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By PwC Deutschland | 06 May 2022

Ministry of Finance circular - Repayments of capital by third country corporations

In a recent circular the German Federal Ministry of Finance (MoF) addresses the tax issues arising from the repayment by third-country corporations of contributions, in relation to both repayments of contributions of nominal capital as well as repayments of contributions made into the free capital reserves. The Supreme Tax Court has previously commented on this set of issues in various previous decisions. In its current circular, the MoF gives guidance on the application of these Supreme Tax Court case law principles.

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Background

Section 27 (8) CTA extends the application of the provision on returns of capital to foreign corporations and associations of persons subject to unlimited tax liability in other EU Member States. The provision was incorporated into the Corporation Tax Act on 7 December 2006 and became applicable for the first time to the 2006 assessment period. In the current circular, the MoF addresses the issue of recognizing a return of capital from third-country corporations, taking into account the Supreme Tax Court case law (Supreme Tax Court I R 117/08 of 20 October, 2010; VIII R 73/13 of 13 July 2016; VIII R 47/13 of 13 June 2016, and I R 15/16 of 10 April 2019).

Supreme Tax Court rulings on the legal situation before the introduction of Sec. 27 (8) CTA (up to and including the 2006 assessment period) and for the legal situation after the introduction of Sec. 27 (8) CTA

With regard to the legal situation prior to the introduction of Sec. 27 (8) CTA, the Supreme Tax Court ruled in its judgment I R 117/08 of 20 October 2010 and in its judgment VIII R 73/13 of 13 July 2016 that in the case of a third-country corporation, a tax-neutral repayment of capital may be permissible, provided it could be assumed through the application of the relevant foreign commercial and corporate law, that the repayment was not made out of contributions to the nominal capital.

In its judgment of 13 June 2016 (VIII R 47/13), the Supreme Tax Court ruled upon the legal situation after the introduction of Section 27 (8) CTA. According to the decision, a repayment of capital can also be made by a company that is domiciled in a third country and for which no tax contribution account has been maintained in accordance with Section 27 CTA. In its decision of 10 April 2019 (I R 15/16), the Supreme Tax Court confirmed this view and also ruled that, although the amount of the distributable profit of a third-country company is to be determined in accordance with the respective foreign commercial and corporate law, its treatment and thus also that of the (subordinated) return of contribution was subject to the statutory fiction under Section 27 (1) sentences 3 and 5 CTA.

The current MoF application letter mainly focuses on the following points:

1. repayments of nominal capital

Section 7 (2) of Act on Tax Measures applying to Increase in Nominal Capital from Company Funds applies to cases of the repayment of nominal capital. The actual existence of a repayment of nominal capital must be proven by appropriate documents (in particular, the resolution on the reduction and repayment of nominal capital).

2. repayment of contributions not made to the nominal capital

The repayment of contributions not made into the nominal capital may qualify as a return of capital within the meaning of Sec. 20 (1) No. 1 Sentence 3 ITA (i.e. the rule whereby capital repayments deemed made from tax contribution account are not treated as dividends).

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The circular also discusses how the amount of the return of capital should be determined as well as on what proof is necessary and what the documents are required.

The principles set out in the circular are to be applied mutatis mutandis to payments made by an EEA corporation where the corporation or association of persons itself has failed to submit an effective application for the treatment of the respective payment as a return of capital pursuant to Sec. 27 (8) CTA.

The circular is applicable to all open cases.

Reference

MoF circular dated 21 April 2022 (IV C 2 - S 2836/20/10001 :002).

Keywords

Corporation tax, capital repayment, third country