German Tax Monthly

Information on the latest tax developments in Germany

June | 2021

Federal Tax Court (I R 12/19): Attribution of Rental Income to a Permanent Establishment and CFC Rules in Third Country Situations

In its decision of 30 September 2020, the German Federal Tax Court [BFH] ruled that the attribution of interim income generated in financial years 2004 to 2006 within the meaning of German CFC Rules by an intermediate company domiciled in Switzerland, although restricting the free movement of capital, was still justifiable and therefore not in contravention of EU law.

If taxpayers subject to unlimited tax liability hold more than half of the shares in a foreign company, the income for which this company acts as intermediary may be liable for tax at the level of shareholders. This applies to income subject to lower taxation (generally income tax of 25%) and qualifying as "passive income".

The plaintiff was a natural person domiciled both in Germany and Switzerland. In any case, his centre of vital interests was in Germany as of September 2005. In 2004 to 2006, he was the sole shareholder of a limited liability company (J-GmbH) based in Switzerland. J-GmbH held a property generating rental income that was subject to tax of less than 25%.

The issue in dispute was whether the rental income constituted passive income in this case. The plaintiff held the opinion that the rental income was ancillary income to J-GmbH's primary activity, which focused on commercial property sales. Moreover, taxation under CFC rules is in violation of the free movement of capital under European Union law and the constitutional rule of law.

The BFH considered the factual elements fulfilled for adding the income of J-GmbH under the CFC rules. In particular, the income in question was so-called "passive income", which should not be excluded from attribution. The rental income is not commercially associated with other "active" operations of J-GmbH to such an extent that it could be functionally attributed to these activities. Commercially related activities should be treated uniformly (functional approach). The activity which is generally considered the main commercial focus is

Content

decisive. An activity to be assessed as uniform according to these criteria exists in particular when income from auxiliary or ancillary activities to a primary activity is to be assessed. According to these criteria, J-GmbH's rental income cannot be functionally attributed to any "active" operation.

Rental income must be excluded from attribution when the taxpayer provides evidence that the income would be tax-exempt based on the applicable double taxation treaty if it had been received directly by the shareholders subject to unlimited tax liability. However, this was not satisfied in the case at hand, as the foreign tax credit method would have been applied to this income.

In conclusion, the ruling senate held that the attribution was not in violation of the free movement of capital under EU law. It is true that this restricts the free movement of capital. However, this restriction is justifiable in view of the legal framework in place for the exchange of information between the German and Swiss authorities in 2006 and 2007. Moreover, the senate was not convinced of any unconstitutionality. The conditions for obtaining a decision from the German Federal Constitutional Court are not satisfied.

Federal Tax Court (I R 72/16): Cross-border 'Company Split-Up'

In its judgment of 17 November 2020, the German Federal Tax Court [BFH] ruled that the principles of "company split-up" for tax purposes also apply when a domestic (German) holding company leases a property located abroad to a foreign operating corporation.

A company split-up for tax purposes occurs when a company (holding company) makes a material business asset (operating basis) available to a commercially operating partnership or corporation (operating company) for use (material interdependence) and one person or several persons jointly (group of persons) control both the holding company and the operating company such that they are able to implement uniform commercial operating activities in both companies (personal interdependence). If the conditions for personal and material interdependence are fulfilled, rental or lease no longer qualifies as property management but as commercial rental or lease. The holding company is a commercial operation in that case.

The plaintiff was a tax-exempt charitable incorporated foundation based in Germany. The plaintiff was also the ultimate parent company of B Group. It was also the sole shareholder of the Dutch company B B.V. After restructuring, it held a property in the Netherlands, which it leased to B B.V. and was used by the latter as commercial premises for its operating activities. Dividend distributions by B B.V. to the plaintiff were subsequently agreed.

In dispute was whether the dividends paid to the foundation should be attributed to its fully tax-exempt asset management or its taxable commercial business operations. In the latter case, only 95% of the dividend is tax-exempt overall.

The BFH ruled that lease of the property by the plaintiff to B B.V. fulfilled the requirements for company split-up for tax purposes, resulting in primary commercial activities by the plaintiff and also representing commercial business operations. There is personal and material interdependence because the plaintiff holds all the shares in B B.V. and leases the property used by B B.V. as business premises to B B.V. The situation would also not change if the constellation were a "domestic holding company" and a "foreign operating company". It is true that in the constellation presented a cross-border company split-up for tax purposes is generally rejected in the literature because it would be contrary to the provisions of the treaties to avoid double taxation if foreign rental income were reclassified as commercial income. Others hold the view however that the principles of company split-up for tax purposes should also be applied without restriction in the present constellation to avoid tax structuring options. In its conclusion, the senate upheld the latter view.

This is the first BFH judgment confirming a cross-border company split-up for tax purposes. A response from the tax authorities is still pending, however the Federal Ministry of Finance joined the proceedings and supported the arguments of the defendant tax office, in whose favour the BFH ruled.

Tax Group: Loss Transfer Agreement in the event of Amendment of Stock Corporation Law

§ 302 of the German Stock Corporation Act [AktG] (loss transfer obligation) has been amended as at 1 January 2021. This amendment may require the modification of existing profit transfer agreements. The German Federal Ministry of Finance [BMF] issued a statement in this regard on 24 March 2021.

In § 302 para. 3 sent. 2 AktG, the phrase "or restructuring plan" has been inserted after "insolvency

plan". This provision provides, particularly for profit transfer agreements, the option of (partial) waiver of the loss compensation claim of the controlled entity in the event of insolvency proceedings regarding the controlling entity's assets. The amendment refers to expansion of this regulation to the newly created restructuring plan.

Establishment of a tax group for income tax purposes requires an effective profit transfer agreement. If the controlled entity is a German limited liability company (GmbH), the profit transfer agreement must include a provision on loss transfer (assumption of losses) pursuant to § 302 AktG for tax purposes. With regard to the specific wording of the loss transfer provision, the date when the profit transfer agreement was concluded is decisive.

New profit transfer agreements that were or are concluded or amended after 26 February 2013 must include a "reference to the provisions of § 302 AktG in its respective wording" (so-called dynamic reference). Existing profit transfer agreements concluded or last amended prior to 27 February 2013 need only contain "a transfer of losses in accordance with the provisions of § 302 AktG". The German Federal Tax Court [BFH] has consistently held that this can be done by full reference to § 302 AktG, citing § 302 AktG verbatim or a combination of reference and citing the law. Furthermore the BFH ruled that the reference to the provisions of § 302 AktG also refers to those regulatory components of § 302 AktG that had not yet taken effect on the date of conclusion of the profit transfer agreement (in the case under dispute, insertion of § 302 (4) AktG in 2004).

The BMF has now expressed an opinion on the modification of existing profit transfer agreements due to amendment of § 302 (3) AktG. The guidance addresses existing profit transfer agreements that were concluded or last amended prior to 27 February 2013, in which loss transfer was agreed by static reference to § 302 AktG (as applicable prior to amendment on 1 January 2021) or by citing this regulation verbatim.

A prerequisite for continued recognition of the tax group is that the previous agreements on the transfer of losses are amended in the profit transfer agreement. Loss transfer must be agreed by reference to the provisions of § 302 AktG in its respective wording (dynamic reference). In this case, modification of the profit transfer agreement to include a dynamic reference to § 302 AktG does not constitute a "new" contract for tax purposes. A new five-year minimum term is therefore not initiated. Amendment is not necessary if a tax group ends prior to 1 January 2022.

The profit transfer agreement concerned must be amended in 2021 at the latest according to the BMF guidance. Recognition of the tax group is not precluded for assessment periods starting 2021, if the existing profit transfer agreement is amended to include a dynamic reference no later than 31 December 2021. According to the BMF guidance, this requires notarisation of the controlled entity's resolution of approval as well as submission of a request to change the entry in the commercial register.

Imprint

Published by
KPMG AG Wirtschafts-prüfungsgesellschaft
THE SQUAIRE, Am Flughafen
60549 Frankfurt/Main, Germany

Editorial Team
Prof. Dr. Gerrit Adrian (Responsible*)
gadrian@kpmg.com

Ilhan Yilmaz

Newsletter subscription
https://home.kpmg/de/en/home/media/abo-kpmgs-german-tax-monthly-newsletter.html

*Responsible according to German Law (§7 (2) Berliner PresseG)

kpmg.de

kpmg.de/socialmedia.de