# New financial freedom of establishment

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The European Court of Justice declares the German tax provision to the detriment of EU foreigners to be null and void.
Once again, German legislators suffered defeat before the European Court of Justice. After the European Court of Justice had already recently made adverse decisions regarding German regulations in the field of corporate law and balance sheet law, now section 8a I No. 2 Corporation Income Tax Act (KStG) was put under the European microscope - and it failed the inspection.
A corporation/ private limited company can be financed either with equity capital or borrowed capital.
Equity capital represents the company's own risk resources raised by the partners, this is essentially the original capital share (nominal capital) and the capital reserves. The nominal capital of a private limited company must currently be at least r 25,000.00. Of course, it is up to the partners if they wish to provide the company with a higher nominal capital.
Borrowed capital represents resources which third parties place at the company's disposal. Third parties in the sense of this terminology can also be the partners themselves. They can meet the financial requirements of their company by a loan - partner's debt financing as it is termed.
The focus is especially on the tax benefits resulting from such forms of financing. These are caused by the fact that interest is admitted to deduction of operating expenses as compensation for the granting of borrowed capital and thus reduces the company's taxable profit. This method was cultivated in practice so extensively that it resulted in a complete - often cross-border - skimming-off of excess profits.
With the introduction of section 8a KStG in 1994, which has now been declared null and void by the European Court of Justice, the fiscal authorities tried to redress this problem. The outcome of this provision was that the compensations for the exploitation rights were turned into hidden profit distributions and as a consequence, a deduction of operating expenses was to a large extent no longer possible. The prerequisites for the application of section 8a KStG were that a non-resident or a person close to him or her places borrowed capital at the disposal of a domestic corporation and that the borrowed capital exceeds triple the proportionate equity capital of the non-resident (safe haven 3:1).
The ECJ has now clearly rejected this regulation that is definitely disadvantageous for non-residents and discriminates against them: such a regulation violates the European freedom of establishment and is thus not applicable. This decision directly applies to non-residents who are resident in an EU country; they can directly refer to this decision before the German fiscal authorities.
For non-residents who are not resident in an EU country this decision has no direct effect. However, they have the possibility to benefit from this decision within the context of "Forum Shopping". Thus it would be worth considering whether in future non-residents have an interest in a German corporation in an EU country. Then a complete partner's debt financing can again be carried out. This is even more advantageous compared to the previous tax credit method due to the meanwhile introduced taxation system with capital yields (half-income method). Especially if

the lender's registered office is in Ireland with its tax rates in the category of tax havens, very interesting yields can be obtained.
The way back with the aim to enact a law with the contents of the old section 8a KStG also for national partners fails because of legal positions protected by the German constitution.