Downloaded from Blogs on 09.10.2026 02:43h

By PwC Deutschland | 05. März 2013

Maximum foreign tax credit should not be reduced by domestic allowances

The ECJ has held that the notional tax on foreign source income should not be reduced by a portion reflecting domestic allowances and reliefs.

Downloaded from Blogs on 09.10.2026 02:43h

German double tax treaties invariably relieve the foreign tax deducted from dividends paid to natural persons by crediting it against the domestic tax due on that income. The credit is therefore the lesser of the amount actually deducted at source and the domestic tax notionally due on the foreign income had it been earned at home. The German method of calculating this domestic comparison is to split the notional German tax due on the entire income had it been all of domestic source, in proportion to the total gross receipts to the gross foreign receipts at issuec. This calculation effective apportions deductions and personal allowances not associated with a particular income source between the two categories of income received. It therefore assumes that personal burdens qualifying for tax relief are financed from income of all sources in their relative proportions. This thus reduces the maximum foreign tax credit in all cases where the notional domestic tax chargeable is lower than the foreign tax actually paid. A German taxpayer faced with this situation has protested that this method of calculating foreign tax relief on dividend income is a hindrance on the free movement of capital.

The ECJ has now agreed with him and has also held that the restriction on the free movement of capital is unjustified. The German government attempted to argue that the financial burden of a taxpayer's personal circumstances should be seen as being financed from his total income of all sources, although the ECJ referred to its case law on taxation in the context of the free movement of workers holding that personal circumstances were primarily a matter for the state of residence. Thus, the calculation of the notional domestic tax due as a limit for the foreign tax credit should be based on the income proportions after deducting the personal allowances and expenses from the domestic income alone. The court also pointed that this method of apportionment did not mean that the German government could ever receive less tax by virtue of the foreign income earned.

It is worth noting that the finding of the court falls short of limiting the foreign tax credit to the notional amount of domestic tax due on the increase in income from the additional foreign source. This is true for all systems of rising rate scales and was pointed out to the ECJ at the hearing. However, the court could not examine the strict application of a marginal calculation, as this had not been requested by the referring court. Rather, that court had stated in its referral that domestic law precluded it from extending the plea made by its own plaintiff. That part of the question thus remains open.

The ECJ reference is C-168/11 *Beker*, judgment of February 28, 2013.

Schlagwörter

foreign tax credit, foreign tax relief, notional tax