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German withholding tax refund requirements for non-resident portfolio shareholders violate EU Law

The German rules on the procedure and documentation requirements for withholding tax refunds to non-resident portfolio shareholders are not compatible with the EU principles on the free movement of capital, as the European Court of Justice (ECJ) said in a most recent decision.

Background

ACC Silicones is wholly owned by *The Amber Chemical Co. Ltd*, both resident in the United Kingdom. In the years at issue (2006 through 2008), *ACC Silicones* had a 5.26% stake in the nominal capital of *Ambratec GmbH*, a German company. The latter distributed dividends to *ACC Silicones*, on which the tax of 20%, plus the solidarity surcharge was withheld. The German Central Tax Office (CTO) granted only a partial refund of 5% according to the 15% limitation set in the double tax treaty (DTA). As regards the refund of the remaining tax the CTO noted that the claimant is required to prove that the condition laid down in point 5 of the second sentence of Section 32(5) Corporation Tax Act (CTA) is met by submitting a certificate from the tax authorities of its country of residence stating that the German tax on income from capital cannot be offset, deducted or carried forward and that no set-off, deduction or carry-forward has actually taken place either.

In his Opinion of 20 January 2022, the Advocate General (AG) suggested to the ECJ that Germany's requirements for withholding tax claims filed by non-resident corporate taxpayers with seat or place of management in the EU or EEA are too strict and thus in violation of Article 63 TFEU on the free movement of capital (more details to be found in our blog post of 25 March 2022).

ECJ decision

The ECJ concurs with the Opinion of the AG and holds the German rules to be not compatible with the principles on the free movement of capital.

The ECJ confirms that there is a difference in treatment since the conditions under which the tax withheld at source on dividends may be reimbursed vary depending on whether the recipient of those dividends is a resident company or a non-resident company. In the case of a resident company, the withholding tax is set off in full against the corporation tax payable by the latter and the remainder is, where appropriate, reimbursed to it. By contrast, in the case of a non-resident company, the reimbursement of tax is subject to the condition that it cannot be set off or its set-off be carried forward in favor of that company or in favor of its direct or indirect shareholders, nor can it be deducted as an operating cost of that company.

Such a **difference in treatment** is permissible only if it relates to situations which are **not objectively comparable** or if it is **justified by an overriding reason in the public interest**, is appropriate for securing the attainment of the objective pursued and does not go beyond what is necessary to achieve it. The ECJ, in his summary, rejected both reasons for justification.

In the present case, it is apparent that Germany chose to exercise its power of taxation over all dividends from 'portfolio' shares, whether those dividends are paid to resident companies or to companies established in other Member States. Those two categories of companies are, for that matter alone, in **a comparable situation** as regards the risk of economic double taxation or of a multiple tax charge on those dividends. They must therefore be subject to equivalent treatment.

The ECJ also **rejects the second reason for justification**. Generally, safeguarding the balanced allocation between the Member States of the power to tax is one of the overriding reasons in the public interest capable of justifying a restriction on the free movement of capital, such as to prevent or jeopardize the right of a Member State to exercise its powers of taxation in relation to activities carried out in its territory. The restriction would thus not only be permissible if it were justified by an overriding reason in the public interest, but also if it were appropriate for securing the attainment of the objective pursued and does not go beyond what is necessary to achieve it. In the opinion of the court, however, such an objective cannot justify the taxation of non-resident companies receiving dividends by a Member State which has chosen not to tax resident companies with respect to this type of income. This conclusion was with reference to the erstwhile landmark decision of the ECJ in the case **C-284/09** *Commission v Germany*, judgment of 20 October 2011 - point 78.

In this judgment from October 2011 the ECJ has held that Germany failed to fulfil its obligations under the principle of free movement of capital by taxing dividends distributed to companies established in other Member States, where the threshold for a parent company's holding in the capital of its subsidiary laid down in Article 3(1)(a) of the EU Parent Subsidiary Directive is not reached, more heavily in economic terms than dividends distributed to companies established in its territory. Pursuant to this, shareholders residing in the EU/EEA are entitled to receive dividends from subsidiaries located in other Member States free of withholding tax, provided that their shareholding represents at least 15 percent (from 2007) or 10 percent (from 2009) of share capital.

Source:

The ECJ case reference is C?572/20 *ACC Silicones* judgment of 16 June 2022. - The complete ECJ-decision to be found **here**.

Notes and takeaway: As our tax specialist team summarized in their ***EUDTG Newsalert of 17 June 2022***, this judgment is of great importance to non-resident corporate taxpayers with a portfolio shareholding in German companies if their withholding tax is higher than the corporate income tax of a comparable German shareholder. Those entities can claim a withholding tax refund in Germany unless the tax treaty ensures that it is fully credited in their state of residence. The complete and detailed EUDTG Newsalert on the ECJ decision is available for download on the relevant **website** of the EU Direct Tax Group.

Furthermore, the decision is **not relevant in third country cases**, as the UK was a member state of the EU in the years in dispute.

Furthermore, the ECJ **did not rule on the documentation requirements as such** (Sec. 32 (2) sentences 3-5 CTA): If the refund of withholding tax does not - as ruled by the ECJ - depend on the fact that it has not been credited or deducted in the case of the shareholder(s) of the parent company, it is irrelevant how the parent company can prove the non-credit and non-deduction.

Keywords

documentation, portfolio dividend, refund claim