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German Tax and Legal News

Lower tax court interprets anti-treaty shopping rules in light of CJEU jurisprudence

WHT refund might be eligible for 6% annual interest payment from tax authorities.

The Lower Tax Court of Cologne, in a 30 June 2020 decision (which recently has been made public), ruled that the interposition of certain entities within a corporate structure was not abusive for purposes of the German anti-treaty shopping rule under section 50d (3) of the Income Tax Code (ITC). The court considered recent Court of Justice of the European Union (CJEU) decisions that held such rule was in violation of EU laws. However, the court opined that such violation does not result in the rule being void, but, rather, the rule must be interpreted and applied in light of EU law.

The court in a second notable statement further ruled that withholding tax refunds that are granted as a result of the unlawful application of the anti-treaty shopping rule should be eligible for 6% annual interest based on EU law principles.

Background

The CJEU held in two December 2017 decisions ([combined cases C-504/16 and C-613/16](#), see [GTLN dated 27 December 2017](#)) that the pre-2012 anti-treaty shopping rules violate both the parent-subsidiary directive (PSD) and the freedom of establishment principle in article 49 of the [Treaty on the Functioning of the European Union](#) (TFEU). The CJEU then ruled on 14 June 2018 ([case C-440/17](#), see [GTLN dated 7 August 2018](#)) that the post-2011 version of the rules in section 50d (3) also violates the PSD and the freedom of establishment. The German Ministry of Finance (MOF) set forth its interpretation of the CJEU decision in a decree dated 4 April 2018 (see [GTLN dated 11 April 2018](#)), in which the MOF limited the application of the ruling to claims for a reduced dividend withholding tax rate that are based on the [EU parent-subsidiary directive](#) (PSD).

Broadly, both the pre-2012 and the post-2011 versions of the anti-treaty shopping rules, which also apply to withholding tax relief sought under an EU directive, provide that a nonresident company that receives a payment subject to German withholding tax must meet certain requirements to be entitled to withholding tax relief. Although there are variations in the pre-2012 and the post-2011 requirements, both sets of rules provide alternative tests that companies may meet to qualify for withholding tax relief, relating to ownership, business activities, business purpose and substance.

Lower Tax Court of Cologne case

In the case decided by the Lower Tax Court of Cologne a Dutch BV held all of the shares in a German GmbH. The Dutch BV was held at 51% by a French entity which was then ultimately held by another French listed entity. The other 49% of the shares in the Dutch BV were held by a German GmbH through a Dutch CV, the German GmbH was then ultimately also held by the same French listed entity. The Dutch BV had two managing directors but no other personnel or office space. The Dutch BV was not engaged in activities other than holding the shares in the German GmbH.

The German tax authorities rejected both the application for a dividend WHT exemption certificate and a WHT refund application with regard to the 49% indirect ownership of the German GmbH. The rejection was based on the argument that the conditions of Sec. 50d (3) ITC are not fulfilled at the level of the Dutch BV. The federal tax office in addition argued that because of the interposition of the CV as a transparent partnership and a German company being the partner in the CV it should not be possible to rely on the listed entity character of the ultimate French parent entity as the German entity is not entitled to benefits under a double tax treaty (DTT) or the PSD. The argument of the applicant that the purpose of the Dutch BV was to avoid an immediate French taxation of any dividends out of the German GmbH was seen as an abusive purpose under the parent-subsidiary directive by the German federal tax office.

The court in its decision referred to the anti-treaty shopping rule and the CJEU decisions that

are described above. The lower tax court however came to the conclusion that even though the anti-treaty shopping rules violate EU law does not automatically results in that the rules are void and no longer applicable, in this case the rules should generally still remain applicable but would need to be interpreted in light of EU law. The broad scope of the German anti-treaty shopping rules in this case has to be reduced on teleological grounds.

The decisions of the CJEU dealing with the German anti-treaty shopping rules focus on the issue whether a structure chosen by the taxpayer could be considered an artificial arrangement whose purpose was to unduly obtain a tax advantage and stated that this has to be the basis for any domestic anti-abuse legislation. The CJEU concluded that a set of rules that is based on irrebuttable presumptions without giving the taxpayer the chance to demonstrate the opposite does not comply with these principles.

The lower tax court evaluated the anti-treaty shopping rules in the case at hand in light of these principles, and concluded that the interposition of a German resident entity cannot be considered abusive or artificial.

The interposition of the German entity in the shareholder chain did not result in a tax advantage as the German entity would have been eligible for a full credit/refund of the German WHT in case of a direct shareholding in the German subsidiary. The interposition of a transparent partnership cannot be considered abusive for purposes of the anti-treaty shopping rule.

The lower tax court furthermore considered the intended French tax savings as not being abusive per se as the intention of taxpayers to minimize their tax burden cannot be seen as abusive. Only in scenarios where this goal is being reached by using purely artificial structures that have no economic justification an abusive character might be given.

The lower tax court finally referred to established CJEU jurisprudence (case [C-565/11](#) and [C-234/10](#)) according to which tax refunds that are based on claims resulting from the violation of EU law have to trigger interest. Due to the lack of more specific rules in EU law the lower tax court applied the general German interest rules that are based on a 0.5% interest per month for tax claims.

Comments

The decision of the lower tax court of Cologne is in line with its previous decision dated 23 January 2019 (see [GTLN dated 04 June 2019](#)) in which the tax court applied the CJEU decisions on the German anti-treaty shopping rules in a broad and comprehensive way. The lower tax court in both decisions makes it clear that the violation of the current version of the anti-treaty shopping of EU law does not automatically result in the non-application of these rules but that the existing rules would need to be interpreted in light of EU law. The CJEU jurisprudence therefore cannot be seen as giving taxpayers unlimited leeway to claim WHT relief under a DTT or an EU directive.

It should be noteworthy that the MOF on 19 November 2020 issued a draft law proposal that includes an overhaul of the German WHT rules (see [GTLN dated 24 November 2020](#)). The package also includes an amended anti-treaty shopping rule and would introduce an annual 6% interest on WHT refunds. The draft law proposal has not yet been approved by the government, it can be expected that the government approval likely will not take place before the beginning of 2021.

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