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Corporation tax on portfolio dividends

The Bundesrat has passed a bill to charge dividend income on investments of less than 10% to corporation tax.

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In October 2011, the ECJ held in a suit against Germany brought by the European Commission that the German withholding tax on dividends to EU and foreign corporations was in breach of the free movement of capital (case C-284/09). Its main point was that the system discriminated against foreign corporations as minority shareholders inasmuch as the dividend withholding tax of 15% plus solidarity surcharge (or lower treaty rate) was effectively a final burden for them, at least from the German point of view, whereas a German corporation in an otherwise similar position would always be entitled to a refund of the amount deducted. The mechanism was simple: the withholding tax was effectively a payment on account of the corporation tax due although dividend income was generally free of corporation tax, the one exception being dividends received by banks on securities held for trading. A resident corporation would therefore always be entitled to credit or reimbursement of any withholding tax borne. Since dividends on strategic holdings of 10% or more generally fall under the Parent/Subsidiary Directive exemption if paid to a corporate shareholder in another EU member state, the discrimination essentially caught portfolio holdings of less than 10% of the share capital of the dividend payer. The judgment left Germany the choice between rendering all portfolio dividends chargeable to corporation tax and waiving the withholding tax on those paid to corporate shareholders abroad. After some debate, the government chose the former.

The bill has now received the blessing of the *Bundesrat* and so passed its last parliamentary hurdle. Its enactment into law is for all practical purposes now certain. It amends the Corporation Tax Act to charge all dividends received on or after March 1, 2013 on shareholdings of less than 10% of the paying company's share capital on the previous January 1 to corporation tax. However, acquisitions of more than 10% during the (calendar) year rank for this purpose as having been acquired as of the beginning of the year, so distributions immediately after a major share acquisition are not "caught". On the other hand, shares in the same company held by different members of a tax group are not added together, so groups with extensive and dispersed investments may need to reorganise their holdings.

It should also be noted that the Tax Act on Investment Funds has been amended to mirror the new liability. However, the corporation tax exemption for capital gains realised on the sale of shares has not been changed. The trade tax liability on dividend income on holdings of less than 15% also remains unchanged.

Keywords

portfolio dividend