

Tax & Legal Newsflash

Supreme Tax Court changes its case law regarding the blocking effect of Art. 9 (1) of the OECD Model Tax Convention

According to the Supreme Tax Court in its ruling of 27 February 2019, published on 15 May 2019, and contrary to its previous case law, Article 9 (1) of the OECD Model Tax Convention, does not prohibit an income adjustment under domestic transfer pricing rules, where the write-off of an unsecured group loan is not recognised as a deduction from taxable profits.

In the case, which concerns the year 2005, a German GmbH operated an unsecured clearing account for a Belgian subsidiary. After the Belgian subsidiary had run into financial difficulties, the GmbH waived its claims arising from the clearing account and wrote off the receivable. However, the tax office neutralised this reduction in profits according to the transfer pricing rules. The tax court, following the previous case law of the Supreme Tax Court, saw the matter differently and upheld the GmbH's appeal.

Previously, the Supreme Tax Court had assumed that, in situations involving a double taxation agreement, Art. 9 (1) of the OECD Model Tax Convention specifically only applied to the correction of prices, so that an income adjustment neutralising a profit-reducing write off of a loan claim or a partial write-down was prohibited (this was referred to as the "blocking effect").

The Supreme Tax Court now views the matter differently and thus set aside the judgment of the tax court. The Court did admit that it would no longer be possible for the tax court to determine whether the loan in question really could be recognised for tax purposes or whether it should be considered as a capital injection into the Belgian subsidiary (i.e. as equity). However, this was not important in the circumstances of the case, as the write off by the German GmbH had to be corrected in any event in accordance with transfer pricing rules. The lack of collateral constituted per se a (loan) condition, which would not be usual between independent third parties. A restriction to price adjustments alone cannot be inferred either from the wording or from the meaning and purpose of Article 9(1) of the OECD Model Tax Convention. Furthermore, EU law did not impede a correction of the income.

The decision has a significant impact on the financing of foreign subsidiaries by domestic shareholders. In a number of other cases, the Supreme Tax Court will shortly be giving concrete form to its new principles.

Source:

Decision of the Supreme Tax Court of 27 February 2019 (I R 73/16), published on 15 May 2019.



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