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By PwC Deutschland | 17. Juni 2024

Trade tax addback of portfolio dividends in 2001 tested before Constitutional Court

After the European Court of Justice had answered the preliminary request submitted by the Supreme Tax Court on the subject of trade tax addback of foreign portfolio dividends in the year 2001, the latter continued to suspend the appeal and now referred the matter to the Constitutional Court. It should be ascertained whether the transitionary regulation, which had been introduced with the replacement of the imputation system in 2001 with the half-charge to income tax, contravenes the principles of legitimate expectations laid down in Article 20 (3) of the Basic Law.

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Background

In an application of April 2004, the plaintiff (*H Lebensversicherung*, a public law institution subject to corporation profits tax and trade tax and which operates a life insurance company) exercised the so-called block option to which life and health insurance companies were entitled at the time. As a result, 20% of the dividend income from the portfolio investments in the foreign corporations were not to be taken as income when determining the profit relevant for corporation profits tax purposes pursuant to Sec. 8b (1) of the Corporation Tax Act (CTA) in the version applicable in 2001. With reference to the add-back provision in Sec. 8 No. 5 Sentence 1 Trade Tax Act (TTA), however, the tax office – for the assessment period 2001 - added back the 20% of the distributions received which were not subjected to corporation profits tax.

Subsequently, during the appeal proceedings, the Supreme Tac Court had requested the ECJ for a preliminary ruling. In its decision *H Lebensversicherung* of 22 June 2023 (**case C-258/22**) the ECJ held that the trade tax addback of foreign portfolio dividends in the year 2001 is in line with the EU provision on the free movement of capital if and to the extent – as in the case of dispute - those dividends had previously been deducted from that trade tax basis (trading income).

Referral to the Constitutional Court

In dealing with the second point of dispute brought by the plaintiff, which the Supreme Tax Court seems inclined to share, the issue of the constitutional propriety of the retroactive applicability of the trade tax addback in the case of dispute was referred to the Constitutional Court seeking a decision on the protection of legitimate expectations.

Regarding the constitutional principles of the protection of legitimate expectations, the parties assume that the issue of portfolio dividends from shares in foreign corporations in the case of dispute is comparable to that of advance distributions addressed in a decision of the Constitutional Court of 10 October 2012 - 1 BvL 6/07. In this judgment the Constitutional Court has allowed a tax change retrospective to the date on which the suggestion for its enactment was announced (details in our **blog post of 14 November 2012**).

Regarding the date of expiry of the protection of legitimate expectations assumed by the Constitutional Court to be after 11 December 2001, **there are differing opinions** as to whether the date of receipt of the dividends by the plaintiff from the fund (12 December 2001) is decisive (as asserted by the tax office) or if an earlier date could be identified. This could be on 11 December 2001, i. e. when the dividends from the foreign corporations were received by the fund.

In the opinion of the Supreme Tax Court, the transitory rule at issue, Section 36 (4) Trade Tax Act, also impedes (violates) the constitutional principles of the protection of legitimate expectations under Article 20 (3) of the Basic Law insofar as it declares those portfolio dividends from foreign corporations to be added back to the trading income which were resolved by the distributing company with binding effect before 12 December 2001 and which accrued to the corporation holding an interest of less than 10% in the distributing company via a domestic special securities fund prior to this date.

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Reference:

Supreme Tax Court, decision of 7 February 2024 (I R 36/23 (I R 5/18)), published on 13 June 2024.

Schlagwörter

trade tax addback