

Lower tax court rules on “direct shareholding” requirement in PSD

Lower tax court broadens application of PSD in a taxpayer-favorable decision

In a decision dated 13 September 2017, the lower tax court of Cologne clarified the definition of a “direct shareholding” requirement under the EU parent-subsidiary directive (PSD) and its implementation into German tax law (section 43b Income Tax Code (ITC)) to qualify for the 0% withholding tax rate on dividends. The tax court held that the interposition of an asset-managing partnership between the German company paying the dividend and its foreign corporate shareholder does not affect the direct shareholding requirement and, therefore, the 0% withholding tax should be applicable. This is the first time a tax court has ruled on what has been a long-standing dispute between taxpayers and the German tax administration.

The case involved a Dutch Coop that held approximately 33% of a German asset-managing partnership in the legal form of a GbR (Gesellschaft bürgerlichen Rechts or civil law partnership). The GbR held 100% of the shares in a German stock corporation (AG or Aktiengesellschaft). The AG distributed a dividend and withheld tax at the German domestic rate of 26.375%. The Dutch Coop then filed a refund application for the full exemption under the PSD and Germany's ITC. The federal tax office rejected the claim and granted a refund based on the 15% withholding tax rate provided under the Germany-Netherlands tax treaty.

To qualify for a 0% withholding tax under the PSD and Germany's implementation of the directive, a qualifying dividend recipient must hold directly at least 10% of the German distributing company. A 10% direct shareholding also is required to qualify for a reduced 5% withholding tax under article 10 (2) lit. a of the Germany-Netherlands treaty; however, no direct participation is required to qualify for the 15% rate under the treaty.

The German tax authorities took the position that if the GbR is treated as a mere asset-managing partnership and is disregarded for tax purposes, its existence from a civil law perspective must be taken into account, and the GbR cannot be disregarded for purposes of the application of the dividend withholding tax refund claim. Section 39 (2) No. 2 of Germany's General Tax Code (AO), which provides for a pro rata allocation of assets of a partnership to the partners for tax purposes, cannot be applied for purposes of the PSD.

The tax court of Cologne disagreed with the tax authorities. In its decision, the court emphasized the transparent nature of an asset-managing partnership and applied section 39 (2) No. 2 AO, and concluded that civil law principles do not have to be applied for purposes of the “direct shareholding” requirement in the PSD and section 43b ITC. The tax court highlighted the fact that section 39 (2) No. 2 AO, as a specific tax provision, has priority over civil law principles. The tax court also dismissed the tax authorities' argument that its interpretation of the direct shareholding requirement is necessary to prevent abuse. The court referred to the German anti-treaty shopping rule in section 50d (3) ITC as a specific anti-abuse rule addressing dividend withholding tax, and concluded that the anti-treaty shopping rule is sufficient for these purposes. In addition, the court was not convinced that the interposition of an asset-managing partnership could qualify as an abusive structure in any circumstances.

The question of when a direct shareholding exists is relevant both for purposes of the application of the PSD and a number of Germany's tax treaties (e.g. the reduced 5% or 0% withholding tax under the Germany-US treaty). The German tax authorities traditionally have adopted a strict interpretation of the concept and denied a reduced withholding tax or an exemption in many cases, so the tax court's ruling, which (at least temporarily) resolves a long-standing dispute with the tax authorities and expands the scope of a direct shareholding will be a welcome relief for taxpayers.

The tax authorities have appealed the lower tax court's decision to the federal tax court

Diese Mandanteninformation enthält ausschließlich allgemeine Informationen, die nicht geeignet sind, den besonderen Umständen eines Einzelfalles gerecht zu werden. Sie hat nicht den Sinn, Grundlage für wirtschaftliche oder sonstige Entscheidungen jedweder Art zu sein. Sie stellt keine Beratung, Auskunft oder ein rechtsverbindliches Angebot dar und ist auch nicht geeignet, eine persönliche Beratung zu ersetzen. Sollte jemand Entscheidungen jedweder Art auf Inhalte dieser Mandanteninformation oder Teile davon stützen, handelt dieser ausschließlich auf eigenes Risiko. Deloitte GmbH übernimmt keinerlei Garantie oder Gewährleistung noch haftet sie in irgendeiner anderen Weise für den Inhalt dieser Mandanteninformation. Aus diesem Grunde empfehlen wir stets, eine persönliche Beratung einzuholen.

This client information exclusively contains general information not suitable for addressing the particular circumstances of any individual case. Its purpose is not to be used as a basis for commercial decisions or decisions of any other kind. This client information does neither constitute any advice nor any legally binding information or offer and shall not be deemed suitable for substituting personal advice under any circumstances. Should you base decisions of any kind on the contents of this client information or extracts therefrom, you act solely at your own risk. Deloitte GmbH will not assume any guarantee nor warranty and will not be liable in any other form for the content of this client information. Therefore, we always recommend to obtain personal advice.