

Newsalert

EU Direct Tax Group

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Advocate General Mengozzi's opinion in case C-298/05 (Columbus Container Services)

The case concerns the question if it is compatible with Community Law to switch from the exemption method in a double tax treaty to the credit method if the foreign income is subject to low taxation abroad and stems from certain "passive" sources.

The plaintiff, a Belgian limited partnership (Coordination Centre) with German resident partners, dealt with financing of subsidiaries and branches. Its profits and losses were assessed as foreign branch profits and assets of the German partners under German domestic law. According to the double tax treaty between Germany and Belgium, profits from and net assets of a Belgian partnership are exempt in Germany (both for income and wealth tax purposes). However, the German International Transactions Tax Act provides for a switch from the exemption to the credit method in respect of certain passive branch profits and assets. This provision was introduced to prevent circumvention of the CFC rules, which apply only to foreign subsidiaries. Doubting the compatibility with Community Law, the Tax Court of Muenster referred the case to the ECJ.

The AG gave his opinion on March 29, 2007. He began by stating that due to lack of information either the freedom of establishment or the free movement of capital could apply. Since the application of both freedoms would lead to the same result here, the question was left for the referring court to decide. The AG then pointed out that the fact that the provision establishes a treaty-override is not in breach of Community Law, since such conflict refers to international vs. domestic law only and does not fall within the ECJ's competence.

The AG then dealt with the question of which situations to compare. He firstly compared situations on a vertical level, examining the treatment of German residents with a low-taxed branch in Belgium versus those with a branch in Germany. No unequal treatment could be assessed here, since the use of the credit method simply increases the tax on the foreign investment to the domestic level.

However, with reference to the ECJ decision in Cadbury Schweppes (C-196/04), the AG also executed a comparison on a horizontal level, thereby comparing the treatment of a German resident with a low-taxed Belgian branch as opposed to with a high-taxed branch in another Member State. In applying different methods in the two situations, the German rule constitutes an infringement of Community Law, as it deters German residents from investing in the Member State of their choice and thereby threatens the Single Market. Based on the "D" decision (C-376/03), the German government argued that Germany may choose between the credit and the exemption method. In the AG's view, the "D" case is not applicable here, as it dealt with residents of two different Member States who were not in objectively comparable situations. Here, in contrast, the situations of residents of the same Member State are compared. Germany cannot claim that its own residents are not in comparable situations depending on the Member State of their investment.

Germany brought forward three justification arguments:

- Measure against harmful tax competition: The AG pointed out that even though the Belgian Coordination Centres can be seen as prohibited state aid, this is a matter for the Commission and does not entitle a Member State to execute "self defence" through infringing tax measures.
- Anti-abuse legislation: Referring to Cadbury Schweppes, the AG assessed that the German rule not only applies to wholly artificial situations and does not allow the taxpayer to prove an actual establishment in the other State, based on objective factors such as premises, staff and equipment. Accordingly, the rule is disproportionate. However, the referring Court should investigate if there are other provisions allowing for such test. In doing so, it should especially check if the Belgian requirements for Coordination Centres regarding the level of employment in Belgium are fulfilled.
- Coherence of the tax system: Since Germany levied *wealth tax* on foreign branches that were subject to low *income* taxation, but not on foreign branches subject to high *income* taxation regardless of the *wealth* tax in that country, the system cannot be considered coherent.

The AG proposed that Community Law precludes such rule as the German, unless this relates only to wholly artificial arrangements. It is up to the national Court to decide if the rule can be justified by such argument.

The discussion on the "D" case shows that the last word on the *Most Favoured Nation Principle* has not yet been spoken. Further, even though the opinion does not include an assessment of the "original" German CFC-rules, it indirectly implies that they also do not comply with the principles established in Cadbury Schweppes.

For more detailed information, please do not hesitate to contact your local PwC contact person or a member of the EUDTG.

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