

Requirements for tax-free repayment of capital by foreign subsidiary tightened

The federal tax authorities have published their opinion regarding the tightened conditions for a tax-free repayment of capital by a foreign subsidiary to a German shareholder. According to the tax authorities, a separate application is required not only for the repayment of share premium, but also for a repayment of stated share capital in order to qualify as tax-free repayment of capital.

Germany's federal tax authorities recently posted on their website their opinion regarding the tightened conditions for a tax-free repayment of capital by a foreign subsidiary to a German shareholder.

Under German tax law, dividends and liquidation proceeds received from a domestic or foreign subsidiary generally are 95% tax-exempt at the level of the German corporate shareholder, with the remaining 5% subject to the general corporate tax rate of approximately 30% (resulting in an effective rate of about 1.5%).

To the extent a dividend or payment of liquidation proceeds qualify as a repayment of capital, the receipt of the payment is 100% tax free. To demonstrate that such a payment constitutes a repayment of capital, a German company must maintain a separate "contribution account" for tax purposes. Payments made out of this account generally qualify for the 100% tax-free treatment. However, the German tax authorities cannot require that foreign subsidiaries keep a contribution account. To enable a German parent company of a foreign subsidiary to receive a tax-free distribution that qualifies as a repayment of capital, the corporate income tax code allows the foreign subsidiary to request a statement from the federal tax authorities confirming the tax-free nature of the payment. Until recently, the separate statement was required only when share premium was repaid - it was not required for a repayment of stated share capital.

According to the recently posted position of the tax authorities, a separate application is required not only for the repayment of share premium, but also for a repayment of stated share capital in order to qualify as tax-free repayment of capital. The tax authorities' new view seems to be targeting structures where retained earnings of a foreign subsidiary have been used to increase the stated share capital that subsequently is repaid to the German shareholder and where a 100% tax exemption has been claimed.

It should be noted that the possibility to make a repayment of capital and obtain a statement from the federal tax authorities applies only to foreign subsidiaries that are resident in the EU; it is not possible for foreign subsidiaries resident outside the EU (e.g. in the US) to distribute share premium or stated share capital to a German shareholder on a tax-free basis.

The application for a statement from the tax authorities must be made on a specific form by the end of the year following the year in which the payment was made (e.g. for payments made in 2014, the application must be filed by the end of 2015). As a result, it is no longer possible to obtain such a statement and to receive tax-free status for repayments of stated share capital made in 2013 or earlier. The legal basis for this approach is questionable, as is the retroactive application of the position of the tax authorities.

The German tax authorities have long held the view that the application that must be filed by the foreign subsidiary cannot be submitted once the subsidiary is liquidated and ceases to exist, and the German parent company cannot file the application on behalf of the liquidated foreign subsidiary. As a result, it is important that the application be submitted before the foreign subsidiary is liquidated.

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