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No flat rate taxation in case of shareholder debt financing of foreign resident corporation

The Supreme Tax Court decided that interest from loans made by a taxpayer to a foreign corporation in which he indirectly holds an interest of at least 10% is subject to the regular progressive scale rate income tax rather than to the (lower) flat rate of 25%. This applies for all tax years prior to the introduction of the Finance Bill 2020.

Background

In the case of dispute, the plaintiff had granted loans to a Dutch corporation (B-BV) in which he indirectly held an interest as sole shareholder via another intermediate Dutch corporation (A-BV). In his income tax return, he declared the interest income from the loans of some €400,000 as investment income and subject to the special tax rate of 25% under Sec. 32d (1) Income Tax Act (ITA). The tax office, on the other hand, applied the higher scale rate of income tax with reference to Section 32d (2) no. 1 sentence 1 letter b ITA. According to that provision the special flat rate of 25% does not apply if the income is paid by a company (...) to a shareholder with a share of at least 10 per cent. This also applies where the creditor of the income is a related party of the shareholder.

Decision

The tax court of Duesseldorf confirmed the opinion of the tax office. Finally, the Supreme Tax Court took the same view and rejected the appeal of the plaintiff.

In the opinion of the Supreme Tax Court, the plaintiff had a close relationship to the shareholder corporation (A-BV) because, due to his participation as the sole shareholder, he was in a position to exert his influence also over B-BV. The Supreme Tax Court did not see any reason to limit the application of Sec. 32d (2) No. 1 Sentence 1 (b) ITA beyond the wording to purely domestic situations. It was not until the introduction of the Finance Bill 2020 that the legislator made amends to the effect that the exclusion of the special tax rate only applied to investment income from shareholder receivables that led to corresponding domestic operating expenses on the part of the company.

The Supreme Tax Court also saw no infringement of the general principle of equality under Article 3 (1) of the German Basic Law, because capital gains paid by a domestic corporation to a shareholder or to a person closely related to the shareholder were taxable under the same conditions as in the case in dispute.

Source:

Supreme Tax Court, decision of 27 June 2023 (VIII R 15/21), published on 17 August 2023.

Keywords

flat rate, shareholder loan