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New decree by Federal Ministry of Finance extends motive test for escape from CFC taxation to third country situations

On 17 March 2021, the German Federal Ministry of Finance (BMF) published a decree on the application of Section 8 (2) of the Foreign Tax Act (AStG) which stipulates the “motive test” taxpayers have to meet to escape controlled foreign company (CFC) taxation.

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The BMF formulates the requirements for meeting the motive test pursuant to Section 8 (2) AStG and also orders that the standards of this test shall apply to EU/EEA as well as third country cases. However, the application of section 8 (2) AStG (substance requirements) only represents the first stage of the CFC taxation escape; at the second stage, it must additionally be proven that the participation in the foreign company does not represent a purely artificial arrangement (a requirement which is questionable under EU law).

To meet the motive test at the first stage of the escape the CFC concerned must:

- purposively utilise resources (e.g. personnel, customer proximity) in the host state. The business activity in the host state must require and reach a relevant scope. Participation in the market activity there must be active, continuous and sustainable.
- be adequately equipped not only in terms of personnel, but also in terms of material resources, so that it is in a position to carry out the intended core economic functions on a stand-alone basis;
- take the essential entrepreneurial decisions itself.

The substance requirements of Section 8 (2) AStG must be fulfilled with regard to each type of passive income individually.

Since, in EU cases, a proper exchange of information is provided for by the Directive on Administrative Cooperation, the BMF decree only deals with administrative cooperation in third country cases (including the European Economic Area). The BMF demands that there must be a sufficient legal framework for an exchange of information which in practice actually operates smoothly (“trouble free”) and reasonably timely. As such a legal framework the BMF accepts, for example, Art. 26 of the OECD Model Tax Convention, Tax Information Exchange Agreements and other bilateral treaties.

It is debatable whether the motive test will still apply to third country cases after the transposition of the ATAD CFC rules into German law because, in its draft bill, the Federal Government argues that the amended German CFC legislation no longer falls into the scope of the free movement of capital.

Source:

Federal Ministry of Finance circular dated 17 March 2021, – IV B 5 - S 1351/19/10002 :001

Keywords

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