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MoF: Credit of foreign corporate tax under previous imputation tax system

In a most recent circular the Federal Ministry of Finance commented on the method of the foreign corporation tax credit under the formerly applicable German imputation system. The focus of the circular are two judgments of the European Court of Justice as regards the calculation and verification of the creditable corporation tax underlying a dividend from another EU country.

Background

I. The imputation system

Up to 2000 corporation tax was levied in Germany on an imputation system of taxing the grossed-up amounts of dividends received but granting a tax credit in the amount of the gross-up factor. This was equal to the corporation tax borne by the dividend payer on the profit distributed. The objective was to ensure that business income was taxed once and once only – ultimately at the personal income tax rate of the natural person shareholder – no matter through how many hands it passed before reaching its final destination. The system was, however, national in that it excluded foreign source dividends (and, for that matter, foreign shareholders) from the tax credit.

II. The ECJ cases Meilicke I C-292/04 of March 6, 2007 and Meilicke II C-262/09 of June 30, 2011

In a **first case** brought by the heirs of a Herr Meilicke, the ECJ held that the double taxation of foreign dividends was a restriction on the free movement of capital, incompatible with community law (Case 292/04 *Meilicke* judgment of March 6, 2007). Specifically, the ECJ held that in view of the objective of “preventing double taxation of corporate profits distributed in the form of dividends”, persons with unlimited tax liability in Germany must be granted a credit of foreign corporation tax comparable to the statutory standard for profit distributions by companies that are not subject to unlimited corporation tax liability in Germany.

However, the ECJ did not rule on the calculation of the imputation credit from a foreign tax system or on the required evidence of payment of the foreign corporation tax, given that a foreign company would be unable to meet the documentation formality specified by the Income Tax Act and based on the German administrative system. The ECJ has subsequently addressed these points in a **second *Meilicke* judgment** (**C?262/09**). In particular, the ECJ held that the shareholder's tax office cannot be required to make, or accept, an estimate of the foreign corporation tax due, or to clarify the situation of the paying company abroad through the mechanism of the Mutual Assistance Directive. On the other hand, the tax office must accept objective evidence and cannot fall back on a formal requirement that a foreign company could not meet by definition (here the form of certificate to be issued by the dividend payer, showing the gross dividend to the recipient and the uplift factor).

The tax authorities of the Member State of taxation are entitled to require that shareholder to provide documentary evidence enabling them to ascertain, clearly and precisely, whether the conditions for obtaining a tax credit under national legislation are met without having to make an estimate of that tax credit.

III. Final decision of the Supreme Tax Court

Taking these ECJ judgments into account, the Supreme Tax Court then laid down the requirements for offsetting foreign corporation tax against a shareholder's domestic income tax in its subsequent and final decision of 15 January 2015 (caseI R 69/12) (more details to be found **here**). In summary, the Supreme Tax Court made two points: an imputation credit for foreign corporation tax presupposed the income to have been grossed up with the relevant amount, and that the documentation submitted was clearly inadequate.

The gross-up would equate the foreign and German income but would presuppose revising the computation of taxable income in the assessment.

The MoF circular

In the current circular the Federal Ministry of Finance addresses in some detail the necessary modifications following the above Supreme Tax Court decision which can be summarized in brief as follows:

I. Documents and evidence to be presented to the tax authorities

As the Supreme Tax Court noted in the above decision I R 69/12 the shareholder must provide full proof of the imputation amount. A tax certificate from the distributing company is not sufficient. The following documents must be submitted to the tax authorities when requested:

Tax assessment notice or registration data of the foreign company and, if required, determination of income (in accordance with foreign law)

Foreign commercial balance sheet of the distributing company

Dividend resolution/ profit distribution resolution

Evidence of the investment interest (participation quota)

In addition, it is at the disposal of the tax office to request further evidence (e.g. the tax balance sheet). A certified translation of the documents may be obtained upon demand. The documents must be submitted for all relevant periods, including documents for previous years if deemed necessary.

II. Requirements for the foreign tax credit under the imputation system

Foreign corporation tax applicable to a distribution may only be credited if the equity capital used for the distribution was subject to corporation tax. This is not the case, for example, if the distribution stems in whole or in part from income that was not subject to tax, e.g. from tax-free dividends received by the distributing company.

The following points must be verified and observed:

Comparability of foreign corporate tax; disallowance of corporation tax credits in accordance with former Section 36a Income Tax Act (whereupon a tax credit is not possible for certain shareholders with a significant shareholding if the tax to be credited is not covered by a corresponding amount of tax paid and it can be assumed that full collection will not be successful after the enforcement proceedings for this outstanding tax have begun); no credit for indirect corporation tax. Last, the distribution must be taken as taxable income (as of 1996: plus the creditable tax).

III. Calculation of the allowable amount of tax credit (the imputation amount)

Based on the requirements under EU law, the imputation system must be applied to cross-border cases in an equivalent manner regarding the creditable amount of foreign tax and without creating a more favorable treatment as compared to the domestic case. This effectively leads to a limitation of the creditable foreign tax to 36% (prior to 1994) or 30% (from 1994).

The foreign tax credit may not exceed the German tax due on the dividend - including the creditable tax from 1996 onwards. Any foreign withholding tax credited against the domestic tax must be taken into account.

IV. Application regulation

The aforementioned principles are to be applied in all open cases to distributions received which are not yet subject to the rules of the half-income method. This circular also applies to distributions from third-country companies.

Source:

Federal Ministry of Finance circular of 7 October 2024 (IV C 2 - S 2700/21/10001 :003), published on 11 October 2024.

Schlagwörter

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