ECJ REPORTS

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I CLT- UFA SA v Finanzamt Koln-West (Case C 253/03), European Court of Justice, 23rd February 2006

The company CLT-UFA has its seat and central administration in Luxembourg. In 1994 it held a branch in Germany.

The Finanzamt fixed the taxable amount for corporation tax in respect of CLT-UFA, a company which was subject to limited taxation in Germany on income generated by its German branch during the financial year in dispute, in accordance with Article 5(1) of the Convention between the Grand Duchy of Luxembourg and the Federal Republic of Germany for the avoidance of double taxation and relating to mutual administrative assistance in the fields of taxation of income and capital and of business and land taxation and its Final Protocol, signed in Luxembourg on 23rd August 1958, as amended by the Supplementary Protocol of 15 June 1973 ('the Convention on the avoidance of double taxation between the Grand Duchy of Luxembourg and the Federal Republic of Germany').

The Finanzamt set the tax rate at 42% of the taxable income of the branch in accordance with Paragraph 23(2) and (3) of the Law on Corporation Taxation 1991 in the version applicable to the circumstances of the case in the main proceedings.

The objection and the action before the Finanzgericht (Finance Court), by which CLT-UFA submitted that that tax rate was discriminatory and that it infringed its right to freedom of establishment under Article 52 of the Treaty read in conjunction with Article 58 thereof, proved unsuccessful. Therefore, CLT-UFA brought an action before the Bundesfinanzhof (Federal Finance Court) seeking annulment of the judgment of the Finanzgericht and amendment of the tax decision in the form of a reduction of the tax rate to 30% of taxable income.

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The Bundesfinanzhof, considering the case, asked the Court, whether Article 52 in conjunction with Article 58 of the EC Treaty is to be interpreted as meaning that charging the profits made in 1994 by a capital company from another Member State through a branch in Germany to German corporation tax at the rate of 42% constitutes an infringement of the right to freedom of establishment, given that:

a) the profits would have been charged to German corporation tax at the rate of only 33.5% if they had been made by a company subject to unlimited corporation tax in Germany which was a subsidiary of a capital company from another Member State and had distributed all the profits to its parent by 30th June 1996

b) the profits would initially have been charged to German corporation tax at the rate of 45% if the subsidiary had retained them until 30th June 1996, but the liability to corporation tax would have been reduced retrospectively to 30% if the profits had been distributed in full after 30th June 1996
The second question was that if the place of business tax rate infringes

Article 52 in conjunction with Article 58 of the EC Treaty, is it necessary to reduce it to 30% for the financial year in dispute in order to cure the infringement?

As far as the first question is concerned, the Court stated that the refusal to apply the reduced tax rate to branches renders the possibility for companies having their seat in another Member State of exercising the right to freedom of establishment through a branch less attractive. It follows that a national law such as the one in dispute in the main proceedings restricts the freedom to choose the appropriate legal form in which to pursue activities in another Member State. Consequently, Article 52 and Article 58 of the Treaty preclude a national law such as the one in dispute in the main proceedings which, in the case of a branch of a company having its seat in another Member State, lays down a tax rate on the profits of that branch which is higher than that on the profits of a subsidiary of such a company where that subsidiary distributes its profits in full to its parent company.

When it comes to the latter question, it follows from the answer to the first question that it is necessary to apply a tax rate to the profits made by a branch which is equivalent to the overall tax rate which would have been applicable in the same circumstances to the distribution of the profits of a subsidiary to its parent company. That is why the second Court's conclusion is that it is for the national court to determine the tax rate which must be applied to the profits made by a branch, such as the one in dispute in the main proceedings, by reference to the overall tax rate which would have been applicable if the profits of a subsidiary had been distributed to its parent company.

II Finanzamt Offenbach am Main-Land vs Keller Holding GmbH (Case C – 471/04), European Court of Justice, 23rd February 2006

During the period 1993 to 1995, Keller Holding, which has its registered office and seat of management in Germany, held as sole shareholder the shares in another company established in Germany, Keller Grundbau GmbH. The latter in turn owned the shares in Keller Grundbau GmbH Wien, a company established in Austria.

In respect of the years 1994 and 1995, Keller Wien distributed dividends which, in accordance with the provisions of the Tax Convention, were received tax-free by Keller Grundbau, which forwarded them to Keller Holding. In accordance with Paragraph 8b(1) of the KStG, the dividends thereby redistributed were not taken into account in the calculation of the basis of assessment for corporation tax to which Keller Holding was liable.

Keller Holding deducted as operating expenditure the entire amount of the interest on the capital borrowed to acquire its shareholding in Keller Grundbau and of the incidental administrative costs. The Finanzamt Offenbach-Stadt, which was the tax office responsible at that time for Keller Holding's corporation tax, refused, by reference to Paragraph 8b(1) of the KStG in conjunction with Paragraph 3c of the EStG, the deduction of those costs to the extent to which they corresponded proportionately to the tax-free dividends, in particular those derived from Keller Wien.

The following institutions were also involved in resolving the case: Hessische Finanzgericht, Finanzamt Offenbach am Main-Land and Bundesfinanzhof.

Finally, Bundesfinanzhof referred the following question to the Court, namely whether it is contrary to Article 52, in conjunction with Article 58, of the Treaty … and to Article 73b of that Treaty … if financing costs incurred by a corporation which have a direct economic link to profits, not subject to tax in Germany, derived from a holding in a capital company established in another Member State may be deducted as operating expenditure only in so far as no profits from that holding are distributed on a tax-free basis.

The Court noticed that the situation relates to facts dating from 1994 so the provisions of the EEA Agreement relating to freedom of establishment and free movement of capital, which applied to relations between the Federal Republic of Germany and the Republic of Austria from 1st January 1994 and until the latter's accession to the European Union must be also taken into account.

Furthermore, the Court stated that tax position of a company having an indirect subsidiary in Austria, like the defendant in the main proceedings, is less favorable than it would have been had that indirect subsidiary been established in Germany. And since it has not been established that the national legislation at issue in the main proceedings is justified by overriding reasons in the public interest, it must be concluded that Article 52 of the Treaty precludes such legislation. However, as that legislation applies to events which took place in 1994, it is appropriate to refer to the provisions relating to freedom of establishment as set out in the EEA Agreement.

Consequently, the Court stated that Article 52 of the EC Treaty (now, after amendment, Article 43 EC) and Article 31 of the Agreement on the European Economic Area of 2 May 1992 must be interpreted as precluding legislation of a Member State which excludes the possibility of deducting for tax purposes financing costs incurred by a parent company subject to unlimited tax liability in that State in order to acquire holdings in a subsidiary where those costs relate to dividends which are exempt from tax because they are derived from an indirect subsidiary established in another Member State or in a State which is party to the Agreement, whereas such costs may be deducted where they relate to dividends paid by an indirect subsidiary established in the same Member State as that of the place of the registered office of the parent company and which, in reality, also benefit from a tax exemption.