

CJEU rules German trade tax rules violate EU law

CJEU rules that German trade tax rules that impose stricter conditions for the deduction of profits from shareholdings in a non-EU company than from German shareholdings violate the EU free movement of capital principle.

The Court of Justice of the European Union (CJEU) issued a decision on 20 September 2018 ([C-685/16, EV](#)), concluding that German provisions that result in the different tax treatment of dividends received from subsidiaries resident in non-EU countries and EU member states are in breach of the free movement of capital principle in the Treaty on the Functioning of the European Union ([TFEU](#)).

Facts of the case

The case involves the German trade tax treatment of dividends received by German companies from non-EU (third country) shareholdings that were not eligible for a tax exemption under the [EU parent-subsidiary directive](#). German legislation provides that dividends from domestic shareholdings are exempt from trade tax provided the parent company holds at least 15% of the subsidiary's share capital. However, the requirements for exemption in respect of third-country shareholdings are more restrictive. In addition to the minimum holding requirement, the distribution also must satisfy other conditions, such as that the 15% minimum shareholding be held continuously throughout the reference period, not merely at the start of the period, and other conditions relating to distributions between sub-subsidiaries.

Decision of the CJEU

The CJEU held that the restrictions under German law could not be justified and, therefore, that they violate the TFEU based on the following analysis.

Article 63 TFEU on the free movement of capital

Based on previous case law, the tax treatment of dividends could fall within the scope of article 49 TFEU on the freedom of establishment and article 63 TFEU on the free movement of capital. Therefore, the purpose of the relevant legislation must be considered. The CJEU also has previously stated that national legislation relating to the tax treatment of dividends that does not apply exclusively to situations in which the parent company exercises decisive influence over the company paying the dividends, should be assessed in light of article 63 TFEU. The actual size of the shareholding in a payer company established in a non-EU member state is not decisive.

In this case, the holding of at least 15% of the share capital of a subsidiary does not necessarily imply that the company holding those shares exercises a definite influence over the decisions of the payer company. Therefore, the German trade tax rules must be assessed in the light of article 63 TFEU. The German rules could not benefit from the grandfathering provisions of article 64(1) TFEU, which specifically excludes certain types of third-country capital restrictions in existence before a particular date, as the rules had previously been amended on several occasions.

Restrictions on the movement of capital

In the present case, the German trade tax rules provide for different treatment of dividends distributed by a resident company and dividends distributed by a company established in a non-EU member state. The conditions for the deductibility for trade tax purposes of dividends paid by subsidiaries established in non-EU member states are more stringent than those applying to dividends paid by resident companies. Consequently, it must be held that the stricter rules violate the free movement of capital.

No justification for differential treatment

The CJEU also held that the difference in treatment must concern situations that are not objectively comparable or must be justified by an overriding reason in the public interest. As the main purpose of the German trade tax exemption is to prevent double taxation by allowing a deduction from the trade tax base for dividends from shareholdings in one or more capital companies, the situation of a company receiving dividends distributed by

resident companies is comparable to that of a company receiving income from shareholdings in nonresident companies. The rules cannot be justified by the need to prevent abuse and tax evasion as they stipulate an irrebuttable presumption of abuse. The CJEU therefore concluded that the restrictions under German law could not be justified and violate the TFEU.

Comment

Resident taxpayers that have been subject to trade tax as the result of the application of these rules should monitor future developments and take steps to ensure that relevant assessments are kept open.

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