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By PwC Deutschland | 19. Juli 2016

No deduction of foreign withholding tax in case of abuse

Dividend withholding tax paid by a foreign intermediary company may not be deducted from the taxable income of the local shareholder of a German company if the entire arrangement is abusive and if, therefore, the dividend income is to be allocated to the German shareholder.

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Taxpayers whose foreign income is liable to tax corresponding to German income tax in the State in which the income originates, may offset the tax paid abroad against German income tax due in respect of income from that State. Specifically, withholding taxes on certain foreign dividends may be credited against the German income tax due. Alternatively, if a tax credit is not possible e. g. for lack of foreign source income, the foreign tax can alternatively be deducted as an expense from the German tax base. This latter rule was the subject of dispute before the Supreme Tax Court.

The German taxpayer sold 55% of the shares in a German GmbH to a Netherlands B.V. and remained with a 25% stake in the GmbH. The dividend was paid by the GmbH via the B.V. and its Dutch parent to a consulting Ltd. having its seat in the British Virgin Islands and whose shares were held entirely by the taxpayer. Though the parties involved were in agreement that the entire transaction was an abuse of legal forms and therefore – for want of foreign source income - a tax credit was not possible, the taxpayer asked for a deduction of the foreign withholding tax levied on the dividend paid from the B.V. to its Dutch parent. The tax office refused, the Supreme Tax Court also rejected the request.

The deduction of foreign withholding tax in order to avoid a double taxation is only possible where the same person paid both domestic and foreign tax on the same type of income. In the case at hand, the tax was rather payable by the intermediate B.V. Under appropriate legal arrangements no foreign withholding tax would have been payable at all. The Supreme Tax Court went on to point out that, on the basis of the inappropriate structure chosen, no German tax would have been payable on the dividends of the GmbH as the dividend income would be taxed in the hands of the B.V. and the subsequent distribution to its parent only be subject to Dutch withholding tax.

Supreme Tax Court judgment I R 73/14 of March 2, 2016, published on July 13

Schlagwörter

abuse of legal forms, deduction of foreign tax, foreign tax relief, foreign withholding tax