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No trade tax add-back for foreign dividends in 2001

The Supreme Tax Court has held that the provision in the Trade Tax Act requiring that foreign dividends on shareholdings of up to 10% be charged to tax if received in 2001 is contrary to European law and must be disapplied for that year.

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In 2000 the corporation tax system changed radically from the imputation/split-rate procedure to the present part-charge/single rate system. In both cases, the idea is to tax corporate income only once, at a burden the ultimate shareholder could expect to bear, had he received the income directly. The achievement of this object depended under the old system upon a lack of foreign income taxable abroad and under the new system upon an accurate reflection in the ratios set by the tax acts of the facts in the given circumstances. This desired result is, and was, seldom, if ever, achieved.

In an effort to keep changeover difficulties to a minimum, the Corporation Tax Act provided that annual profits in 2000 be taxed under the old system, whilst those earned in 2001 fall under the new. Similarly dividends received in 2001 would be taxed as stemming from “old” profits, whilst those received in 2002 would be seen as new system dividends. Dividends from abroad, however, were taxed under the new system in 2001, as there was no need to maintain symmetry between the profit as earned and the profit as distributed. The new system exempted dividend income from corporation tax entirely, but charged it to trade tax if the recipient held less than 10% (now 15%) of the equity capital of the paying company. This meant that a dividend on a portfolio investment abroad would be charged to trade tax in 2001, but not until 2002 if the investment was held in a company at home. The ECJ has already held that a distinction in the tax treatment of domestic and foreign dividends can be seen as a restriction on the freedom of capital movement (case C-377/07 *STEKE*, judgment of January 22, 2009), and the Supreme Tax Court has now taken the same position in respect to trade tax. Accordingly, the provision charging foreign dividends on portfolio investments of corporations in 2001 to trade tax must be disapplied. Interestingly, the court largely ignored the main argument of the taxpayer – that the dividends had been received in 2001 before the enactment on December 20, 2001 of the provision charging them to tax, and that the change was therefore retroactive taxation – saying that if a provision was invalid under community law its constitutionality in Germany was irrelevant.

Supreme Tax Court judgment I R 14/07 of March 6, 2013, published on July 10

Keywords

add-back, foreign dividend, trade tax