

# German withholding tax on dividends and license payments might be against EU law

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## In brief

Dividends and license payments are subject to German withholding tax (WHT) of ca. 26.4% and ca. 15.8% respectively. The WHT can be reduced under a double tax treaty or under a EU directive provided the severe German anti-treaty / anti-directive shopping rules are fulfilled. The Fiscal Court of Cologne has doubts as to whether these rules are in line with EU law. If taxpayers are refused to be granted an exemption, they should therefore appeal based on the grounds of EU law.

## General background

In Germany, dividends and license payments are subject to WHT of ca. 26.4% and ca. 15.8% respectively. If a foreign company receives German-source income that is subject to withholding tax (e.g. dividends, royalties or specific interest payments), the company may be entitled to relief under the EU Parent-Subsidiary Directive, the EU Interest and Royalty Directive, or any applicable double tax treaty or domestic tax law.

Such relief is, however, only granted if the severe German anti-treaty / anti-directive shopping rules are fulfilled. Under the current regulation, relief can (only) be claimed to the extent that

1. the foreign company's shareholder would have been entitled to a refund or exemption had he received the income directly, or
2. the foreign company's gross receipts in the respective business year stem from own active business activities, or
3. for those receipts that do not stem from the foreign company's own active business activities: (i) economic or other significant non-tax reasons exist for interposing the foreign company, and (ii) the foreign company has established a suitable business (e.g. business premises, personnel and equipment) to participate in commerce.

## THE ECJ referral

In the case at hand, a German GmbH distributed dividends to its non-resident shareholder, a Dutch BV in 2013. The immediate shareholder of the BV was a German GmbH. The request of the Dutch BV to refund the retained WHT was denied by the German Federal Tax Office with reference to the anti-treaty shopping rules.

The Fiscal Court of Cologne referred the case to the European Court of Justice (ECJ) and questions whether the refusal of the refund is in line with EU law regarding (i) its violation of fundamental freedoms i.e. the freedom of establishment and (ii) its incompatibility with the EU Parent-Subsidiary Directive. Furthermore, the court questions whether the interposition of the BV can be considered to be abusive.

## Takeaways

If the CJEU confirms that the German anti-treaty shopping rule is not in line with EU law, the German legislator needs to change various aspects of this provision, especially the unequal treatment of German and foreign holding companies.

Until the final decision of the CJEU is handed down, taxpayers should consider to appeal based on the grounds of EU law if the Federal Central Tax Office refuses to grant exemptions or a refund for withholding taxes based on Sec. 50d ITA.

### Contact

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Dr. Ralf U. Braunagel  
Frankfurt

Tel.: +49 69 9585-6376

[ralf.ulrich.braunagel@de.pwc.com](mailto:ralf.ulrich.braunagel@de.pwc.com)

Nicole Dehnhard  
Frankfurt

Tel.: +49 69 9585-2513

[nicole.dehnhard@de.pwc.com](mailto:nicole.dehnhard@de.pwc.com)

Alke Fiebig  
Hamburg

Tel.: +49 40 6378-1318

[alke.fiebig@de.pwc.com](mailto:alke.fiebig@de.pwc.com)

Hansjoachim Köhler  
Frankfurt

Tel.: +49 69 9585-5039

[hansjoachim.koehler@de.pwc.com](mailto:hansjoachim.koehler@de.pwc.com)

Dr. Lars Lawall  
Frankfurt

Tel.: +49 69 9585-6622

[lars.lawall@de.pwc.com](mailto:lars.lawall@de.pwc.com)

Dr. Axel P. Mielke  
Frankfurt

Tel.: +49 69 9585-6926

[axel.mielke@de.pwc.com](mailto:axel.mielke@de.pwc.com)

Jürgen Scheidsteger  
Frankfurt

Tel.: +49 69 9585-5150

[juergen.scheidsteger@de.pwc.com](mailto:juergen.scheidsteger@de.pwc.com)

Christian Tempich  
München

Tel.: +49 89 5790-6321

[christian.tempich@de.pwc.com](mailto:christian.tempich@de.pwc.com)

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