Editorial

Dear readers,

In the first of this issue’s 11 enlightening articles, we examine a decision of the ECJ of December 2017 and call into question the anti-treaty/directive-shopping rule laid down in the old version of Sec. 50d(3) ITA. You will also find comments on the pending ECJ case regarding the German CFC rules and developments in German exit taxation for significant shareholders. Furthermore, we take a closer look at the consequences of the Multilateral Instrument on German tax treaties and the revised German decree on transfer pricing documentation. We also examine Germany’s peer review report on the implementation of minimum standards for mutual agreement procedures.

Following the recent US tax reform, we provide an overview of the key changes for (German) corporations as well as insights into the potential effects for the German license barrier rule. In addition, we look at the updated administrative guidelines on the German tax loss forfeiture rule, and the new German transparency register.

Finally, we introduce a practical law guide on private M&A transactions in Germany and comment on the ban on the sale of luxury items on Amazon (the Coty case).

We wish you pleasant reading.

Your GTCI editorial team

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German anti-treaty-shopping rule in-compatible with EU law

ECJ rejects the anti-treaty-shopping rule laid down in the old version of Sec. 50d(3) ITA and sends a signal for the current version.

In two related proceedings, the European Court of Justice (ECJ) found that the anti-abuse provision set out in Sec. 50d(3) of the German Income Tax Act, ITA (Einkommensteuergesetz, EStG) as amended by the Annual Tax Act 2007 (case nos. C-504/16 and C-613/16 of December 20, 2017) is incompatible with EU law. The decision is of interest not only for earlier cases affected. It also sends a signal for the current version of the rule – and beyond for the EU concept of abuse in general.

A. Old version of Sec. 50d(3) ITA

In principle, the old version of Sec. 50d(3) ITA provides for the refunding or exemption of withholding tax on dividends distributed to parent companies resident in other EU jurisdictions. However, the existence of an abusive tax structure precludes any entitlement to relief. The German legislature assumed that abusive tax structuring existed under the old version of the Act if the involvement of the foreign company was not for ‘business or other material reasons’, the foreign company did not perform a ‘business activity of its own’ apart from its holding function or the foreign company did not take part in ‘general business dealings’. Failure to meet any one criterion of the substance test precluded withholding tax relief.

B. Anti-treaty-shopping rule breaches EU law by

The ECJ held that the anti-abuse rule violates the Parent-Subsidiary Directive and restricts the freedom of establishment. In the view of the Court, the rule does not recognize any justification for avoiding abusive structuring. A general tax rule that automatically precludes a tax benefit for certain groups of taxpayers – as is the case here – does not meet the requirements of a reliable anti-abuse rule. The provision does not specifically aim to exclude purely artificial structures alone. Generally, it covers every setup, including non-abusive arrangements. The rule therefore represents an irrefutable presumption of abuse and does not permit consideration of counter-evidence in the individual case.

C. Implications of the decision on the old version of Sec. 50d(3) ITA

The decision on the German anti-abuse rule will have a direct impact on the old version and old cases – but that’s not all. As the current version of Sec. 50d(3) ITA neither regulates individual cases nor grants the opportunity to provide counter-evidence, the decision also means the current version would presumably not meet the ECJ requirements of an anti-abuse rule. In light of this decision, it would be advisable to proceed against any application rejected by the competent Federal Central Tax Office on the grounds of the above provision.

Moreover, it can be concluded from the decision that – regardless of BEPS and ATAD – the ECJ is continuing to pursue its Cadbury doctrine. Only rules that are expressly targeted at preventing purely artificial and abusive structures, and which grant the opportunity to provide counter-evidence, are compatible with EU law.
Multilateral Instrument – Consequences for German income tax treaties

On June 7, 2017, Germany, together with 67 other countries, signed the OECD’s Multilateral Instrument (MLI) to implement tax treaty-related measures to prevent BEPS. The signature of the MLI has not led to new information on the content of the MLI that was published together with the explanatory statement on November 24, 2016. However, the documents published after the signing provide information on the number of affected income tax treaties and the nature of the expected changes. This article highlights the most important (potential) changes to the German income tax treaty network based on the choices of Germany and those of the contracting states.

A. The MLI in a nutshell

The MLI implements agreed minimum standards to counter treaty abuse of the OECD/G20 BEPS Project and provides suggestions to improve dispute resolution mechanisms. The signing countries can opt out of provisions that do not reflect a BEPS minimum standard. The choice to opt in or out of provisions is made equally for all covered tax treaties, i.e. there are no treaty-by-treaty choices. Thus, the MLI is designed to replace time-consuming bilateral negotiations to modify existing income tax treaties and to ensure the comprehensive implementation of the BEPS recommendations.

B. Which German income tax treaties are affected?

Germany identified 35 income tax treaties as potential ‘covered tax agreements’, but three of these states (Estonia, the United Arab Emirates, and the United States) have not signed the MLI. That means only 32 of Germany’s income tax treaties will be affected. The relevant states are: Austria, Bulgaria, China, Costa Rica, Croatia, Cyprus, the Czech Republic, Denmark, Finland, France, Hungary, Ireland, Israel, Italy, Japan, Korea, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mauritius, Mexico, New Zealand, The Netherlands, Romania, Russia, Slovakia, Slovenia, Spain, Turkey, and the UK.

C. What are the major changes?

I. Principal purpose test (Art. 7 MLI)

To help combat treaty abuse, Art. 7 MLI suggests a general clause that denies treaty benefits if obtaining the benefit (e.g. lower withholding taxes) is one of the main purposes of a transaction. Germany decided to implement a ‘principal purpose test’ which denies treaty benefits if there is reason to believe that obtaining the benefit was
one of the main purposes of the transaction. If the taxpayer wants to be granted the benefits of the income tax treaty, he has the burden of proof that the transaction was within the purpose of the agreement.

- The principal purpose test is included in all covered tax agreements, except for China, Israel, Japan, and Mauritius, that already meet the BEPS requirements. The principal purpose test in the income tax treaties with the UK and Korea will be modified.

Investors in countries of all covered tax agreements therefore need to check whether transactions pass the principal purpose test, e.g. whether there is sufficient substance in a holding company to be eligible for a reduction in the withholding tax.

II. Minimum holding period (Art. 8 MLI)

Article 8 MLI introduces a minimum holding period of 365 days in the event of a minimum ownership requirement for shares and other ownership interests for receiving tax exemptions or reductions for dividends according to Art. 10(2) OECD-MC. The minimum holding period prevents the purchase of shares to meet the ownership requirements immediately before a dividend payout and the subsequent sale afterwards. It is thus specifically designed to reduce treaty abuse.

- The minimum holding period will be implemented for the first time in 12 income tax treaties (China, Costa Rica, France, Ireland, Israel, Mexico, The Netherlands, Romania, Russia, Slovakia, Slovenia, and Spain).

Investors in these 12 countries that have bought shares immediately before a dividend payout will still be eligible for the treaty benefit if they fulfill the minimum holding period of 365 days after the dividend payout.

III. Real estate clause (Art. 9 MLI)

The MLI also introduces a real estate clause as in Art. 13(4) OECD-MC. Capital gains derived by a resident of a contracting state from the sale of shares that derive more than 50% of their value from immovable property located in the other contracting state may be taxed in the latter state.

- In 17 German income tax treaties, the real estate clause will either be included for the first time (China, Italy, Russia, Slovakia, Slovenia), replaced (Croatia, Ireland, Israel, Japan, Malta, New Zealand, Spain) or modified (Costa Rica, France, Mexico, The Netherlands) with the implementation of the MLI.

This clause could trigger important changes for foreign investors in Germany that hold shares in corporations that derive more than 50% of their value from immovable property. This applies especially to investors from China, Italy, Russia, Slovakia or Slovenia because the real estate clause will be implemented for the first time in these treaties. Capital gains from the sale of these shares will be subject to tax in Germany – and no longer in the investor's country of residence – after the implementation of the MLI. Investors should be aware that the modification of the income tax treaty itself could trigger exit tax in their country of residence. German investors with real estate
in Italy, for example, that is held through a corporation should be aware of the change in taxation rights that are now moved to Italy.

IV. Artificial avoidance of permanent establishments (Art. 13 MLI)

Article 13 MLI aims to reduce the artificial avoidance of permanent establishments through the activity exemptions that are deemed not to constitute a permanent establishment. Germany wants to subject all of the existing activities to an explicit 'preparatory and auxiliary' test.

This test will be included in 15 income tax treaties (Austria, Costa Rica, Croatia, Israel, Italy, Japan, Mexico, New Zealand, The Netherlands, Romania, Russia, Slovakia, Spain, and Turkey).

Article 13 MLI further provides an anti-fragmentation rule that will prevent taxpayers from dividing up all of their activities so that related parties each carry out a separate part of the business that, taken individually, does not lead to a permanent establishment, but taken together will constitute a PE. However, Germany has not opted to introduce the anti-fragmentation rule, so these modifications will have only a minor impact.

V. Mutual agreement procedures and consultation procedures (Art. 16 MLI)

Article 16 MLI regulates mutual agreement procedures (MAP) and their implementation. It also includes regulations for consultation procedures.

- The covered tax treaties with the Czech Republic, Italy, and the UK will now include the agreement that MAPs will be implemented notwithstanding any time limits in the domestic law.
- The covered tax treaties with Italy and New Zealand will now include regulations for consultation procedures.

VI. Corresponding adjustments (Art. 17 MLI)

Most of the covered tax agreements include an agreement between the contracting states that one state will make a corresponding adjustment if the other state has corrected a taxpayer’s income because intercompany transactions were not at arm’s length as in Art. 9(2) OECD-MC.

- With the signing of the MLI, a clause for a corresponding adjustment will now be included in the covered tax agreements with France, Lithuania, New Zealand, and Russia.

VII. Arbitration proceedings (Art. 18 through 26 MLI)

Part VI of the MLI contains the requirements for mandatory and binding arbitration proceedings following an unsuccessful MAP as in Art. 25(5) OECD-MC.

- Germany incorporates Part VI of the MLI if the covered tax agreements lack regulations for obligatory arbitration proceedings and if the contracting state has simultaneously opted for Part VI to apply, i.e. in covered tax agreements with Finland, Ireland, Italy, Mauritius, New Zealand, Slovenia, and Spain.
The MLI suggests allowing the taxpayer to initiate arbitration proceedings if the MAP is not successful within two years of beginning. Germany has, however, opted for a three-year period.

- The extended period will apply to all covered tax agreements for which Part VI applies.

Further, countries may choose between two types of decision-making processes for the arbitration panel: ‘final offer’ rules where each competent authority proposes its own resolutions and the arbitrators choose their preferred outcome, or the ‘independent opinion’ approach where arbitrators are allowed to suggest an independent solution. Germany has not specified a preferred option, so the type of arbitration proceedings will depend on the choice of the contracting state.

The ‘final offer’ rule applies to all covered tax agreements for which Part VI applies except for the covered tax agreement with Slovenia, which applies the ‘independent opinion’ approach.

Under Art. 24 MLI, an arbitration decision is not binding on the contracting states if the competent authorities agree on a different resolution of all unresolved issues within three calendar months of the arbitration decision being issued.

- This applies to all covered tax agreements for which Part VI applies except for those with Finland and New Zealand.

D. Summary and outlook

The OECD expects the first modifications of covered treaties to become effective in the course of 2018. The timing will depend on the completion of the ratification procedures of the two contracting states involved. Germany is expected to initiate the legislative procedure to implement the MLI in the spring of 2018. For the German treaty network, the MLI will not enter into force until completion of the national procedures. Germany additionally requires the completion of a consultation agreement and potentially the completion of an implementation act to amend each covered tax treaty individually. The completion of the first implementation acts is not expected until spring 2019. The signing of the MLI and the disclosure of each country’s position sheds light on the potential adjustments to the German income tax treaty network in the near future. The MLI implements tax treaty-related tools to prevent BEPS and regulations for the MAP process, consultation agreements, and mandatory arbitration proceedings. German income tax treaties will be affected differently depending on the clauses included in each existing treaty and the choices of the respective contracting state.

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Germany's peer review report on implementation of minimum standards for the MAP process

The peer review report shows that Germany has an effective and practical MAP program in place as well as longstanding and extensive experience with resolving MAP cases, although the average time necessary for resolving MAP cases slightly exceeded the 24-month aim. Germany complies with most of the elements of the BEPS Action 14 minimum standard. It has mechanisms to prevent disputes from arising, and when disputes occur, it has an efficient MAP process available and accessible. Main area that requires improvement concerns the achievement of the average time of 24 months for the resolution of MAP cases.

On 15 December 2017, the OECD released the second batch of peer review reports relating to the implementation by Austria, France, Germany, Italy, Liechtenstein, Luxembourg and Sweden of the Base Erosion and Profit Shifting (BEPS) minimum standards on Action 14 on improving tax dispute resolution mechanisms. The peer review report for Germany evaluates the country's implementation of the Action 14 minimum standard by analyzing its legal framework and administrative practice relating to the mutual agreement procedure (MAP), as governed by its tax treaties, domestic legislation and regulations, as well as the practical application of that framework. The report, which includes peer input, identifies a few areas for improvement and describes changes adopted and implementation plans shared by Germany. Overall, Germany meets most of the requirements of the Action 14 minimum standard. Where it has deficiencies, it is working to address them.

BEPS Action 14 minimum standard

Under BEPS Action 14, countries have committed to implementing three overarching principles that represent a minimum standard for the MAP process by transposing these principles into domestic law and/or their treaty interpretation and application. The minimum standard principles are:

- Allowing taxpayers access to the MAP process when the relevant requirements are met
- Ensuring that domestic administrative procedures do not block access to the MAP process
- Implementing Article 25 of the OECD Model Tax Convention (OECD MTC) in good faith

German peer review report

The German peer review report contains four sections:

- Preventing disputes
- Availability and access to MAP
- Resolution of MAP cases
- Implementation of MAP agreements

With over 90 tax treaties, Germany’s treaty network is extensive. The country also has an established MAP program and long-standing and extensive experience with resolving MAP cases. Its MAP inventory is very large, with a substantial number of new
cases submitted each year and almost 1,200 cases pending on 31 December 2016, of which 44% relate to transfer pricing. Germany has also signed and ratified the European Union Arbitration Convention.

Germany’s competent authority, the Federal Central Tax Office located in Bonn, was found to resolve MAP cases pragmatically, effectively and efficiently.

Preventing disputes

Germany meets the Action 14 minimum standard for the prevention of disputes. All of its tax treaties include a provision relating to MAP. Disputes may arise that do not necessarily relate to individual cases but are more generally concerned with the interpretation or application of a tax treaty. Germany’s tax treaties generally contain a provision equivalent to Article 25(3) first sentence of the OECD MTC allowing the competent authority to resolve such cases.

Moreover, Germany has a bilateral Advance Pricing Arrangement (APA) program in place. This program also enables taxpayers to request rollbacks of bilateral APAs; such rollbacks are granted in practice.

Availability and access to MAP in all eligible cases

Germany also meets the requirements for availability and access to MAP under the Action 14 minimum standard. It provides access to MAP in all eligible cases. A notification/consultation process is in place for situations in which the competent authority finds that the objection raised by taxpayers in a MAP request is not justified. Germany also has clear and comprehensive guidance containing practical information on MAP.

A minimum three-year period for submitting a MAP request, beginning on the date of the first notification of the action resulting in taxation not in accordance with the provisions of the particular tax treaty, is the baseline to provide certainty to taxpayers and competent authorities on the availability of MAP. Although most German tax treaties contain a provision that allows taxpayers to submit a MAP request within three years, a small number contain a time limit of only two years. Some treaties do not include a time limit at all. In those cases, Germany considers a MAP request only if it has been filed within four years of the notification of the tax measure in question.

An audit settlement can be valuable to taxpayers by providing certainty on their tax position. Nevertheless, as double taxation may not be fully eliminated by agreeing on such settlements, taxpayers should have access to the MAP in such cases.

In Germany taxpayers and tax auditors can agree on the factual findings of the audit. Such agreements provide legal certainty on taxpayers’ tax position and are standard procedure for the settlement of transfer pricing audits in Germany. However, taxpayers may also declare a waiver of rights to request MAP. Although double taxation may not be fully eliminated in this way, access to MAP will generally be denied by the German competent authority on the grounds that the taxpayer accepted the findings of the audit and it is generally no longer possible to establish the facts during a MAP or arbitration procedure in such a way that it possesses evidentiary value.

Furthermore, it is a longstanding practice of transfer pricing auditors in Germany to propose audit settlements under the condition that taxpayers waive their rights to MAP or to suggest reduced income adjustments in exchange for a waiver. This audit practice discourages access to MAP and might be considered as out of line with the spirit of the BEPS Action 14 minimum standard.
In recent times Germany has not denied access to MAP in relation to the application of treaty and/or domestic anti-abuse provisions or in situations where taxpayers complied with the information and documentation requirements set out in Germany’s MAP guidance.

Resolving MAP cases effectively and efficiently

Germany in essence meets the other requirements under the Action 14 minimum standard for resolving MAP cases. Germany’s competent authority was found to use a pragmatic approach to resolve MAP cases effectively and efficiently. The performance indicators used are appropriate to perform the MAP function.

However, from the peer input it followed that audit personnel from tax administrations of the federal states directly involved in the adjustment at issue sometimes attend competent authority meetings and participate in discussions to resolve MAP cases. Although this may not per se cause Germany’s competent authority to enter into MAP agreements dependent on the approval or direction of personnel of federal tax administrations directly involved in the adjustment, the report indicates a risk of this personnel being or becoming involved in the decision-making process – or it could be perceived by treaty partners that the German competent authority depends on their approval or direction.

On average, Germany’s competent authority resolved MAP cases in 26.34 months, which is outside the pursued average time of 24 months. At 33.09 months, the average time to resolve transfer pricing cases is considerably longer than the average time to resolve other cases (22.1 months). However, it is our experience that Germany’s competent authority did resolve transfer pricing MAP cases relating to other OECD member states within 24 months.

In the last few years Germany has recruited more staff in charge of MAP, and a further addition is scheduled for the near future. The report recommends implementing a mechanism to monitor whether the increase in personnel resources will result in transfer pricing MAP cases being resolved more quickly, effectively and efficiently.

Regarding MAP arbitration, the German policy is to incorporate mandatory and binding arbitration in all of its tax treaties. Germany seeks to include a mandatory and binding arbitration provision in all of its future treaties, and it strives to update existing treaties accordingly via bilateral negotiations on the Multilateral Instrument.

Timely implementation of MAP agreements

Germany also meets the Action 14 minimum standard on the timely implementation of MAP agreements, although some of Germany’s tax treaties do not include a provision equivalent to Article 25(2) second sentence of the OECD MTC, dealing with the implementation of a mutual agreement reached notwithstanding time limits in domestic legislation, nor the alternative provisions provided for in Article 9(1) and 7(2) OECD MTC setting time limits for making adjustments. Taxpayers are allowed to submit a MAP request irrespective of whether they have also invoked available domestic remedies for the same case. This means taxpayers are allowed to submit a MAP request regardless of whether their case has already been resolved using domestic remedies. The German competent authority is allowed to deviate from decisions of Germany’s tax courts.

When the German competent authority reaches an agreement with the other competent authority concerned, the agreement is communicated to the taxpayer. On
receiving the taxpayer’s acceptance of the MAP agreement, the local tax authorities implement the agreement by issuing tax assessments. Although Germany does not monitor the implementation of MAP agreements, as this is dealt with by the federal tax administrations, the peer review process has not flagged any implementation issues. However, it is our experience that the federal tax administration in one federal state only partially (95%) implements certain income adjustments governed in transfer pricing MAP agreements on the grounds of German domestic tax law.

Peer review implications for MNEs

MNEs face increased scrutiny from German tax auditors over their international tax and transfer pricing positions. This has led to an increased risk of international double taxation and an accelerated number of MAP cases in Germany. MNEs confronted with taxation that is not in accordance with one of the 90-plus tax treaties or the EU Arbitration Convention, including double taxation, should consider using the efficient MAP process in Germany. MAPs between the competent tax authorities are often preferred over court litigation to avoid international double taxation if the German tax authorities challenge the amount of transfer prices. MNEs’ decision must be balanced against the transfer pricing audit practice in Germany of achieving audit settlements and/or reduced income adjustment in exchange for a waiver of rights to request MAP. Another point to consider is that audit personnel directly involved in the income adjustment also become involved in the process of resolving MAP cases due to Germany’s federal tax structure.

Revised German decree on transfer pricing documentation

At the end of 2016, the German legislature amended the provisions on TP documentation by revising Sec. 90(3) of the General Tax Code (Abgabenordnung – GTC), essentially to implement the OECD/G20 BEPS Project. These updated rules have now been fleshed out in the new administrative guidance on TP documentation, the Decree on the Documentation of Income Allocation (Gewinnabgrenzungsaufzeichnungsverordnung – GAufzV) dated July 12, 2017 (GAufzV of July 12, 2017, Federal Law Gazette I, p. 2367). The guidance sets out, in particular, the requirements to be met in preparing the Local File, which is now supplemented by a Master File.

Quantifying the significance of functions performed, risks assumed and assets used

First of all, the rule setter has revised the basic principles of TP documentation (Sec. 1 GAufzV). According to the revised Sec. 1(3) GAufzV, if the taxpayer „[has] weighted the significance of the functions performed, risks assumed and essential assets used by it or related persons for a business transaction...“, this weighting must be consistent“. It is further stipulated that „in such cases, the functions performed, the extent
of the risks actually assumed and the value of the essential assets used for each business transaction be quantified in an understandable manner.” This new requirement obligates the taxpayer to support the assumed distribution of functions, risks and assets between parties to a controlled transaction in a quantitatively transparent manner. It is intended to objectify the distribution and to rule out purely subjective estimates.

Description of management and organizational structure

Section 4(l) no. 1(d) GAufzV now requires a „description of the management structure and the organizational structure of the taxpayer’s domestic enterprise“ in addition to information on the ownership structure. This is presumably intended to let tax authorities gain insights into the decision flow that in principle exists inside an enterprise and, in connection with specific business relations, the distribution of competence in taking strategic and operational decisions.

The new guidance does not specify in detail how to comply with the required description of the management and organizational structure within a Local File. This leaves scope for the taxpayer to write a detailed description or simply to explain the management and organizational structure using an organigram with comments if necessary. Ultimately, it is up to the taxpayer to take an appropriate decision in the individual case.

Time of determining a transfer price and information available at that time

Under Sec. 90(3) sentence 2 GTC and now in Sec. 4(l) no. 4(a) GAufzV, a TP analysis must state the time that a transfer price is determined. Section 4(l) no. 4(b) GAufzV also requires the documentation of such information that is „available at the time and used for determining prices if it is significant for tax purposes“. Both provisions go beyond the recommendations made in the OECD Action 13 Final Report (cf. OECD Transfer Pricing Documentation and Country-by-Country Reporting of October 5, 2015). Both legislative and executive branches at this point miss their own objective of aligning the German requirements for TP documentation with international standards and in particular the consensus reached in the OECD BEPS Project.

Notwithstanding this, it is highly questionable whether information as to the time of determining a transfer price will be of any additional use. In the view of the OECD and the EU (cf. OECD TP Guidelines 2017, point 3.69 et seqq.; Report on Compensating Adjustments, EU Joint Transfer Pricing Forum, 2014, p. 3 et seq.), ex ante and ex post TP determination, and outcome testing, are permissible. As to TP documentation, the OECD also expressly recommended that the taxpayer make efforts to determine a transfer price in accordance with the arm’s length principle on the basis of the information available at the time. It is, however, advisable for taxpayers in the future to name only the TP method applied in a clear and unambiguous fashion and to document – in relation to this method only – what information was available to them personally and was used at the time of determining a transfer price.

Requirements for the documentation of database studies

Moreover, Sec. 4(3) introduces the duty, when using database studies, to document the search strategy, the search process and the configuration of a database to make it understandable when a tax audit is conducted. However, if we proceed from the
record-keeping requirements stipulated by the Federal Ministry of Finance to date, no new documentation requirements emerge.

Preparation of a Master File

Fortunately, the rule setter of the decree strictly follows the OECD guidelines as to the contents of a Master File and grants the taxpayer a certain degree of leeway. Thus Sec. 5(1) GAufzV in conjunction with the related explanatory notes requires exactly the same documentation for a Master File that the OECD stipulates in its Final Report of October 5, 2015, plus explanatory notes. Furthermore, it is in line with the OECD view for a Master File to provide a „high-level overview“ of a business group and not require „exhaustive listings of minutiae“. This allows the taxpayer to use „prudent business judgement“ on the information to be included or excluded in the Master File. Commendably, these aspects find expression in the revised TP documentation guidance. Under Sec. 5(2) GAufzV, the taxpayer is free to use its prudent business judgement to prepare a Master File in order to achieve its objectives, expending a reasonable amount of effort. The same also applies to the Master File contents specified in the explanatory notes to the GAufzV.

Significance of TP guidelines

Section 2(3) sentences 5 and 6 are virtually unchanged. They stipulate that any TP guidelines can be used for the documentation of groups of business transactions and may make it unnecessary to prepare documents for individual business transactions. Nevertheless, the rule setter expressly highlighted in its reasoning that TP guidelines can represent an important element of an internal TP control system and also referred to the adjustment of tax returns in accordance with Sec. 153 GTC.

Conclusion

As of mid-2017, the revised TP documentation guidance replaces the preceding version, which was in place for nearly one and a half decades. The guidance reflects in particular the OECD’s twin-track approach to TP documentation consisting of the Local File for individual enterprises and the group-wide Master File. Although the official reason given for the changes is solely to make the statutory amendments understandable, a closer look at the guidance reveals a substantial toughening of the documentation requirements. We strongly advise cross-border businesses to keep an eye on these developments.

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Federal Tax Court doubts that German CFC rules comply with EU fundamental freedoms

Purposes and conflicts of the provisions

The conceptual framework of the controlled foreign corporation (CFC) legislation aims to prohibit the abusive shifting of profits into low-tax jurisdictions, thereby deferring the payment of a higher tax by not distributing the profit immediately. In Germany, the rules apply where a CFC generates `passive income` subject to a tax rate of less than 25%. If the rules apply, the income is attributed to the German shareholder and subject to German taxation. This effective taxation of not-yet-distributed foreign profits under the CFC rules has in the past been classified as a restriction of the EU freedom of establishment by the ECJ (decision of September 12, 2006, Cadbury Schweppes, C-196/04) because purely domestic company groups are not subject to comparable taxation. However, the ECJ saw a justification for this restriction in the prevention of abusive and wholly artificial arrangements where no economic substance could be found in the foreign entity.

According to the ECJ, this justification is, by contrast, valid only if the taxpayer is allowed to provide proof of the economic substance in the foreign entity. In the light of this requirement, the German legislature enacted Sec. 8(2) FTA (Foreign Tax Act – Außensteuergesetz) which entails the option to rebut the assumption of passive income. Nevertheless, as the ECJ's decision dealt solely with the EU freedom of establishment, which does not safeguard business activities performed in third countries, Sec. 8(2) FTA applies only to companies situated in EU or EEA countries. In a recent case (decision of October 12, 2016, I R 80/14), the German Federal Tax Court ruled that this provision potentially restricted the EU free movement of capital under Art. 63 TFEU – which also applies to third countries – and initiated the preliminary ruling procedure with the ECJ.

Facts of the underlying case

The plaintiff, a German GmbH, held shares in a Swiss AG amounting to 30%. The named AG derived passive income with investment character and was therefore classified as a CFC by the tax authorities. The plaintiff was consequently subject to Germany’s extended CFC legislation pursuant to Sec. 7(6), (6a) FTA as it held more than 1% of the shares in a foreign intermediate company whose income was taxed at a low rate in the relevant year, 2005. As Sec. 8(2) FTA applies solely to subsidiaries located in the EU/EEA, the plaintiff was granted no option to furnish evidence of economic activity (motive test) because the AG was located in a third country.

Questions raised by the Federal Tax Court

Germany's Federal Tax Court directed three questions to the ECJ. The first two address the questionable application of the standstill clause under Art. 64 TFEU, which would affirm the German CFC legislation even if it restricts the free movement of capital. According to this clause, rules restricting the free movement of capital still apply to third countries if they were put in place before December 31, 1999. This generally applies to the German CFC legislation, which was introduced in 1972. However, the standstill clause of Art. 64(1) TFEU protects only those third-country rules that have not been altered substantially, i.e. to a degree that implies that the idea underlying the
original rules remains unaltered. With that in mind, according to the Federal Tax Court, the standstill clause does not apply to the German CFC legislation because the relevant provisions (Secs. 7-14 FTA) have been drastically reformed since they were introduced, making them in fact entirely new legislation.

Potential impact of the ECJ’s decision on German CFC rules

If the ECJ follows the reasoning of the Federal Tax Court on the non-applicability of the standstill clause, it will ultimately have to answer the third question raised by the Federal Tax Court: whether the principles derived from the Cadbury case can be transferred to the free movement of capital. If the ECJ finds this to be the case, it would imply not only that the extended German CFC rules for passive income from capital investment (especially interest payments) violate European law, but even that the ‘normal’ CFC rules might do so because – while offering an option for rebuttal – their territorial scope is limited to EU/EEA countries.

According to ECJ case law, ‘neutral’ rules, i.e. rules that are neither suitable for nor aimed at mere controlling stakes, are subject to the freedom of capital movement (cf. ECJ decision of November 13, 2012, Test Claimants in the FII Group Litigation, C-35/11; September 11, 2014, Kronos, C-47/12; October 3, 2013, Itelcar, C-282/12). The regular CFC rules are indeed neutral rules. Although Sec. 7(1) in connection with (2) FTA requires the foreign entity to be controlled by a domestic one, the CFC rules by no means apply only to controlling stakes. What’s more, they do not factually require a situation of domination or control. In individual cases it can in fact be sufficient if any given number of domestic residents by chance hold the majority stake in the foreign entity. Sec. 7(1) in connection with (2) FTA thus does not require a specific controlling stake, and its scope is not restricted to such stakes. There are therefore good reasons to argue that the regulations on the regular CFC rules must be measured against the provisions on the free movement of capital under Art. 63 TFEU. In fact, Sec. 8(2) FTA, which provides the opportunity to prove that the foreign entity carries out a genuine economic activity, does not apply to third countries. Hence, applying the regular CFC rules may also constitute a restriction of the free movement of capital vis-à-vis those countries (cf. tax court of Baden-Württemberg of August 12, 2015, 3 V 4193/13).

Incidentally, this is true even if a taxpayer holds a majority stake in the foreign interposed company. In this context, both the ECJ and the Federal Tax Court have affirmed in multiple cases that the „actual stake in the case at hand“ has no impact on the relevant EU fundamental freedom (cf. ECJ decision of November 13, 2012, Test Claimants in the FII Group Litigation, C-35/11; of October 3, 2013, Itelcar, C-282/12; cf. also Federal Tax Court of January 4, 2009, I R 47/08; of August 29, 2012, I R 7/12). As an example, we refer to the ECJ’s decision of November 24, 2016 (SECIL, C-464/14), in which, due to the normative form of the disputed regulation, even an actual shareholding of 98.72% was acknowledged under the stipulation on the free movement of capital.

Conclusion

If the ECJ shares the doubts raised by the Federal Tax Court in its order for reference and affirms that the free movement of capital is infringed as a result of the extended CFC rules, the motive test for a CFC generating passive income with investment character would have to be expanded to taxpayers who are subject to Sec. 7(6) FTC. In the end, however, the highly anticipated ECJ decision may also have an impact on
Germany’s ‘normal’ CFC legislation and lead to a revision of the current regular CFC rules in Sec. 7(1) FTA. This is because the opportunity of rebuttal under Sec. 8(2) FTA does not currently apply to companies located in third countries.

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Current developments in the German exit taxation of significant shareholdings

A universal exit tax applies to business property of German taxpayers under Sec. 4(1) sentence 3 ITA (Income Tax Act - Einkommensteuergesetz). However, private property can also be subject to exit taxation, albeit only for significant shareholdings in a corporation under Sec. 6 FTA (Foreign Tax Act - Außensteuergesetz). This provision can represent a significant stumbling block for taxpayers wishing to permanently leave Germany while retaining a significant shareholding in a foreign or domestic corporation. Recent developments in this area are highlighted here.

German taxpayers are subject to an exit tax on their business property. Section 4(1) sentence 3 ITA provides for an exit tax that is assessed at the fair market value of the asset being assigned to a foreign permanent establishment (Sec. 6(1) no. 4 sentence 1 ITA). For private property, however, no universal exit tax is applicable. Significant shareholdings in a corporation represent an exception to this rule. Section 6 FTA stipulates that these are deemed to be sold once the shareholder permanently leaves Germany or deprives Germany of its right to tax capital gains on this shareholding in any other way. One of the conditions for the tax to apply is that the shareholder has been subject to German resident taxation for at least ten years prior to the relocation.

A significant shareholding under Sec. 6 FTA is defined as one that has been equal to or has exceeded 1% of the capital in a corporation at any time during the last five years. Under the current rules, it is immaterial whether the shareholding is in a foreign or domestic corporation. Should the shareholder holding such a stake relocate to a foreign state, the shareholding is deemed to be sold at the fair market value (Sec. 6(1) sentence 4 FTA). The usual partial exemption of the income applies, so that 60% of the gross gain is subject to income tax. Hence, the shareholder owes tax to the German tax authorities immediately upon the tax assessment. However, this does not involve any cash receipt from which the tax liability might be paid (“dry income”).

Ever since the 2004 ECJ judgment Hughes de Lasteyrie du Saillant, this immediate tax demand has been seen as incompatible with the fundamental freedoms under the TFEU. As a consequence, the German legislature has introduced a provision to the effect that EU citizens who relocate to an EU country do not have to pay the tax immediately. Instead, the tax authorities must grant a deferral, without charging interest or requiring any security (Sec. 6(5) FTA).

In the past, it was doubtful and much discussed whether a significant shareholding that was impaired in its value could be recognized as a loss upon triggering Sec. 6 FTA. In particular, shareholders with several significant shareholdings upon their relocation may encounter a situation where some stakes show hidden reserves while others contain hidden losses. The German Federal Tax Court in Munich decided in a landmark ruling in 1990 that losses could not be recognized under Sec. 6 FTA. Hence, any
taxpayer with a significant shareholding upon relocation which showed hidden losses had to sell the shares before emigrating to crystallize the loss immediately. Only once the sale had been concluded did he leave Germany.

Recently, the Federal Tax Court reaffirmed these principles in a judgment dated April 26, 2017 (file number I R 27/15). The case was filed for tax year 2009, i.e. after a few substantial changes to the underlying law in 2006. The Court maintained its position that losses could not be recognized under the German exit provision on substantial shareholdings. As a consequence, the claimant was left with taxable gains for some of his shareholdings which could not be offset against losses from other significant shareholdings.

Hence, in future, taxpayers will have to plan their relocation more carefully than ever. The hidden losses in significant shareholdings need to be crystallized before the relocation takes place. The hidden gains may then – in cases of relocation to an EU member state – be realized via Sec. 6 FTA because this allows for the unlimited deferral of the exit tax described above.

Another bone of contention regarding Sec 6 FTA has always been the application of the provision to relocations to third countries, i.e. non-EU member states. In these cases, the interest-free deferral is not available according to the wording of the law. Instead, there is a rather minimalist deferral scheme enshrined in Sec. 6(4) FTA. This deferral allows for a payment of the tax due only in five yearly installments and requires security to be provided for the tax owed. Overall, the deferral scheme for third countries is noticeably inferior to the scheme for relocations to EU countries.

For the special case of relocations from Germany to Switzerland, however, this state of affairs may not persist for much longer. The lower tax court of Baden-Württemberg submitted a request for a preliminary ruling to the ECJ on June 14, 2017 (file number 2 K 2413/15) in a case involving a German national’s relocation to Switzerland. The claimant held a 50% stake in a Swiss corporation when he relocated. The German tax authorities charged the exit tax under Sec. 6 FTA. The claimant, however, argued that the provision should not be applicable to his case under the „Agreement of 21 June 1999 between the European Community and the Swiss Confederation on the free movement of persons”. The lower tax court harbored sufficient doubts as to the compatibility of the German tax provisions with EU law that it resolved to submit a ruling request to the ECJ.

For German tax residents considering a relocation to Switzerland, the outcome of the case (file number at the ECJ C-581/17) will be of significant interest. Should the ECJ find the German provisions incompatible with EU law, the beneficial regime of interest-free deferral may well be extended to relocations to Switzerland as well. Over and above the present case, the literature has long questioned whether the regime of Sec. 6 FTA in cases of relocations to third countries is compatible with the free movement of capital under Art. 63 TFEU. Resident taxpayers intending to relocate in the next few years should thus pay very close attention to the developments regarding Sec. 6 FTA.

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US Tax Reform – Key changes for corporations

A. Background

The president of the United States signed the new Tax Cuts and Jobs Act into law on December 22, 2017, thus achieving the most profound tax reform since the Tax Reform Act in 1986. The key elements of the new reform are a 14% point reduction in the federal corporate income tax rate and the transition from a worldwide to a territorial system of taxation. Since these changes will lead to a government shortfall in tax revenue, the Tax Cuts and Jobs Act contains numerous counter-financing measures including a new interest barrier rule, the toll charge, an extension of the current Subpart F-legislation, and the introduction of a base erosion and anti-abuse tax. Nevertheless, this tax reform will cut revenue by approximately USD 1.456 trillion over the next ten years.

B. Key changes in national provisions

1. Reduction in corporate tax rate and amendment of the dividend received deduction

Without a doubt the most gratifying results of the tax reform are the elimination of the progressive corporate tax structure with a maximum tax rate of 35% and the permanent reduction to 21%. Apart from the federal corporate income tax, most states in the US levy an additional state corporate income tax ranging from 0%-12% that is deductible for federal tax purposes. This leaves the taxpayer with a combined maximum tax rate of 30.48% after the reform, down from 42.8% previously.

Before the enactment of the reform, if a corporation paid a dividend to another domestic corporation, the recipient was allowed a (partial) exemption according to its pro rata share (100% if the corporations belonged to a consolidated group, 80% with a share exceeding 20%, and 70% otherwise). The new law lowers the partial exemptions from 80% to 65% and from 70% to 50%, resulting in almost no change in the effective tax rate on dividends. In the case of disposition of stock, any capital gain is taxed at the regular tax rate without partial exemptions.

2. Repeal of the corporate AMT

The new law repeals the system of the alternative minimum tax (AMT) for corporations. Under the old law, the AMT was computed by applying a 20% tax rate on an adjusted taxable income. The taxpayer paid the higher amount of AMT and his regular tax liability. If the AMT applied, the taxpayer was allowed to credit the AMT against his regular tax liability in succeeding taxable years. Regardless of the repeal of the AMT, the AMT credit may still be used against the regular tax liability in subsequent taxable years. Additionally, in 2018, 2019 and 2020 the taxpayer will receive a tax refund equal to the amount of 50% of the AMT credit carryover that has not been offset against taxable income. Any remaining AMT credits are fully refundable in 2021.

3. Modified net operating loss deduction

As a counter-financing measure, the new law is more restrictive on the net operating loss deduction. Under the old provisions, the taxpayer was able to carry losses back
two years and was allowed a restricted loss carryforward of 20 years. After the tax reform the taxpayer is able to carry losses forward indefinitely to future taxable years but can no longer carry losses back to previous years.

Under the old AMT system the net operating loss deduction was limited to 90% of the taxable income (with a 20% tax rate), whereas the new law permits only a loss offset against 80% of the taxable income, increasing the effective tax rate from 2% under the AMT to 4.2% after the reform.

4. Full expensing of qualified property

As a relief for the taxpayer the revised provision on the depreciation of qualified property (generally any material property with a useful life of less than 20 years) obligates the taxpayer to fully expense the purchase price in the acquisition year instead of benefiting from a bonus depreciation of only 50% under the old law. The immediate 100% expensing is subject to a phasedown of 20% per tax year beginning from tax years after 2022, i.e. allowing the taxpayer the last bonus depreciation of 20% in 2026.

5. Capitalizing research & experimental expenses

The new law repeals the immediate expensing of certain research & experimental expenses and requires the taxpayer to capitalize and amortize these expenditures over five years if the R&E activity is conducted in the US and over 15 years otherwise. Even if the R&E activity is discontinued or disposed of during the amortization period, the capitalized asset will not be recovered. Instead, the amortization will continue over the deemed useful life.


6. Entertainment, food and beverage expenses

The new law completely repeals the deduction for entertainment expenses, even if associated with the taxpayer's conduct of trade or business. It is also more restrictive on the deductibility of food and beverage expenses. The new provision retains the 50% deduction for food and beverage expenses including expenses for the operation of a company canteen comprising meals provided at convenience of the employer. For tax years beginning after December 31, 2025, the latter expenses are fully nondeductible for tax purposes.

7. Introduction of an interest barrier rule

Under the Tax Cuts and Jobs Act the US has replaced the earnings stripping rules with an interest barrier rule. The new rule aims to prevent excessive debt financing and base erosion.

The provision applies to business interest expenses of all taxpayers regardless of their legal structure if their average annual gross receipts for a three-taxable-year period exceed USD 25 million.

Business interest expenses exceeding the business interest income is only deductible to the extent of 30% of the adjusted taxable income. For taxable years beginning...
before January 1, 2022, adjusted taxable income is equal to the EBITDA. For succeeding taxable years the adjusted taxable income corresponds to EBIT, leading to a more restrictive interest limitation in future taxable years. Note that the new provision provides an indefinite carryforward of disallowed interest expenses but does not contain an EBITDA (EBIT) carryforward.

For partnerships (transparent for tax purposes) the interest limitation applies first at the level of the partnership. Any business interest expenses that are disallowed as a deduction (excess business interest) on the level of the partnership are allocated to the partners according to their interest in the partnership and can be used against any excess taxable income (EBITDA/EBIT-surplus) allocated to them by the partnership in any succeeding taxable years.

C. Key changes in international provisions

1. Move to a territorial system of taxation

a) Exemption of foreign dividends and sale of 10%-owned foreign corporations

The most profound change concerning the new international tax provisions is the move from a worldwide system of taxation with foreign tax credits to a territorial system of taxation providing domestic C corporations with a 100% exemption of dividends received from specified 10%-owned foreign corporations (100% dividends received deduction – DRD). Since the new law treats the sale or the transfer of a specified 10%-owned foreign corporation as a dividend, the resulting capital gain/loss is generally fully exempted from US taxation accordingly.

To be entitled to the 100% DRD the status of a specified 10%-owned foreign corporation must be maintained for a one-year holding period. The 100% DRD does not apply to hybrid dividends (i.e. dividends for which the foreign corporation received a deduction or other tax benefit). Passive foreign investment companies, regulated investment companies, and real estate investment trusts do not benefit from the 100% DRD either.

b) Toll charge

After the implementation of the new participation exemption regime, the deferred income at the level of the foreign corporation which has not yet been distributed to its US corporate shareholders will prospectively not be taxed if the recipient is allowed a 100% DRD. To counteract this tremendous future tax revenue shortfall, the new law introduces a mandatory one-time repatriation tax (toll charge) for deferred foreign income corporations (DFICs).

The US taxpayer will effectively be taxed on the deferred earnings of its DFIC at a rate of 15.5% on earnings held in cash and 8% on earnings held in non-liquid assets according to its pro rata share in the DFIC. Foreign taxes paid at the level of the DFIC may be credited against the repatriation tax amount (plus the gross-up for foreign taxes) to the extent that the reduced rate under the toll-charge regime relates to the old corporate income tax rate of 35%, amounting to a foreign tax credit allowance of 44.29% for cash and 22.86% for non-liquid assets.

In addition to the foreign tax credit, the taxpayer is allowed to accumulate deferred income/losses among all of its DFICs. To soften the immediate cash effect resulting from the toll charge, the taxpayer may request permission to pay the tax in installments over the next eight years. The first installment (or the entire amount) is due on April 15, 2018.
2. New anti-abuse rules

The revised international system of taxation is accompanied by several new anti-abuse rules to secure the US tax base.

a) Anti-hybrid rules

One of these provisions is a new anti-hybrid rule that aims to prevent a deduction for interest or royalties paid to a related party (that holds > 50%) pursuant to a hybrid transaction or to (or by) a hybrid entity. According to the new provision, the term ‘hybrid transaction’ includes any payments which are treated as interest or royalties for federal tax purposes but are not so treated under the tax law of the country where the recipient resides. Under ‘hybrid entity’ the new law defines an entity that is treated as fiscally transparent for US tax purposes but is not so treated for purposes of the tax law of the foreign country, or vice versa.

Note that this rule applies only if the hybrid transaction or the payments to a hybrid entity actually lead to a double deduction (D/D) or a deduction/no inclusion (D/NI) scenario.

b) Base erosion and anti-abuse tax

Like its name suggests, the base erosion and anti-abuse tax (BEAT) aims to fight excessive base erosion by multinationals. For tax years beginning after the enactment of the Tax Cuts and Jobs Act, the new rule imposes a minimum tax on a modified taxable income (base erosion minimum tax amount – BEMTA). The tax is due only to the extent the BEMTA exceeds the regular tax liability.

The BEAT applies only to US-based corporations with substantial gross receipts (USD 500 million for a three-taxable-year period) and with a ‘base erosion percentage’ (‘base erosion benefits’ divided by the total allowable deduction to the taxpayer in the taxable year) exceeding three percent. ‘Base erosion benefits’ means any payments to foreign related parties (holding more than 25%) that are deductible by the taxpayer in the current taxable year. Interest, license fees or reinsurance payments are therefore subject to BEAT. But the purchase of depreciable property also triggers BEAT to the extent that the depreciation is deductible for US tax purposes in the current tax year. The BEAT does not apply for certain amounts for services and for cost of goods sold (COGS).

The computation of BEAT is straightforward. First, the base erosion benefits are added back to the taxable income resulting in the ‘modified taxable’ income. After applying a five percent rate on the modified taxable income, the resulting BEMTA is compared to the regular tax liability. The difference between BEMTA and the regular tax liability is the BEAT liability. The BEAT rate will be increased in 2019 to 10% and for tax years beginning after December 31, 2025 to 12.5%.

c) Global intangible low-taxed income

The Tax Cuts and Jobs Act adds a new section to the Subpart F-legislation (Subpart F of the IRC contains the US CFC rules) that obligates a US shareholder to include ‘global intangible low taxed income’ of his CFCs in his taxable income.

Unlike its name suggests, GILTI does not solely apply to low-taxed income. In fact it includes as gross income the excess of the (net tested) income of the shareholder’s
CFCs over the (net deemed) tangible return regardless of the statutory tax rate in the foreign state. The first part of the equation, the net tested income, is computed by netting the income of all the CFCs of the US shareholder but excluding, for example, the effectively connected income or the Subpart F income. The second part, the net deemed tangible return, reflects the routine return on tangible assets of the CFCs. It is calculated by multiplying the qualified business asset investment of all CFCs by 10%. The (positive) result is the deemed intangible income that is included in the income of the US shareholder.

To soften the tax effect of the new provision, the shareholder is allowed a deduction equal to 50% (37.5% for tax years beginning after December 31, 2025) of the inclusion. Moreover the taxpayer may credit foreign taxes paid on the tested income against the tax amount resulting from the inclusion. However, the foreign tax credit is limited to 80% and cannot be carried forwards or backwards to other taxable years.

3. Preferential treatment of foreign derived intangible income

As a counterpart to GILTI, the new law also contains a provision to favor foreign derived income from an intangible source that is located in the US, creating an incentive to allocate intangible income (back) to the US. The mechanism is described in more detail in the article by Tim Zinowsky and Benedikt Ellenrieder.

D. Summary

The tax reform, which most people never expected to become law, is now reality. It contains massive tax relief for corporations in the form of a very large tax cut and a move to a territorial system of taxation. But taxpayers now also face many new regulations such as GILTI, BEAT, and the new interest barrier rule. They are well advised to bear in mind the multiple interactions between the new rules for future taxable years.

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US tax reform and German license barrier rules – Is the FDII regime a harmful preferential tax regime?

In issue #02/2017 of this newsletter, Dr. Xaver Ditz and Dr. Carsten Quilitzsch shed light on Germany’s license barrier rules laid down in Sec. 4j of the German Income Tax Act (ITA). In a nutshell, the license barrier rules limit the deductibility of license fees1 to related parties if the corresponding revenues are taxed under a preferential tax regime that is not in line with the OECD/G20 Nexus Approach2. The recent US tax reform introduces a special regime for foreign-derived intangible income (FDII). Now the question arises of whether these new provisions constitute a preferential tax regime in the above sense, resulting in a (partial) non-deductibility of license fees paid by German licensees to US licensors. Given the wording of the law and the reasoning and history of the license barrier, the authors conclude that the FDII provisions do not constitute a preferential tax regime.
I. Background – The FDII rules

The FDII rules are designed to incentivize taxpayers to bring IP income – and with it the relevant functions and jobs – to the US. To this end, they allow a partial deduction\(^3\) for FDII when determining the income, resulting in an effective tax rate for this income of 13.125\(^4\).

The FDII is calculated on a mere fiction in two steps; in simplified terms: First, the deemed intangible income is determined by deducting a routine return of 10% on the tangible assets from the overall income. The foreign part of this income, the FDII, is then calculated by multiplying the deemed intangible income by the ratio of foreign income from sales and services to the overall income.

II. Taxation of FDII – a preferential tax regime?

In principle, Sec. 4j ITA stipulates that license fees are partially deductible only if the corresponding revenues are taxed under a preferential tax regime.

The law includes two criteria to define a preferential tax regime: (1) 'low' taxation of the license fees at the level of the creditor, meaning an effective tax rate of lower than 25\%, and (2) the low taxation is the result of a mechanism that deviates from the 'standard' taxation.

However, German tax law defines neither the term 'standard' taxation nor the deviation from it. Taking a closer look at the wording of Sec. 4j ITA, the preferential tax regime needs to be connected to the existence of license revenues. Furthermore, there should also be a connection between the preferential tax regime and the value of the tax benefit, meaning that for the value of tax benefit a taxpayer receives from a foreign tax regime it must at least be decisive whether he has license revenues or not.

Given the basis for calculating the FDII benefit, the latter can be given without any IP-related revenues or even without any IP being in place – and vice versa, there might be substantial license revenues without the FDII rules resulting in a tax benefit. As a result, there is no sufficient nexus between the FDII regime and license revenues.

This result also holds when taking into account the history of the license barrier rules. The explanation published when Sec. 4j ITA was introduced explicitly refers to „special“ preferential regimes, i.e. „IP boxes, licensing boxes or patent boxes“. On the mechanics of the regime targeted by Sec. 4j ITA, the explanation goes on to state that the provision applies to all regimes that govern „either a full or partial tax exemption of licensing income, special tax rates for licensing income or other benefits tied to license fees“. Here the nexus of the preferential regime with the license revenues already found by referring to the wording of the law is confirmed. Furthermore, the explanation states that a preferential regime should not be in place for „payments that are subject to low taxation as a result of a general tax rate that also applies to other income of the taxpayer“. Therefore, the tax benefit for license revenues has to be a kind of exclusive benefit that applies only to the taxpayer’s IP revenues, not to other income. As shown above, the FDII regime can technically apply to all kinds of income. Hence, the FDII rules cannot be deemed to constitute a preferential tax regime.

This outcome of classifying only tax regimes that apply exclusively to IP-related income as preferential tax regimes is supported by a systematic view of the provision. The OECD uses its Nexus Approach referred to for the exemption in the context of IP boxes only.
III. Summary

The German license barrier rules should not apply to license expenses whose corresponding revenues are subject to low taxation in the US under the FDII regime. Although it must be expected that the German tax authorities will take a different position on the issue, taxpayers are well advised to take legal measures against potential claims of the tax authorities given that Sec. 4j ITA obviously breaches constitutional and EU law.

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The authors published a detailed essay on this topic in German in Internationales Steuerrecht, 2018, 134-142)

1 The license barrier rules cover license fees and payments for all types of rights or use of rights.
2 As described in BEPS Action 5 Final Report, chapter 4. For more details see issue #2/2017.
3 Deduction amounts to 37.5% of the FDII until 2026. Afterwards a 21.875% deduction will apply.
4 16.406% as of 2026.

Section 8c German Corporate Income Tax Act: Updated administrative guidelines in spite of constitutional concerns

In November 2017, the Federal Ministry of Finance issued updated guidelines on the discontinuation of tax loss carryforwards for corporations under Sec. 8c of the German Corporate Income Tax Act (Körperschaftsteuergesetz - KStG). In German tax law, Sec. 8c KStG triggers a proportional (full) discontinuation of tax loss carryforwards in cases where more than 25% (more than 50%) of the shares of a corporation are acquired by new shareholders (or a group of acquirers) within a five-year period.

The new interpretation replaces the nine-year-old preceding guideline that did not yet address the hidden reserves clause or the corporate group clause, which were subsequently added to Sec. 8c KStG. Simultaneously, the federal states’ tax authorities published identical decrees concerning certain aspects of the German Trade Tax Act (Gewerbesteuergesetz) linked to Sec. 8c KStG.

Constitutional concerns about Sec. 8c KStG

Back in 2014, the tax authorities issued draft administrative guidelines that took into account the amendments of Sec. 8c KStG that were codified after the initial administrative guidelines on Sec. 8c KStG had been published in 2008. Although several Federal Tax Court judgments resulted in further regulatory demands, the actual release of the final guidance of the Federal Ministry of Finance at this point is surprising. Due to a landmark decision of the Federal Constitutional Court that found relevant aspects of Sec. 8c KStG unconstitutional, a major revision of Sec. 8c KStG is expected in the near future, possibly even resulting in a completely new regulation.

Following the Federal Constitutional Court’s decision (2 BVL 6/11), Sec. 8c(1) sentence 1 KStG is to be revised by the legislature retroactively for the years 2008 to 2015. If no revised regulation is enacted by the end of 2018, the section will be deemed non-applicable retroactively for those years. In the general perception, it is highly
questionable whether Sec. 8d KStG, introduced in January 2016, could safeguard constitutionality from then on. Section 8d KStG was only recently implemented and prevents the applicability of Sec. 8c KStG under certain circumstances, but it also introduces a distinct regime – which could ultimately do more harm than good. What's more, proceedings are ongoing at the Federal Constitutional Court (2 K 245/17) regarding Sec. 8c(1) sentence 2 KStG which might lead to a similar ruling of unconstitutionality. The publication of the new guidelines despite the regulation's constitutional concerns indicates that the administrative authorities want to adhere to Sec. 8c KStG for as long as possible.

Main revisions of the administrative guidelines

1. The term 'group of acquirers' in Sec. 8c has been defined in more detail. In accordance with a Federal Tax Court judgment of November 22, 2016, the Federal Ministry of Finance does not classify several acquiring entities as a group of acquirers with similar interests if these individuals made arrangements only for the transaction as such. For a 'group of acquirers' to be assumed, the entities must have made arrangements before the transaction that indicate an intention to cooperate 'as a group' after the transaction.

2. The new guidelines bring welcome relief regarding the offset of existing loss carryforwards with a pro-rata profit realized up to the time of the harmful acquisition of shares. Contrary to the 2014 draft, offsetting existing loss carryforwards with pro-rata profits realized up to the moment of the transaction no longer requires an overall positive annual profit in the tax year of the harmful transaction. Thus, an interim loss offset is possible even if the overall financial result for the tax year shows a loss. The allocation of profits to the period of time before and after the transaction has to follow 'factual or economic' considerations. Ideally, the allocation should be based on an interim financial statement. However, a business analysis or a time-proportionate allocation is also possible.

3. The transfer of shares to an acquirer qualifies as a multiple transfer of the relevant shares to the extent that the acquirer was previously the owner of the loss-making company's shares. Based on the ratio legis of Sec. 8c KStG, this might lead to inappropriate results as the legal consequences of Sec. 8c KStG may be triggered without a material change of ownership in the loss-making company, i.e. its 'economic identity' remains unchanged.

4. When a tax group is in place, a harmful acquisition at the end of a tax year will lead to a discontinuation of the loss carryforwards of the controlling company (Organträger) only after the income of the controlled companies (Organgesellschaften) has been attributed to it. However, in the event of an intra-year harmful acquisition, no pro-rata attribution of income to the parent is undertaken before the discontinuation of tax loss carryforwards. An intra-year harmful acquisition of shares of the controlling company likewise affects the not-yet-included negative income of the controlled companies. Furthermore, the subsidiaries' hidden reserves are not taken into account at the level of the controlling company for the application of the hidden reserves clause. Thus, the German tax authorities' interpretation of Sec. 8c KStG as it applies to a tax group is driven mainly by purely technical considerations. It does not appropriately consider the systematic provisions of the German group taxation regime.

5. The new guidelines define a broad scope of application for the corporate group clause. Both single-level and multilevel holdings of wholly owned subsidiaries
qualify for the corporate group clause. The general partnership (OHG), the limited partnership (KG), and similar foreign partnerships – but not civil-law partnerships (GbR) – may qualify as the 'same person' within the meaning of Sec. 8c(1) sentence 5 KStG. Furthermore, the terms 'seller' and 'acquirer' follow a norm-specific interpretation and all instances falling under the provisions of Sec. 8c KStG also potentially qualify for exemption based on the corporate group clause. For the purpose of assessing whether the corporate group clause applies, the new guidance retains the 'three-level' approach previously set out in the 2014 draft. The corporate group clause is explicitly not applicable in cases where the transferor entity or the transferee entity (not the loss-making company) has multiple shareholders and 100% ownership by a single entity cannot be achieved even by adding up the direct and indirect shareholdings.

6. The provisions on the hidden reserves clause remain largely unchanged in comparison to the 2014 draft.

Conclusion

All in all, the revised administrative guidelines provide some welcome clarifications on the amendments of Sec. 8c KStG. If, however, the new guidance – despite the constitutional concerns – can be seen as an attempt at adhering to the unmodified Sec. 8c KStG beyond 2016, the answer is no.

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Germany's new Transparency Register

On the very last day of the transposition period, the German Act on the Transposition of the Fourth Anti-Money Laundering Directive (EU) 2015/849 of June 23, 2017 created a new instrument to fight money laundering and terrorist financing: the all-electronic Transparency Register. It is designed to assist public authorities, certain professionals, and everyone who has a legitimate interest in identifying natural persons who ultimately "own" a specific company or who stand behind certain legal transactions.

Content and purpose of the Transparency Register

The Transparency Register is run by Bundesanzeiger Verlag GmbH, the same company that provides the technical know-how for the 'Unternehmensregister' platform which combines corporate data from the state-run commercial register and from the Federal Gazette. Certain entities and the custodians of certain types of legal arrangements are obliged to obtain and hold adequate, accurate and current information on their beneficial ownership and to report this information to the Transparency Register without delay.

The reporting duty provided for in Sec. 20 of the German Money Laundering Act (MLA) is incumbent on legal persons governed by private law, especially companies, registered associations and private foundations with legal capacity, and on registered partnerships. These have to report the first name and family name of each of their beneficial owners, plus the date of birth, place of residence, and the nature and extent of the beneficial interest held. Correspondingly, shareholders who are themselves beneficial owners have to provide the information which the relevant entities need to fulfill their reporting duties.

According to Sec. 21 MLA, the same information has to be reported by trustees of an express trust, trustees of private foundations without legal capacity (nicht rechtsfähige Stiftung) which are, from the trustor's perspective, self-serving, and custodians of other types of legal arrangements that have a structure or functions similar to trusts. The only requirement is that at least one trustee or custodian is resident in Germany. This means that trusts – which are unknown to German corporate law – may nevertheless be subject to German transparency requirements. In addition – and by way of derogation from the Directive (EU) 2015/849 – it is only the custodians of trusts (or similar arrangements) who also have to identify and report the nationality of each beneficial owner.

The data collected via the Transparency Register is supposed to help authorities and those entities and professionals within the meaning of Sec. 2 MLA who are obliged under the MLA to identify certain business partners. However, obliged entities and professionals may not rely solely on the Transparency Register.

No reporting obligations are placed on civil law partnerships (BGB-Gesellschaften) which have separate assets and therefore, under German law, constitute a legal personality in some respects (Teilrechtsfähigkeit).

Beneficial owners

The MLA defines beneficial owners as the natural persons who ultimately own or control entities or legal arrangements. In the case of entities, a natural person must hold more than 25% of the share capital, control more than 25% of the votes, or exercise
control in a similar way (Sec. 20 MLA). The latter may be based on shareholders' agreements, 'trust agreements' (Treuhandvereinbarungen) or on the position as a legal representative (especially with private foundations with legal capacity) or managing partner. This includes intermediary control though an entity within the meaning of Sec. 20 MLA that itself owns or controls another entity of that kind.

The beneficial owners of trusts and private foundations without legal capacity are – apart from the trustee, the settlor and the protector (if any) – natural persons who are the designated beneficiaries of the trust or the group of natural persons on whose behalf the assets are managed or distributed.

The aforementioned criteria serve to identify the beneficial owners of a given entity, trust or legal arrangement. They also have to be reported to the Transparency Register, as those criteria define the nature and the extent of the beneficial interest held (cf. Sec. 19(3) MLA).

Import of data from other registers and further facilitations

To reduce the expense for entities obliged to report under Sec. 20 MLA, the law provides that those reporting duties are fulfilled if all the required information on beneficial owners can be seen from certain other registers or announcements. These are company announcements according to Sec. 20(6) of the German Stock Corporation Act, shareholders lists according to Sec. 40 of the Limited Liability Companies Act (GmbHG), voting-rights announcements pursuant to Sec. 40, 41 of the German Securities Trading Act, and entries in the commercial register, the partnership register, the register of cooperatives, or the register of associations. After a recent amendment of Sec. 40 GmbHG, shareholder lists may serve to fulfill the reporting duties under the MLA even when a civil law partnership is among the shareholders, as the list now has to provide the full name, birth date, and place of residence of the shareholders of such a civil law partnership and a summarizing name.

Further facilitations apply if a company is listed on a regulated market that is subject to disclosure requirements consistent with Sec. 2(5) of the German Securities Act or subject to equivalent Union law or international standards which ensure adequate transparency of ownership information. In that case, the reporting duties under the MLA are always deemed to be fulfilled.

Penalties for infringements

An infringement of the reporting duties pursuant to Sec. 20 and Sec. 21 MLA and of the duty to provide further information if reports are unclear or cannot be attributed to a certain entity (Sec. 18(3) MLA) constitute an administrative offense. The supervisory authority – the Federal Office of Administration – may impose a fine of up to EUR 100,000. For grave, repeated or systematic infringements the fine may be increased to up to EUR 1m or twice the amount of the economic advantage derived from the infringement.

In addition, the supervisory authority has to publish final sanctions and irrevocable decisions on fines for five years on its website, unless the publication is – even in anonymized form – disproportionate because of an ensuing violation of personality rights or if the publication would endanger the stability of the financial markets or ongoing investigations.
Inspection of the Transparency Register

The register may be inspected by certain public authorities, including supervisory authorities, the Financial Investigation Unit (which is also created by the MLA), prosecution authorities, and certain tax authorities. Obliged legal entities and professionals may, in line with the purpose of the MLA, also inspect the Transparency Register to identify business partners and their beneficial owners. Unlike the commercial register and the corporate register, the Transparency Register is not open to inspection by anybody; only legal or natural persons who can show a legitimate interest may inspect parts of the data collected on beneficial owners. The regulation on the inspection of the Transparency Register gives examples of legitimate interests which seem to signal the need for a close connection with the fight against money laundering or terrorist financing. Obtaining fraudulent access to the Transparency Register constitutes an administrative offence which can be penalized in the same way as an infringement of the reporting duties.

Access to the Transparency Register by persons with a legitimate interest and by certain obliged entities and professionals may be restricted under certain circumstances upon application of the beneficial owner. The right to inspection must be outweighed by conflicting interests of the beneficial owner which are worth protecting. This is the case if the access would expose the beneficial owner to the risk of fraud, kidnapping, blackmail, violence or intimidation, or where the beneficial owner is a minor or otherwise incapable. However, public authorities and certain obliged entities, especially credit institutions, financial institutions and public notaries, must be granted access in any case.

Temporal scope of the transparency obligations

The reports to the Transparency Register pursuant to Sec. 20 and Sec. 21 MLA have to be filed starting from October 1, 2017. Limited liability companies that want to use their shareholder list need to make sure that their lists already comply with the new Sec. 40 GmbHG; this is not necessarily the case, as lists have to be amended accordingly only if a shareholder change occurs. Until these amendments are made, even those entities that will be able to make use of certain facilitations need to file a report until their shareholder list complies with the new rules.

Stricter rules looming

The Council of the European Union is currently discussing a proposal for a directive amending Directive (EU) 2015/849 which would tighten the transparency requirements still further. In particular, the information on companies and partnerships would become accessible to the public irrespective of a legitimate interest. As this is reportedly already the case in France (and the UK, for the time being), it does not seem very likely that the historically reserved German view on the transparency of beneficial ownership in companies will prevail.

Conclusion

The Transparency Register will – not least because of the threat of high fines and public exposure of infringers of transparency rules – increase transparency on the beneficial
ownership of companies and trust-like legal arrangements. It remains to be seen whether authorities and courts will, in interpreting the law, strike a sufficient balance between the legitimate interest in informing authorities, obliged entities and the public on the one hand and the interest in confidentiality of shareholders and other beneficial owners, which is also worthy of protection by the state, on the other. If the current proposal for a new European Directive becomes law, that challenge will grow still further.

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Practical law guide to private M&A transactions in Germany

The M&A guide gives a high-level overview of key issues including corporate entities and acquisition methods, preliminary agreements, main documents, warranties and indemnities, acquisition financing, signing and closing, tax, employees, pensions, competition, and environmental issues. It also includes a rundown of recent developments, in particular:

- **Foreign ownership restrictions:** On July 18, 2017, an amendment to the German Foreign Trade and Payments Ordinance (Außenwirtschaftsverordnung) came into effect, responding to concerns about foreign investments in certain German technology companies. The amendment refines the term "public order and security" by introducing a non-exhaustive but broad list of sensitive business areas. In addition, the scope of the sector-specific review has been widened and the review periods for the Federal Ministry for Economic Affairs and Energy have been extended in general.

- **Competition law:** The German Restriction of Competition Act (Gesetz gegen Wettbewerbsbeschränkungen) was amended effective as of June 9, 2017. The most relevant changes from an M&A perspective are the introduction of a new merger control threshold and the refinement of criteria for determining "dominance" with the aim of covering acquisitions of newly founded companies that have an innovative business model.

- **Tax exemption of capital gains by a non-domestic seller:** On May 31, 2017, the German Federal Tax Court (Bundesfinanzhof) ruled on tax exemptions of capital gains by non-domestic sellers. Under German corporate income tax law, a capital gain realized by a corporation from the sale of shares in another corporation is tax-exempt. However, 5% of the capital gain has to be added back as a deemed non-deductible expense. According to the decision of the Federal Tax Court, this 5% add-back is not applicable if the selling corporation is non-domestic and does not have a permanent establishment or representative in Germany.
Ban on the sale of luxury items on Amazon is permissible

European Court of Justice rules that manufacturers can restrict sales of luxury items via third-party internet marketplaces.

When you think of luxury perfumes, which names spring to mind? Givenchy, Yves Saint Laurent, L’Oréal, Lancôme, Christian Dior, Vichy, Coty? The European Commission and the EU courts are familiar with these names, too, but for a very different reason: legal disputes about their distribution channels. Some have pursued a block exemption to defend their sales approach; others are attempting to prevent sales via the ‘grey market’. In one piquant case, the supplier, Coty, has been in a pungent dispute with its own sales partner over a selective distribution system for Coty’s high-end perfumes.

In its much-publicized Pierre Fabre Dermo-Cosmétique decision, the ECJ examined a contractual clause stipulating that cosmetics and care products had to be sold in a physical space and in the presence of a qualified pharmacist. The Court found that this clause breached European antitrust law because the consequence was a total ban on internet sales for these items. It was therefore clear that many suppliers of high-quality brands in Germany and across the EU would be listening very carefully to the ECJ’s findings on Coty.

The court’s decision in the Coty case (C-230/16) backs restrictions of internet sales of premium items under certain circumstances.

The Coty case

Coty is a leading supplier of luxury cosmetics in Germany. Its portfolio includes Calvin Klein and other premium brands. A dispute arose between Coty Germany GmbH and Parfümerie Akzente GmbH, an authorized distributor.

Coty permitted Parfümerie Akzente to sell contract products online, provided that it used only a dedicated online shop (‘electronic shop window’). Under a supplementary distribution agreement, Parfümerie Akzente was expressly prohibited from using any third-party marketplaces.

With this selective distribution system, Coty wanted to ensure that its luxury cosmetics could be presented and advertised in an appropriate setting. But Parfümerie Akzente refused to sign the additional distribution agreement and started selling the items via amazon.de.

Coty filed a plaintiff’s claim to the regional court of Frankfurt, which dismissed it. The higher regional court of Frankfurt then decided that the case, as an unresolved matter of European antitrust law, should be referred to the ECJ with a request for a preliminary ruling. On December 6, 2017, the ECJ essentially found in favor of Coty and remanded the case back to the higher regional court for the final decision.
Selective distribution systems and breaches of antitrust law

Selective distribution systems are found in many industries. Where they are in place, a distributor that wants to sell a manufacturer's products has to meet certain selection criteria laid out in that manufacturer's distribution contracts. In return, the manufacturer undertakes only to supply authorized sales partners and, as far as possible, prevents products from appearing on the 'grey market'.

Selection criteria can, for example, require the sales partner to advertise products widely, to provide comprehensive customer service, to operate a workshop or to ensure spare parts are readily available. Although such obligations restrict the sales partner's activities, they are not viewed as restraints of competition provided that they are necessary and reasonable, laid down equally in all contracts, and handled in a non-discriminatory manner.

For many years it was accepted that manufacturers of items such as premium perfumes and luxury watches were entitled to make certain demands of their sales partners, especially in connection with where the products were sold (store fittings, decoration, portfolio, trained staff, etc.). This was partly to maintain the 'aura of luxury', but also, from the customers' perspective, to keep the products distinct from items in lower market segments.

The problem with internet sales bans

As mentioned above, the ECJ found a violation of European antitrust law in its Pierre Fabre Dermo-Cosmétique decision (C-439/09) of October 13, 2011. The violation stemmed from a contractual clause in a selective distribution system under which cosmetics and care products had to be sold in a physical space and in the presence of a qualified pharmacist, resulting in a ban on internet sales for these items. Many observers concluded from this that the restriction on online sales to promote the luxurious aura of high-end brands would subsequently become difficult to enforce.

Following investigations by Germany's leading antitrust authority, the Federal Cartel Office, numerous manufacturers have lifted their restrictions on internet sales. In most cases the manufacturers produced everyday items such as garden equipment (Gardena), faucets (Dornbracht) and running shoes (Asics).

No online marketplace for luxury items?

In its Pierre Fabre decision, the ECJ pointed out that the case referred to a complete ban on online sales. With Coty, in contrast, internet sales were restricted to the 'electronic shop window', but not prohibited entirely. Here the ECJ took the view, in line with long-standing practice, that a selective distribution system does not restrict competition if it contains objectively necessary criteria that are laid down equally in all contracts and are not applied in a discriminatory manner.

Explaining its reasoning, the Court stated that it is legitimate for a manufacturer to set selection criteria that emphasize the luxury nature of a product. If the 'aura of luxury' is damaged, the product itself is likely to suffer.

According to the ECJ, the provisions of Coty's supplementary distribution agreements were objectively intended to sustain the luxury image and prestige of the perfumery items. The next question for the court was whether those provisions were also commensurate. A ban on sales via third-party marketplaces, said the Court,
communicates a core message: only authorized sales partners are allowed to sell the 
products in question. For the manufacturer it is important to be sure that items are 
not sold by non-authorized parties. This is not least because of the absence of a con-
tractual relationship with third-party platform providers and the manufacturer's 
ability to influence the online presentation if it is detrimental to the luxury image of 
a product ("The internet sale of luxury goods via platforms which do not belong to the 
selective distribution system for those goods, in the context of which the supplier is 
unable to check the conditions in which those goods are sold, involves a risk of deteri-
oration of the online presentation of those goods which is liable to harm their luxury 
image and thus their very character." [at para. 49])

The ECJ thus argued that an online platform constituting a "sales channel for goods 
of all kinds" does not meet the needs of luxury suppliers. Banning sales via such 
platforms is therefore consistent and commensurate. After all, concluded the Court, 
the sales partner can continue to sell other products on its own website without 
hindrance. The problem of 'locatability' (Auffindbarkeit) discussed by Germany's Feder-
al Cartel Office – which investigated a ban on price comparison engines and keyword 
advertising in the Asics case – played no part in the ECJ's decision. Coty had, after all, 
not prohibited its sales partners from advertising on third-party platforms or using 
search engines. This is likely to be significant for investigations of restrictions in the 
future.

Hardcore restrictions?

The ECJ's decision backing the restriction of online sales of luxury items via third-party 
marketplaces such as Amazon (and presumably eBay, which was not mentioned 
specifically) was not the end of the story. The Court also examined whether the sales 
restriction could be interpreted as an unlawful customer restriction or an unlawful 
restraint on sales to end-customers by selective dealers. Restrictions of this kind, 
known as hardcore restrictions, remove the benefit of a block exemption as set out in 
Art. 4 of the Vertical Agreements Block Exemption Regulation no. 330/2010.

The higher regional court may still examine this question if it emerges that the ban 
on restrictive practices does in fact intervene due to an inappropriate restriction of the 
sales partner or unequal treatment. This scenario seems extremely unlikely. However, 
it is noteworthy that the ECJ, unlike some other voices in literature and practice, does 
not view the ban on third-party platforms as a customer restriction because only one 
sales channel is affected. Besides, the Court argues, there can be no restriction of 
customers because it is not apparent that a particular group of 'platform customers' 
can be separated off from the entire base of customers who shop online.

Practical consequences

The ECJ's decision largely removes current reservations about prohibiting third-party 
platforms, at least for manufacturers that have long been resisting sales of their luxury 
items via Amazon, eBay and other similar marketplaces. This leaves manufacturers 
free to prohibit their sales partners from working with third parties if the sales link 
with the authorized outlet would otherwise be severed and the aura of luxury and 
prestige would be undermined.

But the decision is not a carte blanche for manufacturers to impose absolute mar-
ketplace bans for all goods. They can do so only under certain strict conditions. First,
sales via general marketplaces such as Amazon would in fact be detrimental to the manufacturer's protected sales concept, which in turn must be justified by the nature of the products. Second, the distribution partner must have its own online store and be able to run it actively.

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