

By PwC Deutschland | 08 July 2025

Trade tax addback of profit share of US silent partner

In a most recent judgment, the Supreme Tax Court decided that the trade tax addback of a silent partner's profit share is subject to the free movement of capital which also applies to third countries (here: the USA). The application of the "grandfather" clause of Art 64 TFEU (ex-Article 57 TEC) is generally not affected by statements made in a letter from a lower tax authority.

A. The relevant statutory regulations in the case of dispute

1. Article 24 (3) of the double tax treaty between Germany and the Netherlands (DTT) as regards non-discrimination: "Except where the provisions of paragraph 1 of Article 9 (Associated Enterprises), paragraph 4 of Article 11 (Interest), or paragraph 4 of Article 12 (Royalties) apply, **interest, royalties, and other remuneration** paid by an enterprise of a Contracting State to a resident of the other Contracting State shall (...) be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State (...)".

2. Grandfather (standstill) clause - Article 64 of the Treaty on the Functioning of the European Union (TFEU –ex-Article 57 TEC) allows Member States to maintain certain restrictions on the movement of capital to and from third countries that were in place on 31 December 1993, mainly involving **direct investments** – including in real estate – establishment, the provision of financial services or the admission of securities to capital markets.

The TFEU replaced and updated the Treaty establishing the European Community (TEC) which was applicable in the year of dispute (2000).

3. The „right to be heard“ follows from Article 103 (1) Basic Law ("In the courts every person shall be entitled to a hearing in accordance with law") and Section 96 (2) of the Procedural Code of Fiscal Courts (Finanzgerichtsordnung – FGO) according to which "the judgment may only be based on facts and evidence on which the parties have been able to comment".

B. Background:

Y-Corporation (Y), a company based in the USA, was the majority shareholder of the plaintiff, a German corporation, and held a participation as silent partner. When determining the trade tax assessment amount of the plaintiff for 2000 (year of dispute), the profit paid to Y as silent partner was added back according to Section 8 no. 3 Trade Tax Act (TTA). During an external audit, the plaintiff applied for the profit share of the silent partner to be excluded from the trade tax addback for reason of a violation of the free movement of capital, and with reference to a directive of 11 February 2008 from the Higher Finance Office of Muenster ("Oberfinanzdirektion", a regional state authority that acts as an intermediate body between the Federal Ministry of Finance and the local tax offices). The tax office was of the opinion that the trade tax add-back should nevertheless be made where a silent partner is resident in a third country and where a DTT exists.

The tax court of Düsseldorf had rejected the appeal.

C Decision of the Supreme Tax Court

The Supreme Tax Court considered the plaintiff's appeal to be justified, albeit for reasons of procedural deficiency (**1**). The matter was referred to the tax court of first instance for a different hearing and decision. In terms of the main subject matter, however, the tax court

had correctly held that there was no violation of the prohibition of discrimination under Art. 24 (3) DTT **(2)** and that the trade tax addback was not hindered on the grounds of the free movement of capital which in general also applies with regard to third countries **(3)**.

(1) In the present case, the tax court neglected the plaintiff's right to be heard because it did not inform the plaintiff before the close oral hearing of the tax court's letter of clarification regarding the existence of the requirements for a consolidated tax group for trade tax purposes.

(2) There was no violation of the prohibition of discrimination under Art. 24 (3) DTT per definition: The profit share of the silent partner does not qualify as "interest, royalties or other remuneration" within the meaning of Art. 24 para. 3 DTT. The term "other remuneration" is not specifically defined in the DTT and is therefore subject to interpretation. It thus must be interpreted along the lines of the relevant double tax treaty and independent from national law.

The term "other remuneration" used in Art. 24 (3) DTT does not include the profit share of a silent partner. According to Art. 10 (4) sentence 2 DTT, the profit share of a silent partner is expressly classified as dividend. The treatment of the profit share of the silent partner as a dividend under treaty law and the fact that dividends are not considered interest (Article 11 (2) sentence 3 DTT) is sufficient to assume that profit shares are also not covered by the fallback clause "other remuneration" in Article 24 (3) DTT.

(3) Furthermore, the trade tax addback of the silent partners profit share is generally regarded as a violation of the free movement of capital. Whether this ultimately leads to a restriction of the free movement of capital here and if such a restriction could be justified was ultimately not essential because at the very end a restriction was still permissible under the grandfather clause of Art 64 (1) TFEU (ex-Article 57 TEC).

First, the shares held by Y are viewed as a direct investment as required in Article 57 TEC (now: Article 64 TFEU) because Y was at least the majority shareholder. On the other hand, the silent partnership itself must also be regarded as a direct investment. The required opportunity of control must not be derived solely from the silent partnership itself because the simultaneous position as majority shareholder is sufficient.

Section 8 no. 3 TTA already existed on 31 December 1993. Written interpretations published in a letter from a higher tax authority have no impact on the application of statutory regulations that only have limited favorable effect for taxpayers.

Source:

Supreme Tax Court decision of 26 February 2025 I R 33/21- published on 3 July 2025.

Keywords

Non-discrimination, grandfather clause, silent partner, trade tax addback