ECJ DECISIONS C-504/16 (DEISTER HOLDING) AND C-613/16 (JUHLER HOLDING) DATED 20 DECEMBER 2017

Pursuant to these landmark decisions the former German anti avoidance rule section 50d para 3 German Income Tax Act (applicable until 2011) infringed the Parent Subsidiary Directive and EU law because, in a nutshell, without the tax authorities being required to provide *prima facie* evidence of the absence of economic reasons or of fraud or abuse, it introduces a general presumption of fraud or abuse.

Key issues

- Former anti avoidance rule section 50d para 3 German Income Tax Act (applicable until 2011) infringes the Parent Subsidiary Directive and EU law.
- Local law may provide for anti-avoidance rules only if regarded as seeking to prevent tax evasion and abuses, whereby its specific objective must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, the purpose of which is unduly to obtain a tax advantage.
- Tax authorities have to make an individual assessment in respect of each case.
- This may also have an impact on the current law: Should fiscal authorities refuse a refund of WHT paid on dividends, a tax litigation against this decision should be considered.
- Another submission by the Finance Court Cologne regarding the current law is already pending at the ECJ (decision dated 17.5.2017 (2 K 773/16), C-440/17).

LEGAL CONTEXT

Pursuant to Article 5 (1) of the Parent Subsidiary Directive, profits which a subsidiary distributes to its parent company shall be exempt from withholding tax.

Section 50d para 3 German Income Tax Act ("**ITA**") as applicable until 2011 ("**section 50d para 3 ITA 2011**") restricted the exemption from withholding tax such that a foreign company had no entitlement to complete or partial relief under subparagraphs 1 or 2 to the extent that, at the time the distribution was made, persons had holdings in it who would not be entitled to the refund or exemption if they had earned the income directly and

(1) there were no economic or other substantial reasons for the involvement of the foreign company or

(2) the foreign company did not earn more than 10% of its entire gross income for the financial year in question from its own economic activity or

(3) the foreign company did not take part in general economic commerce with a business establishment suitably equipped for its business purpose.

THE DISPUTES IN THE MAIN PROCEEDINGS AND THE QUESTIONS REFERRED FOR A PRELIMINARY RULING

In the case C-504/16, Deister electronik GmbH, a German corporation ("**Deister**"), distributed dividends to Dutch-based Traxx Investments NV ("**Traxx**") in 2007 which held 26.5% of Deister. Deister deducted withholding tax plus solidarity surcharge thereon (together "**WHT**") on the dividend distribution and paid the WHT to the tax authorities. In 2008, Traxx applied for an exemption from WHT. The sole shareholder of Traxx was an individual tax-resident in Germany. Traxx leased an office in the Netherlands and had two employees.

In the case C-613/16, temp-team Personal GmbH, again a German corporation, distributed dividends in 2011 to Danish-based Juhler Holding A/S ("**Juhler Holding**"), which was wholly owned by Juhler Services Limited, a company incorporated under Cyprus law. The sole shareholder of this company was an individual tax-resident in Singapore. Since 2003, Juhler Holding held 100% of the shares in temp-team Personal GmbH and held further investments in more than 25 subsidiaries. Juhler Holding also owned real estate assets, assumed financial control within the Juhler group companies in order to optimise interest expenditures and exercised supervision and control over the results of its subsidiaries. Juhler Holding was accessible through phone and e-mail (with its own e-mail address). It was listed on the group's website as one of the contact partners. However, it did not have its own offices. temp-team Personal GmbH's profit distribution to Juhler Holding was subject to WHT, and Juhler Holding requested a reimbursement of such WHT.

The submitting Finance Court Cologne considered the section 50d para 3 ITA 2011 to infringe the freedom of establishment. While a German resident parent company would receive relief from WHT, a foreign company would not so be entitled in accordance with section 50d para 3 ITA 2011.

CONSIDERATION OF THE QUESTIONS REFERRED (SUBSTANCE)

Parent-Subsidiary Directive

The ECJ held that Article 5 (1) of the Parent-Subsidiary Directive, in principle, prohibits levying withholding tax on profit distributions from a resident subsidiary to its parent company located in another Member State. Member States cannot unilaterally introduce restrictive measures and subject the general exemption from withholding tax to further conditions. National regulations can only be adopted to prevent tax evasion and abuse.

In order to determine whether an operation pursues tax evasion or abuse, the competent national authorities may not confine themselves to applying predetermined general criteria but must carry out an individual examination of the whole operation at issue. The imposition of a general tax measure automatically excluding certain categories of taxpayers from the tax advantage, without the tax authorities being required to provide even *prima facie* evidence of fraud and abuse, would go beyond what is necessary for preventing tax evasion and abuse.

Section 50d para 3 ITA 2011 does not specifically target to exclude the use of a tax advantage in case of purely artificial constructions aiming the unjustified use of this advantage. The wording of the conditions in section 50d para 3 ITA 2011 is too broad. Amongst other things, the law lacks a requirement for the tax authority to provide initial evidence of the absence of economic reasons or evidence of tax evasion or abuse.

Freedom of Establishment

The Freedom of Establishment pursuant to Article 49 of the Treaty on the Functioning of the European Union includes the right for EU Citizens to take up and pursue activities as self-employed persons and to set up and manage undertakings in another Member State under the same conditions laid down

for its citizens by the law of the Member State where such establishment is affected.

A restriction of the Freedom of Establishment is only permissible if it relates to situations which are not objectively comparable with each other or if they are justified by an overriding reason in the public interest recognised by EU law. The origin of the shareholders of the companies involved in the main proceedings has no influence on the right of these companies to invoke the Freedom of Establishment.

SECTION 50D PARA 3 ITA (IN ITS CURRENT VERSION)

Both decisions relate to section 50d para 3 ITA 2011. This provision has been amended in 2012 by the German legislator and since then provides for slightly less eased requirements. It is unclear if the ECJ would take the same view with respect to section 50d para 3 ITA in its current version. However, based on the reasoning in the abovementioned decisions, it cannot be excluded that also section 50d para 3 ITA as currently applicable infringes the Parent Subsidiary Directive and EU law as it does, pursuant to our view, still limit WHT relief beyond cases of purely artificial constructions aiming the unjustified use of tax advantages.

Another submission by the Finance Court Cologne regarding the current law is already pending at the ECJ (decision dated 17.5.2017 (2 K 773/16), C-440/17).

Against that background, where WHT relief has been denied because of section 50d para 3 ITA, it should be considered to appeal against such decision.

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