C L I F F O R D

C H A N C E

The effect of German withholding tax on dividends breaches EU law

On 20 October 2011, the European Court of Justice (ECJ) decided that the effect (*Abgeltungswirkung*) of German withholding tax on dividends distributed to non-German EU or EEA resident corporate shareholders constitutes a restriction on EU free movement of capital (*EU-Kapitalverkehrsfreiheit*), because German resident corporate shareholders receive a tax credit or tax rebate in the amount of such withholding tax. The ECJ did not limit its decision to future dividend distributions, so it should also apply retrospectively.

What can non-German resident corporate shareholders do?

A withholding tax on dividends is in principle in line with EU law, if German resident and non-German resident shareholders are treated alike, which assuming this is the case, in the future, tax would still need to be withheld on dividends (unless the recipient shareholder has obtained a certificate from the Federal Tax Office confirming the reduction of withholding tax based on a tax treaty or on the EU-Parent/Subsidiary-Directive), and it would make little sense to file objections against the imposition of withholding tax.

However, the German Fisc is now required to refund taxes withheld from dividends distributed in 2007 or later, if an application for a refund is filed by the end of 2011. It has unofficially been confirmed by a representative of the German Federal Ministry of Finance that the normal four year prescription period should apply (a seven to eleven year period has not yet been ruled out, based on the principle of adequacy and equivalence or *effet utile*).

Non-German corporate shareholders should therefore review whether they received dividends from German corporate subsidiaries in 2007 and/or subsequent years and, if so, whether German withholding tax was imposed and not refunded. In such cases, withholding tax refund applications should be filed before the end of 2011 as a precautionary measure.

Given the principles of adequacy and equivalence, further dividends may qualify for a refund (possibly from as early as the beginning of 2000), on the basis of the argument that tax assessments for German corporate shareholders which remain subject to tax audits are not to be considered finally settled.

How can a refund be obtained?

At present, there are no provisions in German law governing the tax refund procedure; which tax office should process refunds (and how) is currently being discussed. As a precautionary measure, non-German resident corporate shareholders should consider:

- filing corporate income tax returns with the tax office where their most valuable German located assets are located and applying for a credit or refund of German withholding tax after the issue of the corporate income tax notice; and
- filing withholding tax refund applications with:
  - the tax office competent for the German corporate subsidiary which distributed the dividends,
  - the German federal tax office (*Bundeszentralamt für Steuern*), and
  - the tax office where their most valuable assets are located.

It is uncertain whether the German legislator will enact rules which govern this tax refund procedure. Indeed, there is a risk that no such rules will be enacted and that the tax courts will have to rule on the correct procedure (as was the case for the musician Gerritse who won his case before the ECJ in 2003, but lost before the German Federal Tax Court in 2007, which held that Gerritse had no right to ask for a normal income tax assessment, but should instead have filed an application for a withholding tax refund instead).

How much should be claimed as a withholding tax refund?

Pursuant to the ECJ decision of 20 October 2011, non-German corporate shareholders should apply for a complete refund of the withholding tax. However, there remains a question as to whether tax on 5% of the gross dividend can be retained by the German Fisc, as 5% of dividends distributed to German resident corporate shareholders are generally taxable. There is no mention of the "tax on 5 per cent" in the ECJ decision and it is unclear why this is so.

Which non-German corporate shareholders are entitled to claim a withholding tax refund?

The ECJ decision explicitly refers to both non-German EU corporate shareholders that own less than 10% of the shares in a distributing German corporate subsidiary and to EEA-corporate shareholders irrespective of the level of their shareholding, except for corporate shareholders resident in Liechtenstein. As Liechtenstein and Germany agreed to exchange tax-relevant information in 2010, corporate shareholders resident in Liechtenstein should now be entitled to rely on the ECJ decision.

Non-German EU corporate shareholders that hold 10% or more of the shares in a distributing German corporate subsidiary may apply for a withholding tax refund, irrespective of whether the EU-Parent/Subsidiary-Directive applies.

Similarly, corporate shareholders resident outside the EEA should also be able to claim a withholding tax refund, when they hold less than 10% of the shares, as the EU free movement of capital movement framework has effect *erga omnes*.

Corporate shareholders resident outside the EEA with a shareholding of 10% or more should also file applications for a withholding tax refund as a precautionary measure, although it remains uncertain as to whether the EU free movement of capital movement framework applies to them.

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