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By PwC Deutschland | 03 June 2022

UPDATE: Credit of Canadian withholding tax on dividends also for trade tax?

The Regional Tax Court of Hesse held that withholding tax levied in Canada on dividends distributed by a Canadian corporation to a German corporation should be credited against German trade tax. The tax authorities have in the meantime launched an appeal against this judgment and the case is now pending before the Supreme Tax Court for final clarification.

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Facts of the case

The plaintiff, a German limited liability company (GmbH), held a 0.22% interest in a Canadian corporation during the years 2008 through 2010 and received dividends which were subject to Canadian withholding tax. In the tax assessment issued by the tax office, the dividends were exempt from corporate income tax according to Sec. 8b (1) Corporation Tax Act (CTA) but were added back for trade tax purposes because the required minimum holding level of 15% was neither met for the local trade tax privilege as in Sec. 9 No. 7 Trade Tax Act (TTA) nor for the dividend relief on significant (at least 10%) holdings following Art. 23 (2)a Sent.2 of the German Canadian double tax treaty concluded between Germany and Canada (DTT).

Judgement

The Regional Tax Court granted the appeal.

The plaintiff is entitled to the foreign tax credit, according to Article 23, para. 2(b)(aa) in conjunction with Article 10 DTT. The Canadian tax withheld at source leads to double taxation, as Germany and Canada levy a similar tax on the same taxpayer and on the same taxable income for the same tax period.

According to the Regional Tax Court, the tax credit applies both to income tax and trade tax. Although the Trade Tax Act does not itself contain specific tax credit provisions, the DTT nevertheless sets the ground for a foreign tax credit also for trade tax. For the definition of the term "income" within the meaning of a tax credit under Article 23 of the treaty, the more comprehensive (wider) term used in Article 2 should be the decisive one: The taxes referred to in Art. 2 para. 3(b) of the treaty are either taxes on income or taxes on wealth. Therefore, since the business tax is not a tax on income, it would - in the opinion of the court- have to be a tax on wealth.

Furthermore, the DTT applies to *persons* who are residents of one contracting state or of both contracting states (Article 1 DTT), and the term "*persons*" includes both an *individual and a company* as stated in Article 3 para. 1a DTT. Considering this and despite the domestic business operation being the object of taxation, the trade tax would therefore also fall within the scope of the German Canadian DTT.

The Regional Tax Court concludes that, although there is no specific tax credit provision under trade tax law, a credit was possible by analogous application of the foreign tax credit provisions for corporation tax and income tax; Sec. 26 (1) Sentence a No. 1 CTA and Sec. 34c (6) Sentence 2 ITA.

Takeaway

At a first glance, the conclusion of the court seems reasonable. On the other hand, it must be considered that (as opposed to Sec. 34c ITA and Sec. 26 Corporation Tax Act) the Trade Tax Act does not itself contain any rules for a credit of foreign taxes against the trade tax due. Further, it is worth to note that the application of the double tax relief for dividends on significant holdings is governed separately in Sec. 9 No. 8 TTA with a specific minimum holding threshold („*profits on shares in a foreign company are, under a double tax treaty, free of trade tax on the condition of a minimum holding of at least 15%…*"). When looking at the structure and character of the Trade Tax Act it might be appropriate to assume that a foreign tax

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credit is therefore not possible, because the sole object of levying the trade tax is the German business operation itself. Despite of this, there is still no reason for the Regional Tax Court why a foreign tax credit trade should not be allowed for trade tax purposes.

It is now a matter for the Supreme Tax Court to resolve this dispute (pending case ref.: I R 8/21).

UPDATE (1 June 2022)

The Supreme Tax Court dismissed the tax office's appeal I (R 8/21); the Court considered the appeal inadmissible (Sec. 126 (1) Tax Court Regulations) and consequently made no comments on the substantive issue as to whether the domestic plaintiff (GmbH) was entitled to credit the Canadian withholding tax paid against the German trade tax (and how, if relevant, such claim should be enforced under procedural law). The ruling 8 K 1860/16 of the Hessian Tax Court is thus legally binding.

Source:

Regional Tax Court of Hesse, judgement of 26 August 2020 (case ref. 8 K 1860/16)

Keywords

foreign tax credit, trade tax, withholding tax