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By PwC Deutschland | 18 January 2019

Trade tax: foreign passive income attribution

Two decisions of the Baden-Württemberg Tax Court have been published in connection with the attribution of foreign passive income for trade tax purposes. In these decisions the Court also raises doubts as to whether the add-back of this type of foreign income is compatible with EU law.

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Supreme Tax Court decision of March 2015

In a decision of 11 March 2015 (I R 10/14) the Supreme Tax Court ruled that foreign passive income added back under Section 10 of the Foreign Taxes Act (i.e. an add-back under CFC rules) constituted a part of the trading income of the domestic business for trade tax purposes, and was attributable to the foreign permanent establishment. As a result, the taxable profit of the domestic business had to be reduced by the CFC income according to Section 9 No. 3 1st Sentence of the Trade Tax Act. Following this decision, the tax authorities issued a decree declaring that the judgement would only be applied to the particular case.

(For the original decision see our **Blog of 6 May 2015**)

Domestic income fiction: change in Trade Tax Act in 2016

The decision of the Supreme Tax Court led to a change in the Trade Tax Act on 20 December 2016. The amendment attributed the CFC income to the domestic business rather than to the foreign PE. This domestic income fiction was to be applied for 2016 periods of assessment onwards. The tax authorities maintain that the new rule was introduced merely for clarification purposes.

Baden-Württemberg Tax Court

The Baden-Württemberg Tax Court, however, did not share the view of the tax authorities and in these two decisions held that the amendment constituted rather a fundamental change in the law. In contrast to the view of the Upper Tax Directive of the State of North-Rhine Westphalia, the Baden-Württemberg Tax Court took the view that the new rule could not be applied retroactively for periods of assessment prior to 2016. The Tax Court took the view that for the years relevant to the cases before them (2011-2013 and earlier) the CFC add-back should be attributed to the foreign PE and thus deducted from the profits for trade tax purposes. Through this decision, the Court followed the 2015 decision of Supreme Tax Court and rejected the decree of non-application of the tax authorities.

CFC rules and EU law

The Baden-Württemberg Tax Court also questioned whether the CFC rule in Section 10 of the Foreign Taxes Act was in conflict with the EU law, in particular with the free movement of capital.

(N.B. The question of compatibility to EU law as it applies to low-taxed investment type income (a sort of “super CFC income” as opposed to the “normal CFC income” in these cases) is currently pending before the ECJ under reference C-135/17).

Source: Baden-Württemberg Tax Court, decisions of 8 May 2018, (6K 1775/16 and 6 K 2814/16); appeals to the Supreme Tax Court are pending under reference numbers: I R 28/18 and I R 29/18

Keywords

CFC, foreign passive income, trade tax, trade tax deduction