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By PwC Deutschland | 10 November 2021

Foreign tax credit possible even if several options to reduce foreign withholding tax exist

The regional tax court of Rhineland-Palatinate had to decide whether, in the case of a right to choose between two methods of reducing foreign withholding tax, the taxpayer must ensure that foreign taxes are credited in as small an amount as possible. The regional tax court is of the opinion that it is at the discretion of the taxpayer if and how to use the option to which he is entitled and that this does not have an adverse impact on the general possibility of a foreign tax credit against his German income tax liability.

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Background

Section 32d Income Tax Act (ITA) provides details on the mechanism of a credit of foreign withholding taxes levied on investment income ("*special rate for investment income*") and supersedes the more general tax credit provision in Section 34c ITA. As a rule, the income tax on investment income is to be 25 per cent. In a second step, this tax is reduced by the credit for foreign taxes under sub-section 5, which reads as follows "*Taxpayers with unlimited tax liability in Germany with investment income from abroad and who are subject in the state of source to a tax comparable to German income tax are to be granted a tax credit against their German tax in the amount of the foreign tax on each item of foreign income as assessed, paid and reduced by any claim for rebate (…)*".

Case of dispute: The plaintiff received investment income (dividend income) from his participation in S.A., a Norwegian corporation. The dividend was initially subject to withholding tax of 25 per cent. Basically, as in the given situation, there are two methods available to determine the tax refund: Upon application for the so called "*shielding deduction*" (in Norway known as *fradrag for skjerming*), the dividend distribution is reduced for the purpose of tax withholding. Alternatively, a partial refund of the withholding tax under the double tax treaty (here: 10 per cent) is possible. The claimant opted for the latter. Thus, from the 25 per cent withholding tax deducted at source 10 per cent were refunded to him by the Norwegian tax authorities. The German tax office, however, refused the tax credit of the remaining 15 per cent because - under Norwegian tax law - the possibility to opt for a zero rate of withholding tax by way of the "*fradrag for skjerming"* was available, albeit not chosen by the plaintiff.

Decision

The regional tax court held that the taxpayer is free to exercise the option to which he is entitled even if he opts for the lower refund claim from the foreign tax authorities (instead of the "shielding deduction") and that the remaining final Norwegian withholding tax of 15% may thus be credited against the plaintiff's income tax for 2017 (year in dispute). By claiming the partial refund of Norwegian withholding tax based on Article 28 (2) of the double tax treaty concluded between Germany and Norway, the plaintiff is no longer entitled to a "*fradrag for skjerming*", so that from this point the Norwegian tax is no longer subject to any claim for rebate (as in Sec. 32d (5) ITA).

For the purpose of the tax credit and pursuant to Sec. 32d (5) Sentence 1 ITA it is only necessary that a claim for rebate existed, actual utilization of that claim (i. e. by way of a refund) is not required for that matter. Thus, the taxpayer is generally free but also expected to pursue all options for a reduction.

In conclusion, the plaintiff is entitled to a refund of the entire remaining foreign withholding tax; this will not be reduced by any refund claim in excess of this amount.

Source:

Regional Tax Court of Rhineland Palatinate, decision of 18 June 2021 (case ref.: 3 K 1688/19); as yet and

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according to reports the judgment is final since no appeal was brought before the Federal Tax Court.

Keywords

foreign tax credit, foreign withholding tax, withholding tax reduction