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Federal Constitutional Court: Inadmissible review of norm regarding the solidarity surcharge on corporate income tax credits

In a decision published on 26 November 2021, the Federal Constitutional Court (Bundesverfassungsgericht,) declared as inadmissible a referral by the Supreme Tax Court (Bundesfinanzhof) regarding Section 3 of the Solidarity Surcharge Act 1995 as amended on October 15, 2002 (SSA, 1995).

Background

The Supreme Tax Court is of the opinion that Sec. 3 of the German Solidarity Surcharge Act 1995, as amended, is unconstitutional to the extent that it neither provides for a claim to a solidarity surcharge credit similar to the corporation tax credit under Sec. 37 (5) of the German Corporation Tax Act (CTA), as amended on December 7, 2006, nor does it provide for the corporation tax credit – refunded in installments - to reduce the tax base for the solidarity surcharge.

Facts

According to Sec. 3 (1) No. 1 Solidarity Surcharge Act 1995 (SSA), as amended, the tax base for the solidarity surcharge for companies is calculated on the basis of the corporate income tax (CIT) assessed (i.e. after deduction of CIT credits or refunds to the extent that a positive amounts us assessed). The systematic is connected to the 2001 change in the system of income taxation of corporations from the imputation system to the half-income system.

Until the end of 2000, profits retained by a corporation and not distributed were initially taxed at the retention rate of (most recently) 40% and the solidarity surcharge was levied thereon. If the profit was later distributed, the corporate income tax was reduced to (most recently) 30%. The difference between these two rates was refunded when the company made a distribution. Thus, a corporate income tax reduction potential arose at the level of the company up to the time of the distribution, which was determined by the amount of the differences in tax rates. At the shareholder level, the distribution was taxed at the taxpayer's individual income tax rate. In this context, the corporate income tax paid by the corporation was credited against the income tax of the shareholder.

Since 2001, a single uniform and final corporate income tax (15% since 2008) has been levied at the level of the corporation for both retained and distributed profits. At the level of the shareholder, only 60% of the distributed capital income is taxed (before 2009 50%).

The transition from the imputation system to the half-income system was designed by the legislator in such a way that a corporate income tax credit was determined on the basis of the potential refund resulting from the difference between the two rates. The resulting corporate income tax credit thus assessed was to be reduced over a 15-year (later 18-year) transition period by 1/6 of the open profit distributions made in each of the following years until the corporate income tax credit was used up.

The respective amount of the reduction was paid out to the company - by way of a set-off against corporate income tax payable or by way of refund. Where there was a set-off against corporate income tax payable, the tax base for the solidarity surcharge was reduced at the same time in accordance with Sec. 3 (1) No. 1 SSA 1995, as amended. Where, however, there was a refund, i.e., to the extent that the corporation tax credit to be paid out exceeded the corporation tax assessed, the corporation tax refund had no effect on the amount of solidarity surcharge due to the limitation proviso of Sec. 3 (1) No. 1 half-sentence 2 SSA 1995 (to the extent " a positive amount remains").

The Act on Tax Measures Accompanying the Introduction of the European Company (SE) and Amending Other Tax Regulations (SEAA) of December 7, 2006, changed the system of the corporation tax credit. The distribution-dependent payment of the corporation tax credit was replaced by a pro rata refund of the remaining credit independent of profit distributions. According to Sec. 37 (5) Sentence 1 CTA in the version of the SEAA, in the period from 2008 to 2017 the corporation had a claim to a refund of the corporation tax credit finally assessed as at December 31, 2006 in ten equal annual installments to be paid out on September 30 each year.

In addition to the claim for a refund of the corporation tax credit, the plaintiff in the main proceedings applied unsuccessfully to the tax office for the separate assessment of a claim to a refund of a corresponding solidarity surcharge credit. The action brought against this before the Cologne Tax Court was unsuccessful.

The Supreme Tax Court suspended the appeal proceedings in which the plaintiff is pursuing its claim and referred the question to the Federal Constitutional Court for a decision as to whether Sec. 3 SSA 1995, as amended, is compatible with the German Constitution to the extent that payments of the corporation tax credit pursuant to Sec. 37 para. 5 CTA - as amended by the SEAA - do not reduce the tax base for the solidarity surcharge and neither Sec. 3 SSA 1995 (as amended). nor any other provision require an assessment of a claim to a solidarity surcharge credit.

This violates Article 3 (1) of the Constitution and the principles of the protection of legitimate expectations under the rule of law (Article 2 (1) in conjunction with Article 20 (3) of the Constitution). Whereas the refund of the corporation tax credit under the original transitional provisions would have reduced the corporation tax assessments and thus also the solidarity surcharge, this is no longer the case under the SEAA. As a result those taxpayers who, relying on the original regulation, had refrained from making profit distributions and thus claiming their corporate income tax credit with a reducing effect for the solidarity surcharge would be disadvantaged. No objective reason for this disadvantage is apparent.

Decision of the Federal Constitutional Court

The Federal Constitutional Court declared the submission inadmissible as the rationale presented did not meet the requirements of Sec. 80 (2) Sentence 1 Federal Constitutional Court Act. The submissions on the relevance of Section 3 of the SSA 1995, as amended, provided by the Supreme Tax Court left obvious questions unanswered.

The Supreme Tax Court has interpreted Sec. 3 (1) No. 1 SSA 1995, as amended, to the effect that the provision precludes the separate assessment of a solidarity surcharge credit on the basis of the corporation tax credit to be paid out under Sec. 37 (5) CTA , as amended, because according to the wording of the provision, the corporation tax assessed is only tax base for the solidarity surcharge "if a positive amount remains", i.e. not if there is a refund and the corporation tax liability is therefore negative.

Following this defensible interpretation, the appeal would not be successful if the provision were to be considered constitutional. On the other hand, the appeal would be successful if the legislator were to remedy any unconstitutionality of Sec. 3 SSA 1995 in such a way that, in addition to the claim to the refund

of a corporation tax credit pursuant to Sec. 37 (5) Sentence 1 CTA in the version of the SEAA, a separate claim for the refund of the solidarity surcharge in the amount of 5.5% of the corporation tax credit (credit solution) were introduced.

When considering a possible infringement of the principle of equality, the fact that the legislator has several options for eliminating an established unconstitutionality will not be relevant to the Federal Constitutional Court's interpretation of the norm. Likewise the fact that the legislator would also have had the option of taking into account the corporation tax credit refunded in installments - as under the original provision – by way of a set-off against corporation tax assessed (i.e. so that the credit would reduce the tax base for the solidarity surcharge) will have no impact on the admissibility of the submission to the Constitutional Court. It will be enough if a finding of unconstitutionality gives the plaintiff the opportunity to attain a regulation more favorable to him.

However, a regulation favorable to the taxpayer will not be possible if the legislator is prevented from creating such a regulation for legal reasons or for obvious factual reasons. The Supreme Tax Court would therefore have had to address the question of whether the "credit solution" sought by the plaintiff in the main proceedings would be constitutionally permissible or whether it would in turn be subject to constitutional objections vis-á-vis the principle of equality.

A definitive burden of corporations with solidarity surcharge was already possible both under the application of the imputation system and during the transitional phase to the half-income system under the provisions of the Tax Reduction Act and the Tax Concessions Reduction Act, i.e. before the entry into force of the SEAA. Accordingly, the obvious question is whether the "credit solution" favoured by the plaintiff in the main proceedings, which excludes any definitive burden of solidarity surcharge connected to the corporation tax credit paid out in installments, would not (once again) result in an unjustified unequal treatment of various groups of taxpayers who, on the basis of the previous imputation system, have or had the potential to reduce corporation tax or, during the transitional phase, had the potential for a corporation tax credit. The Supreme Tax Court does not address this in any way.

Neither do the comments on the unconstitutionality of Sec. 3 SSA 1995 meet the requirements of Sec. 80 (2) Sentence 1 Federal Constitutional Court Act. There is no need to consider whether the Supreme Tax Court, in its interpretation under non-constitutional law, has sufficiently demonstrated the incompatibility of the provision in question with Article 3.1 of the Constitution or with the constitutional principle of the protection of legitimate expectations (Article 2.1 in conjunction with Article 20.3 of the Constitution). In any event insufficient justification has been provided to show that it is impossible to interpret Sec. 3 (1) No. 1 SSA 1995 (in conjunction with Sec. 37 (5) CTA in the version of the SEAA) in a manner which conforms with the Constitution.

The arguments provided by the Supreme Tax Court against a constitutional interpretation do not go far enough. In particular, the Supreme Tax Court argues that the legislator deliberately decided when changing the system by means of the SEAA that the payment of the corporation tax credit should no longer reduce the tax base for the solidarity surcharge. In this context, the Supreme Tax Court admits that the solidarity

surcharge is not mentioned in the explanatory memorandum to the Act. However, the Supreme Tax Court assumes that the legislator could not have been unaware that the assessment and payment of a corporate income tax credit in installments would nullify the effect on the solidarity surcharge.

However, it does not follow from this that a separate assessment of a solidarity surcharge credit based on the corporate income tax credit or an inclusion of the corporate income tax credit paid out in installments within the corporate income tax assessment procedure and thus affecting the tax base of the solidarity surcharge would contradict the clearly recognizable intention of the legislator when enacting the SEAA.

With the SEAA, the legislator intended, on the one hand, to simplify the previous system of distribution-dependent refund of the corporate income tax credit and to make it easier to administer. On the other hand, it wanted to improve the calculability of revenues for public budgets. The Supreme Tax Court does not state that one or the other objective would have been thwarted by the separate determination of a solidarity surcharge credit on the corporate income tax credit or by taking into account the annual payment rate in the assessment basis for the solidarity surcharge in the assessment procedure.

The Supreme Tax Court does not deal in detail with the question of whether - if not the legislative intention when enacting the SEAA - the wording, the legislative history, the overall context of the relevant provisions and their meaning and purpose preclude an interpretation of Sec. 3 (1) No. 1 SSA 1995 that is in conformity with the Constitution. In particular, it fails to elaborate on non-constitutional law in a way that would allow conclusions to be drawn on the inadmissibility of a constitutional interpretation of Sec. 3 (1) No. 1 SSA 1995 in terms of the mitigative solution. The Supreme Tax Court rules this out because the claim to the refund of the corporation tax credit has been separated from the assessment procedure and thus is a tax refund claim.

What consequences the classification as a tax refund claim has for the consideration of this claim in the tax base for the solidarity surcharge remains unclear. In particular, the question is not answered as to whether, according to the tax system and the overall context of the relevant regulations, the reason that a the one-time assessment and annual refund of the corporate income tax credit is not considered in the tax base of the solidarity surcharge during the respective corporate income tax assessment procedure, is because, for example, the normative content of Sec. 3 (1) No. 1 Half Sentence 2 SSA 1995, as amended, would otherwise be fundamentally redefined. Thus, the reasoning of the submission does not reflect its the specialised court's function to disburden the Federal Constitutional Court. This should be achieved by ensuring that the competent specialised courts consider the relevant case properly according to non-constitutional legal principles.

Reference

Federal Constitutional Court , Press Release No. 99/2021 of November 26, 2021 (Decision of October 27, 2021, 2 BvL 12/11).

Schlagwörter

corporate income tax credits, half-income system, solidarity surcharge