

GERMAN ANTI-TREATY-SHOPPING RULE VIOLATES EU LAW

Following the previous landmark decision on 20 December 2017, the European Court of Justice concluded in its decision dated 14 June 2018 (C-440/17) that not only the former version of the anti-treaty shopping rule section 50d para 3 German Income Tax Act (applicable until 2011), but also the current version is not in line with the EU Parent Subsidiary Directive and the Freedom of Establishment.

BACKGROUND

By the end of 2017, the European Court of Justice ("ECJ") ruled that the German anti avoidance rule section 50d para 3 German Income Tax Act ("ITA") as applicable until 2011 ("**section 50d para 3 ITA 2011**") infringed the EU Parent Subsidiary Directive as well as the Freedom of Establishment. Section 50d para 3 ITA 2011 restricted the withholding tax exemption for distributions made by a company resident in Germany to a foreign company.

For details please refer to our newsletter dated 18 January 2018.

Section 50d para 3 ITA has been amended in 2012 with slightly eased requirements ("**section 50d para 3 ITA 2012**"). Subsequent to the 2017 ECJ decisions, the Federal Ministry of Finance published a new tax decree on 4 April 2018, in which it – obviously in anticipation of the upcoming ECJ decision on section 50d para 3 ITA 2012 – already limited the scope of application of section 50d para 3 ITA 2012.

For details please refer to our newsletter dated 25 April 2018.

THE NEW DECISION

In the case C-440/17 (GS) it was disputed whether GS, a Dutch-based corporation, is entitled to a refund of withholding tax in respect of dividend payments by its German subsidiary. This German corporation, in which GS held more than 90% in 2013, distributed dividends to GS in 2013.

Both the initial application for a withholding tax refund as well as the following appeal were rejected by the tax authorities. As a result, GS brought an action before the submitting finance court Cologne based on the infringement of section 50d para 3 ITA 2012 against the Freedom of Establishment and the Parent Subsidiary Directive.

The ECJ decision is a continuation of its previous decisions, which was to be expected.

Key issues

- Also the currently applicable version of the anti-avoidance rule section 50d para 3 German Income Tax Act (applicable until 2011) infringes the Parent Subsidiary Directive and EU law.
- The determination of a wholly artificial arrangement requires a comprehensive examination in each individual case.
- A general presumption of fraud and abuse cannot justify either a fiscal measure which compromises the objectives of a directive or a fiscal measure which prejudices the enjoyment of a fundamental freedom guaranteed by the treaties.
- Now the legislator needs to amend the law.

The ECJ argued that

- the mere fact that the activity of a foreign holding entity is limited to the holding of shares and that it does not have income other than from such shareholdings does not mean that this is a wholly artificial arrangement which does not reflect economic reality;
- the general assumption of tax evasion or abuse without any initial evidence provided by the tax authorities is not allowed;
- section 50d para 3 ITA 2012 provides for an irrefutable assumption of tax evasion or abuse as it does not allow the parent company to prove that the structure is not wholly artificial without economic reality; and
- it contradicts the principle that the determination of a wholly artificial arrangement requires a comprehensive examination in each individual case.

Against that background, the easements published by the tax authorities in their tax decree dated 4 April 2018 are not sufficient. Rather, the German legislator is once again required to amend the anti-treaty shopping rule such that it meets the requirements of European law. In open cases, it is advisable to appeal against any decisions that previously denied the withholding tax and solidarity surcharge exemption or reimbursement because of section 50d para 3 ITA 2012.

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