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Hidden distribution from foreign company is investment income in Germany

The Supreme Tax Court has held that a benefit from a foreign company to a German shareholder is a hidden distribution taxable in Germany as investment income.

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A German family held the entire share capital in a Spanish company. The company did not trade and was not registered in Spain as a taxpayer for lack of any intention of earning income. Its only asset was a villa on Mallorca, used solely by the family members free of charge. There was no attempt to hire the villa out on a commercial basis. The German tax office found that the company had allowed its shareholders a benefit from their unrestricted use of the villa and assessed them to income tax on the basis of their receipt of investment income corresponding to the annual rental of the villa at market rates.

The Supreme Tax Court has now agreed with the tax office that the shareholders had received a hidden distribution from their Spanish company in the amount of the market value of the rental they did not pay. This hidden distribution was taxable in Germany as investment income. A Spanish determination that the company, itself, did not trade and was not a taxable entity was irrelevant to the German position of the shareholders. The court also emphasised that there was no German distinction between a cash dividend receipt and a hidden benefit through failure to charge for a service rendered. It did, however, insist on further investigation of the Spanish legal position. If Spanish law – as distinct from practice in the case at issue – provided for taxation of a hidden distribution benefit as a dividend, the consequence would be taxation in Germany with a credit for any Spanish withholding tax deducted at source. If Spanish law did not classify the benefit to the shareholders as a dividend, it would be taxable in Germany under treaty as other income, that is, without credit for any Spanish tax.

Supreme Tax Court judgment I R 109-111/10 of June 12, 2013 published on October 2

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