directive, anti-treaty shopping rule, freedom of establishment