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Advocate General's Opinion on German participation exemption regime

Germany – Free Movement of Capital - Third Country - Dividends – Participation Exemption – Standstill Clause

On February 7, 2018, Advocate General (AG) Wathelet of the Court of Justice of the European Union (CJEU) issued his Opinion in the EV v Finanzamt Lippstadt case (C-685/16) concerning the compatibility of the German participation exemption regime applicable to dividends originating in third countries with the free movement of capital. The AG concluded that the German legislation is contrary to the free movement of capital.

Background

In 2008 and 2009, a German subsidiary of the EV group received dividends from its wholly-owned subsidiary resident in Australia. The dividends distributed by the Australian company had previously been received from a sub-subsidiary resident in the Philippines.

The German tax authorities considered that the dividends received by the German company did not fulfill all the conditions foreseen by the German participation exemption regime applicable to dividends received from subsidiaries resident in third countries and denied the exemption.

The German company appealed this decision, arguing that the requirements applicable to nationally-sourced dividends were less strict and that such difference in treatment between domestic and certain cross-border dividend distributions constituted a restriction to the free movement of capital.

The AG's Opinion

The AG first focused on which freedom was applicable: the free movement of capital or the freedom of establishment. Referring to previous CJEU case law, the AG noted that with respect to dividends originating in a third country, it is sufficient to consider the purpose of the national legislation at issue in order to determine the applicable freedom. As the German rules do not apply exclusively to cases where the recipient company exercises decisive influence over the subsidiary distributing the dividends, the AG concluded that the rules should be analyzed under the free movement of capital. In this respect, he concluded that it is not necessary to take into account the actual facts and circumstances of the case or to analyze whether the 15% minimum holding requirement foreseen by the German legislation confers a decisive influence over the participation held.

The AG further observed that there is a difference in treatment constitutive of a restriction, as the requirements to be met to benefit from the exemption if the dividends are distributed by a company resident outside the EU are stricter than those foreseen in cases where the distribution is made by a German company.

Regarding the "standstill clause", the AG concluded that it is not applicable, as it is clear that the German legislation applies to direct investments and that it has been significantly modified since 1993.

Finally, the AG assessed whether the restriction may be justified in this case. Referring to settled case law, he first noted that a German shareholder receiving foreign-sourced dividends and a German shareholder receiving nationally-sourced dividends are objectively comparable. He then analyzed whether the restriction may be justified by an overriding reason in the public interest, and concluded that neither the risk of tax avoidance nor the need to guarantee the effectiveness of fiscal supervision are applicable.

The AG thus concluded that the German legislation is not compatible with the free movement of capital, as it establishes stricter requirements for exempt dividends received from a non-resident company, than those applicable when the paying company is a German resident.

EU Tax Centre comment

It remains to be seen whether the CJEU will follow the AG's Opinion when assessing the applicability of the free movement of capital to the case at hand, in particular with respect to his conclusion that the German legislation at issue does not apply exclusively to cases where the shareholder exercises decisive influence over the subsidiary distributing the dividends.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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