Case C-431/21

Summary of the request for a preliminary ruling pursuant to Article 98(1) of the Rules of Procedure of the Court of Justice

Date lodged:

15 July 2021

Referring court:

Finanzgericht Bremen (Germany)

Date of the decision to refer:

7 July 2021

Applicant:

X GmbH & Co. KG

Defendant:

Finanzamt Bremen

Subject matter of the main proceedings

Tax law – Transactions with a foreign element – Obligation to keep records on the nature and content of business relations with related parties – Arm's length principle – Sanctions in the event that such records are not submitted or are unusable

Subject matter and legal basis of the request

Interpretation of EU law, Article 267 TFEU

Question referred for a preliminary ruling

Must Article 43 of the EC Treaty and Article 49 TFEU, which guarantee the freedom of establishment (or, respectively, Article 49 of the EC Treaty and Article 56 TFEU, which guarantee the freedom to provide services), be interpreted as precluding national legislation under which, in situations involving transactions with a foreign element, the taxpayer must keep records on the nature and content

of his or her business relations with related parties, including the economic and legal bases for an arm's length agreement on prices and other terms and conditions with the related parties, and under which, where the taxpayer fails to submit those records when requested to do so by the tax authority, or where the records submitted are fundamentally unusable, not only is there a rebuttable presumption that his or her income subject to tax domestically, which such records serve to determine, is higher than the income that he or she has declared, and, if in such cases the tax authority is required to make an estimate and such income can be determined only within a certain range, in particular only on the basis of price bands, the upper value of that range may be taken as the basis to the detriment of the taxpayer, but, in addition, a surcharge is to be imposed which is at least 5 per cent and at most 10 per cent of the excess income determined, but not less than EUR 5 000, and which, in the event that usable records are submitted late, is up to EUR 1 000 000, but not less than EUR 100 for each full day of delay, whereby the imposition of a surcharge is to be waived only if the non-compliance with the record-keeping obligations appears to be excusable or if any fault involved is only minor?

Provisions of European Union law relied on

Articles 49 and 56 TFEU

Provisions of national law relied on

Paragraph 90(3) of the Abgabenordnung (German Tax Code; 'the AO') in the version of 29 July 2009. That provision provides, inter alia, that, in situations involving transactions with a foreign element, a taxpayer must keep records on the nature and content of his or her business relations with related parties within the meaning of Paragraph 1(2) of the Außensteuergesetz (Law on foreign transaction tax; 'the AStG'). The obligation to keep records also includes the economic and legal bases for an arm's length agreement on prices and other terms and conditions with the related parties.

Paragraph 162(3) of the AO in the version of 14 August 2007. That provision reads, inter alia: 'If a taxpayer infringes his or her obligations to cooperate under Paragraph 90(3) by failing to submit records, or if records submitted are fundamentally unusable, or if it is established that the taxpayer has not kept records within the meaning of the third sentence of Paragraph 90(3) in a timely manner, there shall be a rebuttable presumption that his or her income subject to tax domestically, which the records within the meaning of Paragraph 90(3) serve to determine, is higher than the income that he or she has declared. If, in such cases, the tax authority is required to make an estimate and such income can be determined only within a certain range, in particular only on the basis of price bands, the upper value of that range may be taken as the basis to the detriment of the taxpayer.'

Paragraph 162(4) of the AO in the version of 13 December 2006. According to that provision, the tax authority may impose, inter alia, a surcharge of EUR 5 000 if a taxpayer fails to submit records within the meaning of Paragraph 90(3) or if the records submitted are fundamentally unusable.

Paragraph 1(2) of the AStG in the version of 14 August 2007. That provision reads as follows: 'A party is related to a taxpayer if:

1. the party has a direct or indirect shareholding in that taxpayer of at least 25% (substantial shareholding) or can exercise direct or indirect influence over the taxpayer or, conversely, where the taxpayer has a substantial shareholding in that party or can exercise direct or indirect influence over that party; or

2. a third party has a substantial shareholding in that party or taxpayer, or can exercise direct or indirect influence over the party or the taxpayer; or

3. the party or the taxpayer is in a position, when agreeing the terms of a business relationship, to exercise an influence on the other which has its source outside that business relationship, or if one of those parties has a particular interest in the other's generation of income.'

Succinct presentation of the facts and procedure in the main proceedings

1 The applicant is a limited partnership (KG) having its registered office in Germany. Its commercial purpose was the holding and management of participations, in particular of undertakings resident in Germany, as well as the provision of services to affiliated undertakings and third parties. It held 100% of the shares in a subsidiary limited liability company (GmbH) having its registered office in Germany, which, in turn, held 100% of the shares in four other limited liability companies having their registered offices in Germany (controlled companies).

2 The applicant's general partner, which was authorised to represent it, was a limited liability company which also had its registered office in Germany. The applicant's sole limited partner was a company (B.V.) having its registered office in the Netherlands. Its sole shareholder was Y N.V., which also had its registered office in the Netherlands. Y N.V. therefore indirectly held 100% of the shares in the applicant through its shareholding in the applicant's limited partner. In 2013, the limited liability company (GmbH) which was the applicant's general partner was merged with the applicant.

3 Y N.V. provided services to the applicant on the basis of a business management contract. Various persons, who worked as managing directors or in other positions at Y N.V. or in other companies of the group, were engaged to that end.

4 In accordance with the business management contract, the remuneration was to be based on the costs and expenses actually incurred. Those were to include direct

and indirect costs. In particular, wage costs incurred were to be reimbursed. By contrast, costs incurred for activities in the interests of the shareholders of Y N.V. (shareholder's costs) were not to be billed. Y N.V. was obliged to record and document in full the reimbursable costs and expenses. After the end of the calendar year, Y N.V. was to establish a final account, which was to be sufficiently detailed to enable the applicant to charge the costs in question in turn to the controlled companies. However, Y N.V. did not provide the applicant with detailed annual accounts on the services provided and the costs incurred.

5 On the basis of a tax audit notice of 17 January 2012, an audit was conducted at the applicant in respect of the years 2007 to 2010. The subject of the audit was, in particular, the management fees paid by the applicant to Y N.V. At the beginning of the audit, the applicant was informed that the focus of the audit was, inter alia, the transfer prices and the documentation pertaining to the foreign element.

6 In the course of the audit, the applicant submitted various documents to substantiate the chargeable costs incurred by the applicant on the basis of the business management on the part of Y N.V. Documents were requested on several occasions in the context of the audit. The subject of the inquiries made in respect of the audit and the documents submitted by the applicant were, in particular, the possible double counting of individual cost items, the inclusion of shareholder's costs and the determination of the staff costs taken into account. With regard to the staff costs, the audit questioned in particular the number of hours worked, the determination of the hourly rates and the appropriateness of the hourly rates. The audit criticised the applicant's lack of arm's length documentation (*Angemessenheitsdokumentation*) on several occasions. In its view, such documentation is a necessary part of the documentation under Paragraph 90(3) of the AO.

7 On 17 March 2016, the applicant and the defendant, with the participation of Y N.V., entered into an agreement on the facts in respect of the audit period, by which they agreed that the management fee amounts recorded by the applicant as operating expenses in the years 2007-2010, in the amount of EUR 400 000.00 per year (EUR 1.6 million in total), would be regarded as not being appropriate.

8 In the audit report of 10 June 2016, it was stated that the factual documentation (*Sachverhaltsdokumentationen*) and arm's length documentation submitted by the applicant did not allow the facts to be sufficiently clarified. The report stated that that was why the agreement on the facts had been concluded. It also stated that the documentation submitted was not usable. In accordance with Paragraph 162(3) and (4) of the AO, a surcharge of at least 5% of the excess income per year is to be imposed, that is to say EUR 20 000.00 per year. Consequently, by notice of 8 November 2016, the defendant imposed on the applicant, in accordance with Paragraph 162(4) of the AO, a surcharge of EUR 20 000 for each of the tax assessment periods 2007, 2008, 2009 and 2010, in the amount of EUR 80 000.

9 The applicant filed an objection to the imposition of that surcharge; it was dismissed as unfounded. The applicant then brought an action before the referring court.

The essential arguments of the parties in the main proceedings

10 The applicant considers that the records submitted met the statutory requirements. It submits that the defendant imposes excessive demands on the requirements for the records to be submitted. According to the applicant, the records can be regarded as being fundamentally unusable only if the deficiencies are of such seriousness that the submission of the deficient records is tantamount to a complete failure to submit records. However, the defendant carried out an intensive examination of the records submitted by the applicant, a circumstance which militates in favour of the records being usable.

11 In its view, Paragraph 162(4) of the AO in particular infringes EU law because it unjustifiably discriminates against cross-border business activities. Paragraph 162(4) of the AO applies only to taxpayers who maintain business relations with related parties that are based abroad. According to the applicant, this restricts the freedom of establishment guaranteed under EU law. Such interference cannot be justified. In particular, it is not necessary to impose a tax surcharge that is applicable exclusively to cross-border business relations.

12 The defendant defends the imposition of the surcharge primarily with the argument that the records submitted are fundamentally unusable because the applicant did not submit any arm's length documentation demonstrating efforts made to reach an arm's length agreement. In addition, it emerged from information communicated by the Dutch tax authority that no records of working hours had been kept at Y N.V. for the purposes of billing the applicant. According to the defendant, the unusability of the records submitted results directly from that. Even if it were assumed that the records submitted were usable, they had in any event been submitted late, which can also justify the surcharge. An infringement of EU law is not apparent.

Succinct presentation of the reasoning in the request for a preliminary ruling

13 The referring court has doubts as to the compatibility of Paragraph 162(4) of the AO with Article 49 TFEU and, respectively, Article 56 TFEU. It considers the provisions on freedom of establishment to be applicable first and foremost. However, should the provisions on the freedom to provide services be applicable, the referring court takes the view that the same questions would arise in that connection.

14 Paragraph 90(3) of the AO provides for special record-keeping obligations for cross-border business relations with related parties. Paragraph 162(4) of the AO prescribes the imposition of a surcharge if the taxpayer does not submit records

upon request or submits them late, or if the records submitted are fundamentally unusable.

15 The referring court takes the view that those provisions constitute a restriction of the freedom of establishment, because a domestic taxpayer who maintains business relations with related parties that are resident in another Member State is subject to special record-keeping obligations, and failure to submit the required records leads to a sanction in the form of a surcharge, whereas those special record-keeping obligations and the imposition of such a surcharge are not provided for in respect of taxpayers with business relations with domestic related parties.

16 The requirement of special records and the threat of negative consequences in the event of non-compliance with the record-keeping obligation is likely to impede the freedom of establishment. This is because persons from other Member States might refrain from setting up subsidiaries in Germany or establishing business relations with them in order to avoid incurring expenses and costs for keeping special records in respect of those subsidiaries and to avoid the risk of surcharges being imposed at the expense of the subsidiary in the event of non-compliance with the record-keeping obligations (see, in that regard, judgment of 21 January 2010, *SGI*, C-311/08, EU:C:2010:26).

17 The referring court takes the view that, in particular, the objective of preventing tax avoidance and the objective of preserving the balanced allocation between the Member States of the power to tax enter into consideration as justification for the restriction of the freedom of establishment. Combating tax avoidance may justify also measures aimed at ensuring the effectiveness of fiscal supervision.

18 National legislation which seeks to prevent profits generated in the Member State concerned from being transferred outside the tax jurisdiction of that Member State via transactions that are not in accordance with market conditions, without being taxed, is in principle appropriate for ensuring the preservation of the allocation of powers of taxation between the Member States (see judgment of 31 May 2018, *Hornbach-Baumarkt*, C-382/16, EU:C:2018:366).

19 The objective of Paragraphs 90(3) and 162(4) of the AO is to prevent profit shifting carried out for reasons pertaining to company law between affiliated undertakings, from Germany to other countries. By means of the records to be kept pursuant to Paragraph 90(3) of the AO, the tax authorities are to be enabled to verify compliance with arm's length principles and thus the proper allocation of profits. The threat of the surcharge is intended to increase the willingness of taxpayers to comply with the record-keeping obligations.

20 The provisions therefore fundamentally serve legitimate purposes. They also appear to be appropriate for attaining those objectives. However, the question arises as to whether those provisions are necessary to attain the objective pursued. The referring court takes the view that, even on the assumption that

Paragraph 90(3) of the AO is to be assessed as being in conformity with EU law (as found by the Bundesfinanzhof (Federal Finance Court, Germany) in a decision from 2013), it appears doubtful whether Paragraph 162(4) of the AO is compatible with EU law from the perspective of necessity, as that provision goes beyond what is necessary to achieve the legitimate objective.

21 It is true that the obligation to keep records under Paragraph 90(3) of the AO would be largely devoid of purpose if the legislature did not attach to non-compliance any negative consequences for the taxpayer. That does not mean, however, that any sanctioning of the infringement of the obligation would be justified. Referring to the judgment of 21 January 2010 in *SGI* (C-311/08, EU:C:2010:26), the referring court recalls that legislation is necessary for the attainment of the pursued objective only if it is limited to the correction of arrangements which are inconsistent with the arm's length principle.

22 Moreover, it should be noted that, in addition to the provision on the surcharge under Paragraph 162(4) of the AO, German law provides for a further sanction in Paragraph 162(3) of the AO where the taxpayer infringes his or her obligations to cooperate. In accordance with that provision, there is a rebuttable presumption that the income subject to tax domestically, which the records within the meaning of Paragraph 90(3) of the AO serve to determine, is higher than the income declared by the taxpayer. In addition, where the tax authority makes an estimate of income that can be determined only within a certain range, in particular only on the basis of price bands, it may take the upper value of that range as the basis to the detriment of the taxpayer.

23 That provision already attaches far-reaching tax consequences to the non-compliance with the record-keeping obligations under Paragraph 90(3) of the AO, with the result that it appears to be ensured that any arrangements that do not comply with the arm's length principle are corrected and the taxpayer does not derive any tax advantage from infringing the obligation. By contrast, the (additional) imposition of a surcharge pursuant to Paragraph 162(4) of the AO does not further contribute to ensuring that tax assessment is as correct as possible and takes the arm's length principle into account. Rather, it appears to serve solely as a sanction for an infringement of the obligations to cooperate under Paragraph 90(3) of the AO.

24 The doubts as to the necessity of the surcharge provision are reinforced by the provisions on the determination of the amount of the surcharge. For instance, the amount of the surcharge is linked to the excess income determined and is therefore not directly dependent on the actual tax effect of the determinations. Furthermore, if the conditions are met, the surcharge is to be set at the amount of EUR 5 000 even if excess income ultimately could not be determined. Moreover, although the surcharge is limited to a maximum of 10 per cent of the excess income determined, no absolute ceiling is set for the surcharge – except in the case of late submission of records.

25 Since the referring court takes the view that a justification appears doubtful, the question set out above is referred to the Court of Justice for a preliminary ruling.