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By PwC Deutschland | 17 October 2022

Trade tax: Dividend income exemption also in case of double residence

According to a decision of the Supreme Tax Court, the dividend income exemption for trade tax on qualifying shareholdings is also available for distributions of companies of foreign legal form with its statutory (registered) seat abroad, provided the foreign company is comparable to a German corporation, has its place of management in Germany and therefore maintains a permanent establishment there.

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Background

Sec. 9 no. 2a of the Trade Tax Act (TTA) protects profit distributions on shares in non-tax exempt domestic companies (…) from trade tax. The investment - at the beginning of the tax period - must at least be 15 per cent and the distributions be included in the trading profit (which is the starting point to determine the final and overall trading income subject to trade tax).

The plaintiff (a GmbH) was the sole shareholder of a Belgian partnership (BVBA). The sole managing director of BVBA was a natural person (A) with sole residence in Germany. BVBA is undisputedly similar to a corporation for German tax purposes. It did not engage in any active business and otherwise held a 14 % stake in a Mexican corporation (CV). In 2009, the latter made a profit distribution to BVBA in respect of its 2008 earnings and BVBA further distributed these profits to the GmbH. The tax office added back 95 per cent of the dividend from BVBA to the plaintiff's trading income subject to trade income tax.

Decision

The Supreme Tax Court held that the conditions for a trade income tax exemption are met. Sec. 9 no. 2a TTA is also applicable to foreign legal entities and the term used therein of "*domestic* company" includes not only corporations with domestic management established in Germany, but also legal entities established abroad with a place of management in Germany. That is true here, since A (the managing director of BVBA) was a German resident individual. Also, the plaintiff held a 100% interest in BVBA in the year in dispute.

BVBA - through A - has a German domestic place of management and is per se the subject of trade tax in accordance with Sec. 2 (1) sentence 3 TTA (permanent establishment through domestic management). According to the Supreme Tax Court, denial of the trade tax exemption would lead to double trade tax burden on the distribution in Germany.

An addback of 95% of the dividend pursuant to Sec. 8 no. 5 TTA is excluded once the company’s share of profits meets the requirements for trade tax deductions mentioned in Sec. 9 no. 2a (“profit distributions on shares in a non-tax exempt domestic company…”). This is the case here.

BVBA's management was located in Germany, it did not engage in any activities which require the add-back of passive income from low tax regimes as in Sec. 8(1) Foreign Tax Act and it held less than 15% in the Mexican CV.

Source

Supreme Tax Court decision of 28 June 2022 (I R 43/18), published on 13 September 2022.

Keywords

dividend exemption, trade tax addback