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BFH (I R 30/18): Triangular Constellations in the Context of Double Tax Treaties

On 1 June 2022, the German Federal Tax Court (BFH) decided on a case of triangular constellations in the context of double tax treaties. Double tax treaties (DTTs) regulate (the allocation of) taxation rights for predefined sets of circumstances on a bilateral basis (i.e. for the respective contracting states) in order to avoid double taxation. In the case at hand, the question arose whether the provisions of one DTT could override the provisions of another DTT if more than one DTT were to be taken into account.

In the case under dispute, the jointly assessed plaintiffs and appellants had their central life interests in the joint apartment in Germany. During the disputed assessment periods 2012 and 2013, the plaintiff (husband) worked as a geriatric nurse in Switzerland and generated income from this employment. For this purpose, he had moved into a second home in France and commuted to his place of work in Switzerland every working day. According to the DTT Germany-Switzerland the salary was exempted in Germany. Switzerland did not levy any taxes because the DTT Switzerland-France assigned the taxation right for the income of cross-border commuters to France due to the existing cross-border commuting regulation with France (waiver of taxation right by Switzerland). The plaintiff paid taxes on the income in France. The DTT Germany-France allocated the taxation right for this (third country) income to Germany. The question under dispute was whether the allocation of taxation rights for third country income to Germany under the DTT Germany-France could override the exemption of this income under the DTT Germany-Switzerland.

The previous instance (Lower Tax Court of Münster) concluded that the income was to be exempted in accordance with the DTT Germany-Switzerland and subject to the progression proviso provided for therein. The German Federal Tax Court confirmed the Lower Tax Court's judgment and ruled that DTTs are basically equal-righted and to be interpreted autonomously and independently of each other. Germany's obligation to exempt certain income is not affected by the fact that a DTT with another state (in this case France) allocates the taxation right for this same income to Germany. As a basic principle, the taxpayer can benefit from any preferential treatment granted by one of these treaties.

Content

According to Article 34 of the Vienna Convention on the Law of Treaties, which has been transposed into domestic law, a treaty does neither create obligations nor rights for a third state without its consent. There is no cross-treaty impact of the provisions of a DTT, i.e. the regulations only apply for the contracting states of the respective bilateral DTT. Insofar as non-taxation occurs in individual cases, such non-taxation can only be prevented by means of provisions under the double tax treaty or by means of unilateral domestic tax provisions. In the case under dispute, no subject-to-tax clause was included in the DTT Germany-Switzerland and the respective unilateral domestic tax provisions (Sections 50d (8) and (9) of the German Income Tax Act [EStG]) were not applicable due to the particular features of the case (cross-border commuting regulation referred to in the DTT Switzerland-France).

Differing conclusions cannot be drawn by referrals (renvoi) to private international law, as in each case domestic law is directly applicable due to the ratification of the double tax treaties into domestic law (Article 59 (2) sentence 1 of German Basic Law [GG]).

There was no need for the German Federal Tax Court to further address questions regarding dual residency, as the plaintiff was resident in Germany according to the tie-breaker rule in the DTT Germany-France.

BFH (I R 43/18): Trade Tax Treatment of Dividends from Dual Resident Corporations

In its ruling of 28 June 2022, the German Federal Tax Court [BFH] had to decide the issue of whether dividends distributed by a dual resident corporation to its German parent corporation are subject to trade tax in Germany.

In principle, every corporation is subject to German trade tax if it maintains a permanent establishment in Germany (Section 2 of the German Trade Tax Act [GewStG]). Trade tax is calculated based on trade income. According to the German Corporation Tax Act [KStG], trade income refers to the calculated profit from business operations, which is increased or decreased through add-backs or reductions pursuant to the German Trade Tax Act [GewStG]. Accordingly, only 5% of the dividend amount is subject to trade tax for the recipient if the recipient holds at least a 15% interest in the corporation paying dividends and the corporation paying dividends either

- has its registered office and place of effective management abroad (Section 9 No. 7 GewStG) or
- is a domestic corporation within the meaning of Section 2 GewStG (Section 9 No. 2a GewStG).

Otherwise, the dividend is subject to trade tax in full.

In the case under dispute, a German limited liability company [GmbH] (plaintiff) received a dividend distribution from its wholly owned subsidiary. The special feature was that the subsidiary corporation had its place of effective management in Germany in the year under dispute and its registered office in Belgium. Its sole managing director resided in Germany and operated from there.

In dispute was whether the dividends received by the plaintiff were subject to trade tax in full or only at 5%.

The tax office was of the opinion that a "domestic corporation" within the meaning of Section 9 No. 2a GewStG can only be a corporation that has its registered office and place of effective management in Germany. The dividends would therefore be fully subject to trade tax for the plaintiff.

The BFH, on the other hand, ruled in favour of the plaintiff. The wording of Section 9 No. 2a GewStG with respect to "domestic" was not limited to corporations with their registered office and place of effective management in Germany. In fact, it also covered corporations, as in the case under dispute, which had their registered office abroad and only their place of effective management in Germany. Due to the place of effective management in Germany, a permanent establishment within the meaning of Section 2 GewStG was also maintained in Germany in the case under dispute. As the corporation paying dividends did not maintain a permanent establishment in Belgium (pure holding company), the dividends were also attributable to the German permanent establishment. As a result, only 5% of the dividends were subject to trade tax for the plaintiff.

The BFH explicitly left open whether this would also apply to the reverse case. In other words, in the event that the corporation paying dividends has its registered office in Germany and its place of effective management abroad.

Court of Justice of the European Union (C-538/20): Deduction of Definitive Losses incurred by an Exempt Permanent Establishment under EU Law

Court of Justice of the European Union (questions of the BFH have now been answered by the ECJ as part of its decision of 22 September 2022.

At the centre of the decision was the question of whether in cases of permanent establishments exempted under a double taxation

treaty (DTT), where the State in which the parent company is located exempts the income of the non-resident permanent establishment as a whole from taxation by virtue of a bilateral agreement, there is at all a necessary objective comparability of the situations within the meaning of CJEU case law.

In this context, the Court recalled that, as regards measures laid down by a Member State in order to prevent or mitigate the double taxation of a resident company's profits, companies which have a permanent establishment in another Member State are not, in principle, in a comparable situation to that of companies which have a resident permanent establishment. The two situations become comparable where national legislation treats those two categories of establishment in the same way for the purposes of taking into account the losses and profits made by them. On the other hand, where the Member State of the head office waived its power to tax the profits of a non-resident permanent establishment based on a double tax treaty, the two situations are not comparable in the light of the measures taken by the Member State in order to prevent or mitigate the double taxation of profits and, symmetrically, the double deduction of resident companies' losses.

Therefore, the Court concluded that denying the utilization of 'final' cross-border losses did not constitute a restriction on the freedom of establishment.

As a result, according to CJEU case law, a distinction would have to be made as to whether the exclusion of final losses in the state of residence is based on a national regulation or a bilateral agreement (double tax treaty). If losses of a permanent establishment are exempt under a double tax treaty, it could nevertheless be possible to take foreign permanent establishment losses into account by way of exception if the national law contains a switch-over or subject-to-tax clause (treaty override) and the application of the double tax treaty exemption method is thereby denied in the specific case.

Amendment of the Regulation to apply the Act to Combat Tax Avoidance and Unfair Tax Competition

The German Federal Ministry of Finance [BMF] has published a ministerial draft for a Regulation to apply the Act to Combat Tax Avoidance and Unfair Tax Competition.

The Act to Combat Tax Avoidance and Unfair Tax Competition (Act to Combat Tax Havens – StAbwG) of 25 June 2021 provides administrative and legislative measures that apply in relation to those states and territories that are non-cooperative tax jurisdictions. Tax jurisdictions are non-cooperative pursuant to the StAbwG, if they are on the EU list of non-cooperative countries and territories for tax purposes and specified in the StAbwV.

The EU list was updated in October 2022. The zero-rate jurisdictions of Anguilla, Bahamas and Turks and Caicos were added to the EU list. Zero-rate jurisdictions are jurisdictions that do not levy corporation tax or levy corporation tax at a rate of zero or close to zero percent. Their monitoring mechanisms with regard to the commercial substance of local companies show significant shortcomings.

This amending regulation transposes this expansion into German law.

The EU list and the amended StAbwV therefore list the following twelve non-cooperative tax jurisdictions: American Samoa, Anguilla, Bahamas, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, Turks and Caicos, US Virgin Islands and Vanuatu.

For the regulation to enter into force, it must be promulgated in the German Federal Law Gazette after approval by the Upper House of the German Parliament (Bundesrat).

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