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# German Tax Monthly

Information on the latest tax developments in Germany

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## Update: Coalition Agreement for a New Federal Government

The coalition parties of the new Federal Government – Christian Democratic Union of Germany (CDU / CSU) and Social Democrats (SPD) – officially signed their coalition agreement on 5 May 2025. On 6 May 2025, Friedrich Merz (CDU) was elected as the new Chancellor in the Bundestag and the government was sworn in. Lars Klingbeil (SPD) will become finance minister in the new federal government.

The coalition agreement contains a large number of tax policy measures. However, all measures of the coalition agreement are subject to financing.

In the area of business taxes and tax incentives, the reduction of corporate income tax in five steps by one percentage point each, starting on 1 January 2028, and the introduction of an investment booster in the form of a degressive depreciation on equipment investments of 30% (annually) in 2025, 2026 and 2027 are worth mentioning. The federal government plans to publish a draft law for these two measures before the parliamentary summer break.

For an overview of the most important tax projects of the new federal government, please refer to German Tax Monthly issue May 2025.

## Federal Tax Court (VIII R 32/21): Interest on Withholding Tax on Dividends Not Refunded in Breach of European Law

In its judgment of 25 February 2025 (VIII R 32/21), the Federal Tax Court ruled, among other things, that interest must be paid on dividend withholding tax refunds under EU law if the Federal Central Tax Office withholds the refund of dividend withholding tax from the shareholder without any indications of an abusive arrangement in the individual case.

It was disputed whether and to what extent claims for refund of withholding tax on dividends and solidarity surcharge are subject to interest.

The plaintiff is a corporation domiciled in Austria. It held an interest in a German stock corporation (B-Inc.). The plaintiff's shareholder was a foundation. The foundation was a non-profit organization and exempt from corporation tax. In the case in dispute, withholding tax and solidarity surcharge were withheld on four dividend distributions made by B-Inc. in March 2007, 2008, 2009 and 2011.

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The plaintiff had applied to the Federal Central Tax Office for partial exemption from German withholding tax (exemption certificate) with reference to the Parent-Subsidiary Directive (Section 43b Income Tax Act – ITA). The Federal Central Tax Office initially refused to issue the exemption certificate in November 2009 with reference to the anti-treaty/directive provision of Section 50d (3) ITA (version 2007). The plaintiff filed an appeal against this. In its opinion, the participation structure - tax exemption of the foundation as an indirect shareholder - argued against an abusive use of the parent-subsidiary directive. As a result, the Federal Central Tax Office issued the exemption certificate in February 2010, but revoked it again in March 2011 and again referred to the anti-treaty/directive rule as justification.

The plaintiff subsequently submitted a total of four applications for refund of the withholding tax and the solidarity surcharge. Taking into account the case law of the CJEU in the Deister Holding and Juhler Holding cases of 20 December 2017 (C-504/16 and C-613/16), according to which the (old) German anti-treaty shopping rule is contrary to European law, the Federal Central Tax Office ultimately refunded the withholding tax plus solidarity surcharge (payment date 13 August 2018 and 1 October 2018).

Following the repayments, the plaintiff applied for interest to be assessed for the period from the respective date of tax withholding until payment of the respective refund amount. The Federal Central Tax Office rejected the applications.

However, the Federal Tax Court ruled in favor of the plaintiff. It is true that under unilateral German law, interest is not payable on back payments and refunds of withholding tax such as on dividends and the solidarity surcharge. However, under EU law, there is an obligation to pay interest on refunds (in accordance with the Parent-Subsidiary Directive) of dividend withholding tax if the Federal Central Tax Office denies the refund of dividend withholding tax with reference to the anti-treaty/directive provision of Section 50d (3) ITA 2007 without any indications of an abusive arrangement in the individual case. According to established case law of the CJEU, there is a right to interest if a Member State has levied a tax in breach of the provisions of EU law. This does not only apply in cases in which the breach of EU law is pursued by way of a legal action and the refund of the taxes levied in breach of EU law is enforced in court. It is also sufficient to defend against the breach of EU law in the context of objection proceedings. It is decisive and sufficient that the withholding of the refund amounts was based on an interpretation or application of the relevant national regulations contrary to EU law.

In the absence of EU legislation, the conditions for the payment of such interest - in particular the rate and method of calculation of interest - must be determined in accordance with the national legal order of the Member States. In that regard, it must be borne in mind that the interest paid covers the entire period which, depending on the circumstances of the case, lies between the date on which the person concerned paid or should have received the tax in question and the date on which it was refunded or paid to him.

Therefore, for the start of the interest run a distinction must be made as to whether a certificate of exemption was previously available:

1. In the case of pure reimbursement - i.e. without a prior exemption certificate procedure - the interest period begins three months after the submission of a formally correct refund application (as an appropriate official processing period).
2. If an exemption certificate initially granted is revoked by the Federal Central Tax Office with reference to the anti-treaty/directive provision without there being any indications of an abusive arrangement, the interest period begins on the date on which the dividend withholding tax is withheld.

In both cases, the interest run ends on the day the refund amount is paid out.

With regard to the amount of the interest rate, the Federal Tax Court states that the general interest rate under the German Fiscal Code - which applies to the relevant interest period - is to be applied (according to the legal situation at the time 0.5% per month). This is not limited to full months of interest, but is calculated on a daily basis.

## Federal Tax Court (I R 23/21): Managing Holding Company as Controlling Company of a Tax Group

In its ruling of 27 November 2024 (I R 23/21), the Federal Tax Court decided that a managing holding company in the legal form of a partnership can act as a controlling company of a tax group for corporate income tax (CIT) purposes even without any other commercial activities.

Under German CIT law, partnerships can also be controlling companies of a tax group in addition to corporations. However, an additional requirement applies to partnerships as controlling companies: they must carry out an original commercial activity, i.e.

pure asset management, such as the mere holding of investments in other companies, is not sufficient.

A limited partnership (LP) operated as a managing holding company within the Z-group without own staff. In the year at issue, 2008, D, E and F had been the main managing directors of the LP-group. D, E and F also worked as managing directors of LP’s general partner and of LP’s controlled company of the tax group, the plaintiff. The holding company exercised uniform management through several subsidiaries. The three managing directors of LP's general partner (D, E and F) had also taken on tasks for the subsidiaries. From September 2008, specific management actions were also documented, such as management meetings, approvals of investments and significant location and financial issues.

For 2008, the tax office did not accept the tax group between LP and the plaintiff due to the lack of paid commercial activity by LP. The LP had not provided any paid services to its subsidiaries.

The court ruled in favor of the plaintiff. In the year in dispute, the LP had carried out an (original) commercial activity within the meaning of the tax group rules. This requirement is also met if a controlling company in the legal form of a partnership acted exclusively as a managing holding company. No additional commercial activities, such as intra-group paid services or other commercial activities, are necessary.

According to the court's principles, the managerial activity of the holding company can generally be carried out by establishing guidelines on the business policy of the controlled companies and forwarding them to the controlled companies, or by giving written instructions to the controlled companies. Recommendations from the controlling company, joint meetings and consultations may also be sufficient if they are recorded in writing.

To date, the tax authorities have placed additional requirements on the commercial activity of a managing holding partnership (Ministry of Finance, guidance of 10 November 2005). The tax authorities recognize a commercial activity if a company provides services (e.g. preparation of accounts, IT support, etc.) to one or more group companies. The prerequisite is that the services are provided for a separate fee and are invoiced at arm’s length.

The court did not need to answer the question of whether a managing holding company necessarily presupposes participation in at least two subsidiaries, since in the case at issue LP had several subsidiaries.

## Federal Tax Court (I R 45/22): German AOA Rule (Section 1 (5) Foreign Transactions Tax Law) Is an Income Correction Rule and Not a Profit Determination Rule

According to the ruling of the Federal Tax Court (I R 45/22) of 18 December 2024, the German AOA rule (implementation of the Authorised OECD Approach in Section 1 (5) Foreign Transactions Tax Law – FTTL) is an income correction rule and not an independent regulation for determining the profit of permanent establishments (PE).

The German AOA rule regulates the adjustment of income if the conditions for a business relationship, in particular the transfer prices on which the determination of the income of a domestic PE of a foreign company is based for tax purposes, do not comply with the arm's length principle and (for example) the domestic income of a limited taxpayer is reduced as a result. The details of the arm's length principle and its uniform application are regulated in the Ordinance on the allocation of profits of PEs.

The plaintiff is a corporation under Hungarian law. It maintained a PE in Germany in the year 2017 and provided work contract services in assembly. The plaintiff carried out an inducement-related profit determination for the PE. Contrary to the tax bases declared by the plaintiff, the tax office calculated the profit of the PE based on the Ordinance on the allocation of profits of PEs. It calculated the profit for corporation and trade tax purposes based on the operating expenses (cost of materials, personnel expenses and other operating expenses), applying a markup rate of 10%. The plaintiff lodged an objection. As a result, the tax office dismissed the objection to the extent that it reduced the mark-up rate to 5% of the personnel costs and other operating expenses. The cost of materials was no longer taken into account. Otherwise, it rejected the objection as unfounded. The action of the plaintiff to the Lower Tax Court was successful. The tax office lodged an appeal.

The Federal Tax Court confirmed the decision of the Lower Tax Court. It ruled that the German AOA rule in Section 1 (5) FTTL in conjunction with the Ordinance on the allocation of profits of PEs is not a sufficient legal basis in the case in dispute for completely rejecting a determination of profits based on the taxable event without further examination and replacing it exclusively with a "determination of profits" based on the so-called cost-plus method as a cost-oriented transfer pricing method for limited tax liability. The German AOA rule is an income correction rule and not an independent regulation for determining the profit of a domestic PE. The Court had already recognized this based on a summary review in a proceeding for provisional legal protection (decision of 24 November 2021, I B 44/21). In particular, the Senate had stated in that decision that the rule is linked to a reduction in income resulting from an agreement on terms and conditions (transfer prices) that are not arm's length. The Court upheld this legal opinion and added that the classification of the German AOA rule as a profit determination provision is already contradicted by the systematic position of the provision in the Foreign Transactions Tax Law.

The Federal Tax Court (I R 49/23) issued a second, partially identical decision on this legal issue on the same date.

## Federal Tax Court (I R 47/21): Permanent Establishment Under Tax Treaty Law of a Taxi Company in the Premises of a Taxi Radio Center

The Federal Tax Court (I R 47/21) has ruled that, for the assessment of the existence of a permanent establishment (PE), the permanent provision of personal use structures (in the case in dispute: personal stand container) can be an indication of the existence of a permanent power of disposition over the business equipment (in the case in dispute: office space).

In the case in dispute, it was questionable whether a taxi company had a PE under tax treaty law in the premises of a taxi radio center in Switzerland. The taxi operator (plaintiff) was resident in Germany (unlimited tax liability in Germany). However, he carried out his taxi business in Switzerland, for which he held a driving license issued in Switzerland, a Swiss taxi license and three Swiss taxi owner permits. If he maintained a PE in Switzerland for his business under tax treaty law, his PE income would be exempt in Germany. In Switzerland, the plaintiff's income from the taxi company was subject to cantonal income tax and direct federal tax.

The taxi company was registered in Swiss canton X at its registered office. The taxi operator was a member of a taxi network, which was an association of independent taxi operators to form a taxi radio center. The taxi orders were processed via this center.

The plaintiff always had access to the premises of the center. These consisted, among other things, of an office room and a separate room for the staff employed by the taxi radio center. The office room was equipped with three desks (each with a computer, monitors and telephone), one of which was mainly used by the plaintiff. At this desk, the plaintiff mainly carried out administrative tasks (bookkeeping, Swiss tax returns, payment of invoices, telephone calls and other correspondence) once or twice a week. He also had a stand container labeled with his (company) name at his disposal, in which he kept the documents required for bookkeeping and monitoring driving and rest times (e.g. customer cards, credit statements from major customers, daily tachograph charts and control cards). The taxi center also maintained a post office box in the nearby post office, which received the vast majority of the mail for the plaintiff's taxi company. In addition to the plaintiff, two other taxi companies had their business address in the office of the taxi center and used its premises, each with their own stand container and mailbox.

The court concluded that the plaintiff's income from his taxi company is fully exempt from taxation in Germany, as the taxi company carried out its activities through a Swiss PE within the meaning of Article 5 DTT Germany/Switzerland. The office space of the taxi radio center constituted a fixed business establishment over which the plaintiff had sufficient power of disposition. This could be derived from the plaintiff's membership in the center, which granted him a legally independent right of joint use of the office space for his own business activities at any time. Furthermore, it could be considered that the permanence of the power of disposition had manifested itself in the personal usage structure of a stand container that was left exclusively to the plaintiff and labeled accordingly, for which only he had the key.

The activities carried out in the taxi radio center (business management and business administration) could also not be regarded as merely ancillary activities within the meaning of Article 5 (3) letter e DTT Germany/Switzerland. The main activity of a taxi operator with several employed taxi drivers is not limited to driving taxis to transport passengers. Rather, this also included the managerial and central administrative activities that the taxi operator carried out in the office in Switzerland.

In addition to the taxi radio center in Switzerland, the court did not recognize any other PE in Germany, so that the business profits were fully attributable to the Swiss PE.

## Federal Tax Court (I R 41/21): Parallel Imports Can Lead to Hidden Profit Distribution

The Federal Tax Court has ruled that regarding so-called parallel imports of (original) pharmaceuticals, a hidden profit distribution may exist at the group's own (domestic) sales company in favour of the (foreign) group parent company.

The plaintiff belonged to an internationally active pharmaceutical group with a foreign parent company. A domestic (group) distribution company, which was a subsidiary of the plaintiff and with which a consolidated tax group relationship existed under corporation tax law, was responsible for the distribution of the group's original products in Germany. Due to statutory provisions, pharmacies in Germany are obliged to purchase a certain proportion of the goods from parallel importers at more favourable prices (so-called import promotion clause). Although the associated sales successes of the parent company are also indirectly attributable to the sales activities of the domestic sales company, the sales company was not remunerated separately for this within the group. The tax office therefore assumed a hidden profit distribution (prevented increase in assets at the level of the sales company) as a result of the cost savings of the parent company and increased the income of the plaintiff (as the parent company).

After the Lower Tax Court at first instance was of the opinion that there was no hidden profit distribution, the Federal Tax Court has now overturned the previous decision: In the case of parallel imports of (original) pharmaceuticals, a prevented increase in assets at the group-owned, domestic distribution company in favour of the group parent company (amount of the transfer price) cannot be rejected on the grounds that the parallel import is not in the actual interest of the group parent. This is because the distribution company carries out its marketing activities in the interests of the group as a whole, which also benefits economically from the parallel imports.

A transfer of assets due to a saving in expenses at the foreign parent company and the recognition of a hidden profit distribution could therefore not be ruled out. The aforementioned marketing activities of the distribution company with an indirect effect on parallel imports should generally be remunerated.

However, due to a lack of findings, the Federal Tax Court could not conclusively decide on the amount of the prevented increase in assets at the plaintiff due to a saving in expenses at the group parent company. The Lower Tax Court must now make these findings in the second instance.

In doing so, the Lower Tax Court will first have to determine whether an inducement can be assumed to be caused by the shareholder relationship, based on the assumption that it is precisely the "arm's length remuneration" of the group distribution company's sales representatives, including the turnover from parallel imports, that it would be arm's length to pass on these costs. If necessary, this (hypothetical) arm's length test would have to be confirmed by an external (using market studies) or internal arm's length comparison. In this context, it will also be necessary to consider how high the economic advantage of the parent company from the parallel imports was in the case of the dispute.

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