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The ATAD general anti-abuse rule in Germany

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As the German tax laws contains since decades a general anti-abuse rule in Sec. 42 of the German Fiscal Code, the German legislator did not see the necessity to implement the ATAD general anti-abuse rule into German law. The German tax authorities as well as the main tax commentators are of the opinion that the minimum standard of the ATAD GAAR is completely fulfilled by the already existing German GAAR in Sec. 42 of the German Fiscal Code.

Introduction

1. The following table shows how the Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (in the following: ATAD[1]) is been reflected in German tax law. Most of the tax rules governed in ATAD - except of the anti-hybrid rules (Article 9 of the ATAD) – were already largely existent when the ATAD entered into force, such as the exit taxation, the GAAR, CFC rules. In the view of commentators, the German interest expense limitation has even been used as "best practice" for the drafting of Article 4 of the ATAD also resulting in no implementation measures. With respect to the German GAAR, no necessity had been seen to implement Article 6 of the ATAD into German tax law (see "pre-existing" in the column "Transposed") at all.

However, with respect to some of the articles of the ATAD (Articles 5, 7 and 8 of the ATAD), amendments of the German tax law are necessary to align the current version of the German tax rules to the requirements of the ATAD rules. This is especially true for the German CFC rules where such alignment should in the same time be used for a "modernization" of the German CFC rules. The amendment of the exit taxation and CFC rules, as well as a first implementation of the anti-hybrid rules should be transposed into German tax law through the Draft Law to implement ATAD into German Tax Law (draft as of 10th December 2019)[2]. Even though the deadline for the ATAD implementation has already been elapsed, there is still no formal decision by the Government to start the legislative procedure for this law.

1 See Official Journal of the European Union, 19 July 2018, L 193/1.

2 See *Entwurf eines Gesetzes zur Umsetzung der Anti-Steuervermeidungsrichtlinie (ATAD-Umsetzungsgesetz – ATADUmsG)*, 10th December 2019 (Draft Law to Implement ATAD into German Tax Law).

ATAD provision	According to German tax provisions	Transposed
Interest limitation (Article 4)	Sec.4h ITA (Income Tax Act – EStG), Sec. 8a CITA (Corporate Income Tax Act – KStG)	Pre-existing
Exit taxation (Article 5)	Sec. 6 FTA (Foreign Tax Act – AStG), Sec.4 para. 1 sent. 3-5 ITA, Sec. 12 para. 1 CITA	Pre-existing; amendment planned (Draft Law to Implement ATAD into German Tax Law as of 10th December 2019)
GAAR (Article 6)	Sec. 42 FC (Fiscal Code – AO)	Pre-existing
CFC rules (Articles 7 and 8)	Sec. 7 ff. FTA	Pre-existing; amendment planned (Draft Law to Implement ATAD into German Tax Law as of 10th December 2019)
Anti-hybrid rules (Article 9 and 9b)	Sec. 4k ITA	Implementation planned (Draft Law to Implement ATAD into German Tax Law as of 10th December 2019)

I. The anti-abuse clause in German tax law

2. A general anti-avoidance rule ("GAAR") is known in Germany since decades. The current version of the German GAAR appears in Sec. 42 FC and stems from the last amendment entering into force in the year 2008.

The German GAAR is headed as "Abuse of legal arrangements" (*Missbrauch von rechtlichen Gestaltungsmöglichkeiten*) and has the following content (non-literal translation of Sec. 42 para. 1 sent. 1 and para. 2 FC): Through the abuse of legal arrangements the tax law cannot be circumvented. An abuse is given, if (i) an inappropriate legal arrangement is chosen which results in a tax advantage which is not provided by German tax law compared to an appropriate arrangement and (ii) if the taxpayer does not prove non-tax reasons which are substantial taking into account the general view of all circumstances.

3. Even though the legislator tried to define the term "abuse", due to the non-specific description – which is in the nature of the term "abuse" – **it was and still is in the responsibility of the jurisprudence to define the conditions of the German GAAR**[3].

The burden of proof with respect to the inappropriateness of the legal arrangement lies with the tax authorities, however, the substantial non-tax reasons need to be proven by the taxpayer.

In principle, a taxpayer is free to structure its business in a tax efficient way. It is not inappropriate as such to aim for tax advantages. However, according to the tax authorities, a legal arrangement is inappropriate if the taxpayer choses an unusual way instead choosing a course of action as typically intended by the legislator. Therefore, a legal arrangement is seen as inappropriate if a rational acting party would not choose such an arrangement taken into account the actual situation and the intended economic aim. Thus, uneconomic, cumbersome, complex or artificial arrangements should qualify as inappropriate in the view of the tax authorities.

In case an abuse of legal arrangements is given, the tax liability will be calculated pretending an appropriate legal arrangement would have been conducted based on the economic circumstances.

4. How ATAD Directive's anti-abuse clause has been transposed into German domestic law - The German tax authorities were of the opinion that the minimum standard of the GAAR as regulated in the ATAD is completely fulfilled by the already existing German GAAR in Sec. 42 FC[4]. Also the prevailing opinion in the literature states that it is not evident that there could be cases which could fall under the ATAD-GAAR, but not under Sec. 42 FC, *i.e.*, the German GAAR. Thus, no changes of the German GAAR took place due to the ATAD. The ATAD does not explicitly specify which action a Member State has to pursue in case the Member State is of the opinion that no change of the law is required. Therefore, no transposition note is required when national law already corresponds to the content of a directive[5].

To conclude, as it was considered that the German GAAR does fulfill the required minimum standard of a GAAR by ATAD, the German legislator did not introduce a new GAAR or amend the already existing GAAR.

5. How local tax authorities are going to apply the provisions transposing ATAD's anti-abuse rule (*i.e.*, including issued tax authorities' guidelines or statements) - As, according to the guideline issued by the German tax authorities how to apply the Fiscal Code ("*AO-Anwendungserlass*"), the minimum standard of the ATAD GAAR is already provided by the German GAAR as governed in Sec. 42 FC, there should be no different application of the GAAR just because of the entry into force of ATAD.

II. Articulation of the new rule with the existing legal framework and case law

6. As there has been no implementation of the ATAD GAAR into German domestic tax law, the interaction between the German GAAR in Sec. 42 FC and the special anti-abuse rules (SAARs) existing in the German tax law will be discussed[6].

A. Articulation of the German general anti-abuse clause with other German special anti-abuse domestic provisions

7. In the German tax literature, there exists a long standing discussion how the GAAR in Sec. 42 FC and the SAARs (special anti-abuse rules) do interact.

Based on jurisprudence, the prevailing opinion states that in case a SAAR exists for the legal arrangement under consideration and the prerequisites of this applicable SAAR are not fulfilled, the German GAAR (*i.e.*, Sec. 42 FC) should not be applicable. Thus, in case the result of the assessment of a SAAR results in the outcome that no abuse is given, there should be no further assessment based on the GAAR whether an abusive structuring has been conducted.

However, this opinion has been rejected by the German tax authorities which pretended that both, the SAAR and the GAAR, need to be assessed in a cumulative manner. Thus, the legislator changed the wording in Sec. 42 para. 1 FC as follows (non-literal translation):

3 See also Kraft, IStR 2018, p. 614.

4 See Franz; DStR 2018, p. 2242; AEAO § 42 Nr. 2.7.

5 See Franz; DStR 2018, p. 2241

6 See for a detailed analysis, Kraft, IStR 2018, p. 614.

- in case the requirements of a SAAR are fulfilled, the tax consequences are to be determined based on this specific SAAR (Sec. 42 para. 1 sent. 2 FC) ;

- in case the requirements of an applicable SAAR are not fulfilled, the tax liability is – if an abusive situation is given – to be determined as it would arise in case of an appropriate legal arrangement taking into account the economic circumstances (Sec. 42 para. 1 sent. 3 FC).

To summarize, and this is also the opinion of the German tax authorities, **the GAAR is to be applied even though a SAAR is provided to tackle an abuse of the law targeting a specific situation and the assessment of the prerequisites of this SAAR has come to the result that this SAAR is not applicable**. As one can imagine, this view is heavily criticized in German tax literature, and there are also voices of German tax judges that might interpret the law in a slight different way. However, it has to be noted that the tax court of Hamburg has recently ruled[7] that an existing, but non-applicable SAAR (because the prerequisites were not given) does not prevent the application of the German GAAR if targeted steps were used in order to circumvent the specifics of the SAAR (so-called qualified tax abuse). This decision has been appealed and waits for a decision of the German Federal Tax Court since 2 years[8].

8. In this respect it is also quite interesting how the ATAD copes with this interaction of GAAR and SAAR. Even though there is no explicit rule provided for in the Directive determining whether a SAAR and the ATAD GAAR are cumulatively applicable or whether the GAAR should not be applicable in case a SAAR is existent, one can find at least some hints in the **recitals of the ATAD**. Recital 11 states that "*General anti-abuse rules (GAARs) feature in tax systems to tackle abusive tax practices that have not yet been dealt with through specifically targeted provisions. GAARs have therefore a function aimed to fill in gaps, which should not affect the applicability of specific anti-abuse rules.*" (underlined by us). In my view, this statement does support the view that a GAAR should only be applicable if no SAAR exists for the situation in question.

9. Another argument for the precedence of the given SAAR could be taken from the **Roman law**. The more specific law takes precedence over the more general law (*lex specialis derogat legi generali*). This principle serves to avoid contradictions when several rules were to apply. It is based on the presumption that the legislator did not want to create a regulation with a limited scope of application which is largely without scope or whose purpose is thwarted, since a more general regulation can always be reverted to. Thus, also the principle of *lex specialis derogat legi generali* could be used as an argument for having the SAAR precedence of the GAAR.

B. Articulation of the German anti-abuse clause with other anti-abuse provisions transposing EU secondary law (*i.e.* Parent subsidiary Directive, Interest and Royalty Directive, Merger Directive, etc.)

10. Most of the anti-abuse rules governed in EU Directives have been implemented or were already reflected in German tax law. Thus, the way of interaction between the German GAAR and these EU SAARs will be described in the following.

1° Parent-Subsidiary Directive

11. The Parent-Subsidiary Directive[9] contains a SAAR close to the wording of the ATAD GAAR: "*Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances.*" In addition, the Parent-Subsidiary Directive includes also a rule with respect to the interaction of the Parent-Subsidiary Directive SAAR and domestic anti-abuse rules: "*This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse.*"

The German GAAR in Sec. 42 FC as well as the anti-directive shopping rule of Sec. 50d para. 3 ITA have been implemented far before the aforementioned SAAR has been included in the Parent-Subsidiary Directive. Thus, again, the German legislator did not see any necessity to implement the Parent-Subsidiary SAAR into German tax law.

In a nutshell, Sec. 50d para. 3 ITA is intended to prevent taxpayers from abusively benefiting from withholding tax relief under double taxation agreements (DTAs) or EU directives, in particular the Parent-Subsidiary Directive, through the interposition of companies without genuine economic business.

In a guidance of the German tax authorities[10], the interaction between Sec. 50d para. 3 ITA and Sec. 42 FC is explicitly governed as follows: In principle, Sec. 50d para. 3 ITA is the more specific provision and therefore should have precedence of the GAAR. However, in case the conditions of Sec. 50d para. 3 ITA are not met, the GAAR in Sec. 42 FC is to be examined since its applicability is not excluded by Sec. 50d para. 3 ITA or any other legal provision.

Based on jurisprudence of the Federal Court of Justice to Sec. 50d para. 3 ITA (so-called *Hilversum-decisions*), this order of application could be questioned[11].

7 27 June 2017, 6 K 127/16: EFG 2017, p. 1718.

8 See reference number: BFH I R 52/17.

9 Council Directive 2011/96/EU, 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast) : OJ L 345, 29 December 2011, p. 8.

10 See Guidance of the Federal Ministry of Finance to Sec. 50d para. 3 ITA, as of 24 January 2012, IV B 3 - S 2411/07/10016.

11 See Kraft, IStR 2018, p. 614 (621).

2° Interest and Royalty Directive

12. The Interest and Royalty Directive[12] contains a SAAR with the following wording: "*Member States may, in the case of transactions for which the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse, withdraw the benefits of this Directive or refuse to apply this Directive.*" In addition, the Interest and Royalty Directive includes also a precedence rule: "*This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse.*"

The German legislator has implemented quite literally the anti-abuse provision of the Interest and Royalty Directive in Sec. 50g para. 4 sent. 1 ITA. With respect of questions of precedence, Sec. 50d para. 4 sent. 2 ITA states that the application of the anti-abuse provision in the anti-directive shopping rule of Sec. 50d para. 3 ITA should not be affected by Sec. 50g para. 4 sent. 1 ITA. Thus, the order of application could be seen as follows: First, Sec. 50d para. 3 ITA has to be applied, second Sec. 50g para. 4 ITA and finally, the GAAR in Sec. 42 FC.

3° Merger Directive

13. The Merger Directive[13] contains the following SAAR: "*A Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Articles 4 to 14 where it appears that one of the operations [...] has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that the operation is not carried out for valid commercial reasons such as the restructuring or rationalization of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives.*" A rule stating a precedence of the domestic anti-abuse rules is not included.

The German Reorganization Tax Act (RTA - "*Umwandlungssteuergesetz*") does not include a general anti-abuse rule with respect to reorganizations. There are some specific anti-abuse rules in the RTA which, *e.g.*, deny in certain situations the use of losses. The Federal Tax Court ruled that the existence of these special anti-abuse rules precludes the application of the German GAAR. The reasoning was as follows: The German legislator identified certain abusive situations with the use of losses in merger constellations and included a specific anti-abuse rule to prevent this unwanted use of the losses. Thus, any other constellation which is not covered by this specific anti-abuse rule should be qualified as non-abusive and, thus, there should be no room for the application of the GAAR[14].

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12 Council Directive 2003/49/EC, 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States : OJ L 157, 26 June 2003, p. 49.

13 Council Directive 2009/133/EC, 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States, codified version : OJ L 310, 25 November 2009, p. 34.

14 See Federal Tax Court (BFH), 18 December 2013, I R 25/12, BFH/NV 2014, p. 904. This decision is not applied by the German tax authorities. See also Kraft, IStR 2018, p. 614 (621).