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Profit participation rights at fixed rate is interest under German-Austrian tax treaty

In a dispute between Germany and Austria on the right of taxation of payments from registered certificates the ECJ held that such interest should be taxed only in the country of residence of the beneficial owner unless such debt-claims explicitly provide the creditor with a participation in the debtor’s profits.

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The dispute before the European Court of Justice (ECJ) concerned the interpretation and application of Article 11 of the double tax treaty between Austria and Germany as regards the right of taxation of interest from registered participation certificates (profit participation certificates – 'Genussscheine') acquired by UniCredit Bank Austria AG (Bank Austria) from the German Westdeutsche Landesbank (WestLB) as the issuer of the certificates. According to Art. 11 (1) of the treaty "interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State". Apart from this general rule Art. 11 (2) states "that income from rights or debt-claims with participation in profits (…) or income from profit-participating loans and profit-sharing bonds, may also be taxed in the State in which it arises, in accordance with the laws of that State". Interest is defined as income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, Art. 11 (3) of the treaty.

Under the terms of issue, the amount of the annual payment was a percentage of the nominal value of the certificate ranging from 4.4% to 7.4%. Since the issuer had made profits over the entire holding period of the certificates the interest has always been paid at the fixed annual rate as provided for in the terms of issue. Austria claimed that the remuneration from the certificates is not a "participation in profits" within the meaning of Article 11 (2). Germany took the contrary view and claimed the right to tax the interest as well. It supported its claim by a judgment of the Supreme Tax Court from August 2010 where it was held that a contractual profitability condition in the certificates at issue rendered the interest profit-dependent and thus entitled Germany to withhold tax on the interest paid to the Austrian recipient (creditor). Since a mutual agreement procedure initiated by Austria failed in 2011 the case was brought before the ECJ.

The ECJ is of the opinion that the context in which the phrase "income from … debt-claims with participation in profits" is used and the objective and meaning of Article 11 of the German-Austrian treaty calls for a strict interpretation and be limited to situations in which the remuneration from the debt-claim varies and depends – at least partially – on the amount of the debtor's profits. In the case at hand, though, the certificates granted an entitlement to the payment of annual interest at a fixed predetermined rate calculated on the basis of the nominal value of those certificates. The terms of issue did not provide that the interest rate be supplemented, at the very least, by a variable element representing a part or a share of the profits made by the debtor. Thus, irrespective of the amount of profit of the debtor, the interest rate was based solely on the nominal value of the certificates.

The claim made by Austria was thus granted. The ECJ conceded that the interest rate may be reduced to zero where the debtor incurs losses. However, if no losses are incurred in subsequent years, the creditor would be entitled to payment of arrears during those years and therefore this was more a suspension of interest until the bank returned to profitability than a clause for participation in profits. To the ECJ this only implied that the annual payment of interest was affected by the presence of sufficient net profit for that financial year, and not that, in addition to annual interest, the certificates gave rise to an entitlement to a share in those profits.

The ECJ case reference is C-648/15 *Austria v Germany* judgment of September 12, 2017

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Schlagwörter

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