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Differing forms of double tax relief not restriction on free movement of capital

The ECJ has held that no restriction on the freedom of capital movement arises from relieving domestic double taxation on dividend income under an exact imputation system, whilst foreign double taxation is relieved by exempting the foreign income.

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At the time in question, Germany operated an imputation system of corporation tax. Dividends received from other German companies were taxable income against a credit in the amount of the underlying corporation tax paid by the distributing company on the tax now due by the recipient. If the recipient owed no tax, (e.g. because of losses) his imputation credit was paid out in cash. Dividends from abroad, on the other hand were exempt from corporation tax altogether (minimum shareholding of 10%), the foreign tax then becoming a final burden. A German resident holding company with subsidiaries in other EU member states and in third countries claimed that this distinction placed it at a disadvantage because it was unable to claim any relief for the foreign tax paid, despite its domestic losses.

The ECJ has now held that the company did not suffer any unjustified restriction on its fundamental freedoms. Interestingly, the court held the relevant freedom to be that of capital movement, even though the actual investments ranged from 93% to 100% of the share capital of each subsidiary. The court's basic point here was that the German exemption threshold of a 10% holding was too low to guarantee a significant influence on a subsidiary's management; hence the exemption provision was aimed at capital investment, rather than at the establishment of a business operation.

All foreign subsidiaries fell under the freedom of capital movement. However, the ECJ saw them as being in an objectively different position than domestic investments. Since community law did not require a member state to refund at its own expense a foreign tax paid or to offset a tax disadvantage arising entirely in a foreign state, a member state was entitled to relieve double taxation by exempting the foreign dividend from a further, domestic charge. This preserved the domestic loss carry forward potential and also protected the foreign income from further taxation up to a higher domestic level. It could therefore be of advantage to a taxpayer, not to mention its administrative simplicity.

The ECJ case reference is C-47/12 *Kronos*, judgment of September 11, 2014.

Schlagwörter

dividend income, double tax relief, foreign income