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Tax neutral repayment of capital contributions by companies tax resident outside the EU also possible

The transfer of shares to German-residents shareholder as part of a US spin-off generally constitutes investment income under Section 20 (1) No. 1 of the Income Tax Act (ITA); Section 20 (1) No. 1 Sentence 3 ITA is to be interpreted in line with EU law, so that companies resident outside the EU may also repay capital contributions on a tax neutral basis, even though they do not maintain a contributions account for tax purposes under Section 27 of the Corporation Tax Act (CTA).

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The taxpayers acquired shares in a US corporation (“A”) in 2006. In 2008 they were issued with shares in another US company (“B”), which was a subsidiary of A, as part of a spin-off. The tax office treated the receipt as investment income taxable under Section 20 (1) No. 1 ITA.

According to Section 20 (1) No. 1 Sentence 3 ITA receipts under this subsection will not be included in the tax base to the extent that they emanate from the distributing company’s tax contributions account within the meaning of Section 27 CTA.

Section 27 CTA requires German corporate unlimited taxpayers to maintain a tax contribution account, which records changes in capital contributions, other than contributions to or repayments of share capital. Section 27 CTA further provide companies, which are unlimited taxpayers in other EU States, with a mechanism to maintain a tax contributions account. Section 27 makes no reference to companies, which are tax resident outside the EU.

As a result of this it has been unclear whether non-EU companies are able to make tax neutral repayments of capital contributions, as it is not possible to show that the receipt “emanates from the tax contributions account” (Section 20 (1) No. 1 Sentence 3 ITA) in such cases.

The Supreme Tax Court has now held that to restrict the application of the tax neutrality offered by Section 20 (1) No. 1 Sentence 3 ITA to receipts from German resident and EU resident companies would be a restriction to the right to free movement of capital and thus in contravention with Article 63 TFEU.

Further the Court stated that it could not recognise any reasons significant enough to justify a resident shareholder being refused the opportunity, ab initio, to prove that the distribution he received from a non-EU company was a repayment of capital contributions. The Court could not accept the argument that the restriction is justified because of the practical difficulties of establishing whether the receipt could be deemed to emanate from a tax contributions account, as these difficulties also exist in the case of EU resident companies.

Supreme Tax Court decision of 13 July 2016 (VIII R 47/13)

Schlagwörter

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