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Germany’s dividend withholding tax hinders free movement of capital

In a case brought by the Commission, the ECJ has held that Germany’s withholding tax on dividends to other corporations is in breach of community law in that it discourages persons from other member states from investing in Germany.

Dividends paid by a German corporation are subject to a 25% withholding tax. On application, this can be reduced to the lower treaty level, or, if applicable, waived under the provisions transposing the Parent/Subsidiary Directive. German resident corporations are exempt from corporation tax on their dividend income, but can claim a full offset of the withholding tax deducted at source from their corporation tax otherwise due. If a net debit remains, they can claim a cash refund. A German company receiving a dividend from anther German company is therefore never faced with a tax burden, whereas a foreign company receiving the same dividend might be, if it does not qualify for Parent/Subsidiary Directive exemption.

The European Commission sees this difference in treatment as discriminatory. The more favourable treatment of domestic corporations as shareholders tends to discourage corporate residents from other member states from investing in Germany. It therefore hinders the free movement of capital. The ECJ has now agreed with this view. It has rejected German arguments in support of this discrimination (domestic and foreign investors are in different positions – the distinction is to maintain the coherence of the tax system – the credit of withholding tax is a matter for the state of residence) as unfounded. Germany is thus left with the choice between offering all foreign corporations with shares in German companies the right to recover the withholding tax deducted at source from their dividends, and exempting all intercorporate dividends from withholding tax altogether.

The ECJ case reference is C-284/09 *Commission v. Germany*, judgment of October 20, 2011.

Schlagwörter

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