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Euro Tax Flash from KPMG's EU Tax Centre

CJEU decision on German dividend withholding tax refund rules

CJEU – Germany – Free movement of capital – Withholding tax on dividends – Comparability

On June 16, 2022, the Court of Justice of the European Union ('CJEU' or 'Court') rendered its decision in the ACC Silicones case (C-572/20). The case concerned the compatibility of the German rules on reimbursing withholding tax on dividends received from portfolio investments with EU law.

In line with the opinion previously issued by the Advocate General ('AG'), the Court concluded that the evidential requirements under German law for portfolio investments are contrary to the free movement of capital.

Background

The plaintiff was a UK company which held, between 2006 and 2008, 5.26 percent of the share capital in a German company. The UK company was 100 percent owned by another UK entity, which was listed on the UK stock exchange. The plaintiff received dividends from the German company, which were subject to a 20 percent withholding tax plus solidarity surcharge of 5.5 percent in Germany (21.1 percent in total). The UK company successfully reclaimed the withholding tax that was levied at a rate in excess of the 15 percent rate provided by the Germany / UK double tax treaty. However, the German tax authorities denied the reimbursement of balance tax paid (i.e. 15 percent, which is the balance of the withholding tax suffered which had not already been reimbursed due to the Germany / UK tax treaty provisions) on the grounds that ACC Silicones did not comply with the evidential requirement provided by the German law.

For portfolio investments, the German rules on dividend withholding tax refunds are stricter in cases where the recipient is a EEA company – not resident in Germany. Among other requirements, such foreign recipients are required to prove, by submitting certificate(s) issued by the foreign tax authorities, that neither the foreign taxpayer nor one of its direct or indirect shareholders is able to offset the German withholding tax, or deduct the tax as an operating cost or a business expense. In contrast, German recipients are allowed to offset the tax in full against German corporate income tax payable, with a reimbursement of any withholding tax in excess of the corporate income tax liability (without further documentary evidence).

ACC Silicones challenged the decision issued by the German tax authorities and the case was brought before the Finanzgericht Köln (Finance Court, Cologne). The German court noted that, due to the fact that ACC Silicones' shareholder was a listed company, it would have been impossible for the plaintiff to provide the evidential requirement under German law. Given the difference in treatment between German and foreign divided recipients, and the practical impossibility of the latter to provide the required evidence, the Court referred the case to the CJEU. The Advocate General (AG) recommended that the Court finds the measures under dispute to be contrary to EU law – see E-News Issue 147.

The CJEU decision

The Court first recalled that, in respect of shareholdings below the thresholds established by the EU Parent Subsidiary Directive, Member States are free to tax dividends and establish domestic measures to mitigate double taxation, as long as the rules are not contrary to the free of movement of capital. A restriction of the free movement of capital would be considered to arise where there is a difference in treatment between situations which are objectively comparable, and the measure giving rise to this difference is either not justifiable, is not appropriate to achieve the objective pursued or is disproportionate in the manner it achieves the objective.

The Court noted that the measure under dispute sets out different conditions for benefiting from dividend withholding tax refunds, depending on whether the recipient of the dividends is resident in Germany or not. In line with settled case-law, the Court confirmed that once Member States impose a levy on dividend income for both resident and non-resident shareholders, the circumstances of the non-resident companies becomes comparable to that of resident companies. When determining if the rules represent a restriction of the free movement of capital, it is necessary to analyze if the relevant tax treaty fully neutralizes differences between the tax treatment applied to resident and non-resident companies. Whilst it is up to the referring court to perform this assessment, the CJEU noted the relief mechanism set out by the UK / Germany double tax treaty (i.e. credit against the tax payable in the UK), does not guarantee full neutralization in all cases. In this regard, cases could arise, for example, when the UK tax payable on the dividends received is lower than withholding tax levied in Germany.

The Court also observed that the analysis should be completed at the level of the recipient and should not take into account the possible set-off of the German withholding tax against the tax liabilities of the recipient's direct or indirect shareholders. Moreover, based on settled case-law, the ability of a non-resident company to avail of a deduction for WHT that has not been reimbursed does not fully neutralize a difference in treatment between resident and non-resident companies where the resident company is entitled to a reimbursement of the withholding tax suffered. On this basis and subject to the verifications to be carried out by the referring court, the CJEU concluded that the measure under dispute represents a restriction to the free movement of capital.

The Court also rejected Germany's argument that the difference in treatment is justified by the need to preserve the balanced allocation of taxing rights between Member States. The Court noted that a Member State cannot rely on the preservation of a balanced allocation of taxing rights between Member States as a justification for taxing recipients of dividends in other Member States if it chose not to tax German resident companies on the same income (in this case, portfolio dividends distributed by German companies to German recipients benefit from a complete neutralization of the effects of withholding tax being applied at source).

Furthermore, the Court rejected the second argument presented by Germany that the measure was necessary to ensure that withholding tax is not double-counted by non-resident companies or by their direct or indirect shareholders (i.e. once through reimbursement by the German tax authorities and then again by being offset against their tax liability or deducted as an operating cost in their State of residence. In denying the German argument, the Court agreed with the AG that the measure was not applied in a consistent manner, as German resident recipients are not targeted despite the fact that it cannot be ruled out that German resident companies might have non-German resident direct or indirect shareholders that may take the withholding tax into account at their own level. In the Court's view, it is not clear that the objective of the measure is obtained and the justification could not be accepted as a result.

EU Tax Centre comment

The CJEU decision is broadly in line with its previous case law on the taxation of outbound dividends. Given the finding that the measure under dispute breaches EU law, the CJEU decided not to address the referring court's question regarding the proportionality and effectiveness of the German rules. It would have been particularly interesting to see if the Court would have followed the AG's argumentation on this issue, as the AG stated that Member States should not adopt a formalistic approach, and instead should accept alternative proof brought by taxpayers.

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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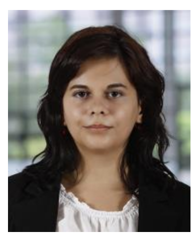

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