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Response of tax authorities to European Court of Justice’s decision on the “activity requirement” for trade tax exemptions on dividends from third countries

The tax authorities of the Federal States have issued a joint response to the ECJ’s decision in EV (C-685/16) on 20 September 2018, in which the Court decided that the “activity requirement,” contained in the rule providing for a trade tax exemption on distributions from third countries contravened EU law.

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The ECJ decided in EV that the requirement in the Trade Tax Act, that dividend income from third country sources was only exempt if it was deemed “active” income under the terms of the Foreign Transaction Taxes Act, contravened the EU principle of free movement of capital (Article 63 TFEU), as a similar requirement did not apply to distributions from domestic companies.

On 25 January 2019, the tax authorities of the Federal States released a statement of practice together with the Federal Ministry of Finance on the application of the trade tax exemption in cases involving third countries. According to the statement of practice:

- the participation of at least 15% in the subsidiary must exist at the beginning of the reference period; this contrasts to the provision as it stands, which requires that the participation must exist **uninterruptedly** from the beginning of the reference period;
- the special requirements subjecting gross income received from the subsidiary to an “activity test” do not have to be met;
- the special requirements for profits from sub-subsidiaries which are obtained via the subsidiary, including the activity test and the requirements on the provision of proof, are not to be applied.

The above principles are to be applied to all open cases and are to continue until legislation is introduced to amend the offending provision.

Keywords

EU Law, activity test, free movement of capital, trade tax exemption