Tax Notes Int'l, Nov. 10, 2014, p. 483; and *Tax Notes Int'l*, Sept. 22, 2014, p. 985.)

Cross-border hybrid mismatches normally result in either a deduction being allowed in one country with no corresponding recognition of income in another or a deduction being allowed for the same expense in two different countries, Morgan said. ''A lot of that is going to be stopped,'' he said. ''And we'll see the cost of financing generally going up as a result.''

Morgan said much of the success of any initiative to crack down on cross-border tax avoidance depends on to what extent the U.S. is on board. ''If the U.S. doesn't change its subpart F rules, [the multinational companies] will shift financing outside Europe and maybe start using Bermuda, Singapore, or Hong Kong entities,'' he said. ''That's a big unknown. [The European countries] talk about limiting interest deductions, but there is only so far you can go with that.''

Information Sharing and the CCCTB

In the press briefing, Vestager said previous attempts to share information on personal bank accounts and establish a common European tax base for companies made slow progress, in part because EU governments have to act in unison on these issues.

Morgan said recent developments making the expanded exchange of financial information a reality might be too much of a good thing, at least from the tax authorities' point of view.

''The problem here is [that] perhaps we have too much information, not too little,'' Morgan said, referring to the U.S. Foreign Account Tax Compliance Act, the OECD's common reporting standard, and the EU savings tax directive. ''The bottom line here is we're going to have very extensive exchange of information. We'll have so much, it will be hard for tax authorities to do anything with it.''

Morgan also played down expectations for the common consolidated corporate tax base initiative, which calls for allocating multinational companies' taxable income among the EU member states in which they operate. ''It's nothing like as simple as it sounds,'' he said. ''You can't apply the same approach to a bank as you do to a manufacturing company.'' Morgan said he doubts that many EU member states will be willing to surrender their sovereignty over taxation to make the common consolidated corporate tax base a reality anytime soon.

Vestager also said her agency must be thorough in its investigations into whether three EU countries conferred illegal state aid on multinational companies. Under EU law, no member state can grant to a company an advantage that isn't generally available to its competitors. The investigations involve rulings given by Luxembourg to Amazon EU Sàrl in 2003 and to Fiat Finance and Trade Ltd. SA in 2012; by Ireland to Apple Operations Europe and Apple Sales International in 1991 and 2007; and by the Netherlands to Starbucks BV in 2008. Vestager said on December 11 that she expects her office to complete the investigations by the second quarter of 2015. (Prior coverage: *Tax Notes Int'l*, Dec. 15, 2014, p. 985.)

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Germany

Court Orders Revisions to Inheritance Tax Regime

Germany's Federal Constitutional Court on December 17 held that elements of a law exempting successors of family-owned companies from paying inheritance tax are unconstitutional and ordered the government to revise and tighten the law by mid-2016.

According to the court, the Inheritance and Gift Tax Act, which allows families to pass companies on to the next generation tax free, violates the German constitutional principle of equality because it also exempts heirs from paying inheritance taxes on non-company assets. The court criticized the fact that even though the law applies to all family-run companies regardless of size, it doesn't require checks to determine whether the exemption is economically necessary for larger companies.

Also, the court said exempting companies employing fewer than 20 people from compliance requirements to show they qualify for the tax break disproportionately privileges smaller companies.

Despite those criticisms, the court emphasized that it's constitutional to grant some form of inheritance tax exemption for family-run companies to ensure job preservation during a company succession and ordered that the current law remain in place until the government fixes it by June 30, 2016. However, it gave the government the option to amend the law retrospectively to the day of the decision.

Under the current regime, last amended in 2009, corporate assets may be passed to heirs tax free as long as the heirs keep the assets for at least seven years without firing a significant number of employees. The Federal Fiscal Court challenged the law, arguing that it unfairly favored family-owned businesses.

Michael Meister, parliamentary state secretary at the Federal Ministry of Finance, welcomed the judgment in a December 17 statement, noting that the Constitutional Court objected to only some elements of the Inheritance and Gift Tax Act, and not to the constitutionality of tax breaks for family-owned businesses. The MOF will hold consultations with the country's 16 *Länder*, or states, in early 2015 to get stakeholder input on amendments to the law.

Andreas Richter of the Berlin office of P+P Pöllath + Partners told Tax Analysts that the federal government will act more or less as a mediator between the states to ensure the proper reform of the inheritance tax law because all the revenue from the tax goes to the states. He also noted that even though inheritance tax does not account for a large amount of revenue in general, it is particularly important for some states, such as Hamburg, Bavaria, and North Rhine-Westphalia.

However, Richter said he expects some political debate about whether to apply the amendments retroactively. He noted that the decision seems to suggest that the government should introduce retroactive changes to only specific elements of the inheritance tax exemption regime, but that some legal observers say those changes should be applied to the entire regime.

Close Watch

Both politicians and the business sector, particularly the so-called *Mittelstand*, which comprises millions of privately owned small and medium-size companies that account for 90 percent of businesses in Germany, have been keeping a close eye on the court's decision. Critics of the law have argued that the exemption is too generous and gives high-income individuals yet another way to avoid paying taxes, but its supporters say that eliminating or restricting the exemption will lead to the sell-off or total collapse of family-owned companies.

Richter said the outcome wasn't a surprise. ''Everyone was preparing for this,'' he said. ''I would say this is not what people hoped for, but if you really followed the debate on a political level, then this is very much within the parameters of what was expected.''

Many entrepreneurs are relieved that the concept of the exemption is constitutionally justified, said Ninja-Antonia Reggelin, tax policy adviser at Die Familienunternehmer — ASU EV, an association representing German family entrepreneurs. ''This provides the necessary legal certainty family entrepreneurs have been waiting for,'' she told Tax Analysts.

One challenge for larger family-run businesses is having to meet a ''needs test'' to show the exemption is necessary to keep running, according to Reggelin. However, it's unclear what criteria that test will have and to what size companies it will apply. She said the court's vague wording could give the government many options. In the worst case, family business successors will face a ''huge compliance burden'' or, if they fail the test, end up paying the full inheritance tax amount anyway. ''That of course is very worrying for bigger family companies,'' she said.

Regarding the court's criticism of the compliance requirement exemption for family companies that employ fewer than 20 people, Reggelin said the government initially thought the compliance requirement wasn't necessary and would be only a bureaucratic burden on smaller companies but that the court disagreed. ''Generally, entrepreneurs agree with the requirement to provide proof of securing jobs in the company for a certain period of time,'' she said. ''They don't want to take anything for granted, so they will show they can do this even though it's a bureaucratic hassle and may not be easy.''

Reggelin noted that the current regime makes it possible to create ''cash companies'' into which individuals could funnel private assets separately from company assets. Germany introduced new legislation last year to crack down on those kinds of structures, but the court held that there's an even greater need for stricter rules. ''This is something family entrepreneurs also agree with; we don't want any tax avoiders to profit from the rules,'' Reggelin added.

Richter said he expects a few weeks of uncertainty for family-owned companies following the court's decision. ''Those who feel the need to transfer businesses will sit down and talk to us and really look at various scenarios and look for solutions if those scenarios come about,'' he said.

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India

Lower Court Holds Against Vodafone In Call Center Sale

India's Income Tax Department has jurisdiction to issue a tax assessment against Vodafone India Services Private Ltd. for underreporting its capital gains on the 2007 sale of a call center in Ahmedabad to Hutchison Whampoa Properties, the Income Tax Appellate Tribunal (ITAT) held December 10.

In its decision, the ITAT wrote that the transaction was structured to ''circumvent the transfer pricing provisions of the Income Tax Act'' and was effectively an ''international transaction between two related parties and thus would be subject to the transfer pricing provisions.''

The call center transaction was part of a larger agreement through which Hutchison Whampoa sold its separate telecoms business in India to Vodafone in 2007. That transfer was accomplished by the sale of a Hutchison Whampoa subsidiary based in the Cayman Islands in a transaction that was the subject of a separate assessment by Indian tax authorities, who claimed that Vodafone owed $2.2 billion in capital gains tax. In 2012 the Indian Supreme Court decided in Vodafone's favor on the grounds that the Central Board of Direct Taxes does not have authority to tax overseas transactions.