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German Tax and Legal News

Federal tax court rules on "direct shareholding" requirement in PSD

Federal tax court confirms broadened application of PSD in a taxpayer-favorable decision

In a decision dated 18 May 2021 (and published on 9 September 2021), Germany's federal tax court upheld a 2017 decision of the lower tax court of Cologne clarifying the definition of the "direct shareholding" requirement under the EU parent-subsidiary directive (PSD) and its implementation into German tax law (section 43b Income Tax Code (ITC)). The PSD allows a foreign shareholder under certain conditions to benefit from a 0% withholding tax rate on dividends. The federal tax court confirmed that the interposition of an asset-managing, nontrading partnership between the German company paying the dividend and its foreign corporate shareholder does not affect the direct shareholding requirement, and, therefore, the 0% withholding tax should apply. The federal tax court provided welcome clarification on what has been a long-standing dispute between taxpayers and the German tax authorities.

The case involved a Dutch Cooperative (Coop) that held approximately 33% of a German asset-managing partnership in the legal form of a civil law partnership (GbR or Gesellschaft buergerlichen Rechts). The GbR held 100% of the shares in a German stock corporation (AG or Aktiengesellschaft). The AG distributed a dividend and withheld tax at the German domestic rate of 26.375%. The Dutch Coop filed a refund application for the full exemption under the PSD and section 43b ITC. The federal tax office rejected the claim and granted a refund based on the 15% withholding tax rate under the Germany-Netherlands tax treaty.

To qualify for the 0% withholding tax under the PSD and section 43b ITC, a qualifying dividend recipient must hold directly at least 10% of the German distributing company. A 10% direct shareholding also is required to qualify for the 5% withholding tax under article 10, paragraph 2(a) of the Germany-Netherlands tax treaty; however, no direct participation is required to qualify for the 15% rate under article 10, paragraph 2(c) of the treaty.

The German tax authorities took the position that if the GbR is treated as a mere asset-managing partnership and disregarded for tax purposes, its existence from a civil law perspective must be taken into account, and the GbR cannot be disregarded for purposes of the PSD and section 43b ITC. As such, the tax authorities determined that section 39 (2) No. 2 of Germany's General Tax Code (AO), which provides for a pro rata allocation of assets of a partnership to the partners for tax purposes, did not apply for purposes of the PSD and section 43b ITC.

The federal tax court confirmed the position of the lower tax court and rejected the tax authorities' arguments. Like the lower tax court, the federal tax court emphasized the transparent nature of an asset-managing, nontrading partnership and applied section 39 (2) No. 2 AO concluding that civil law principles should not be applied for purposes of the direct shareholding requirement of the PSD and section 43b ITC. The federal tax court highlighted that section 39 (2) No. 2 AO, as a specific tax provision, has priority over civil law principles.

The federal tax court referred to section 8b (4) ITC, which requires a direct 10% minimum shareholding in order to make use of the German participation exemption for dividends. Section 8b (4) sent. 4 and 5 ITC provide that for purposes of determining whether a direct 10% minimum shareholding exists, shares in a corporation that are held through a trading partnership must be allocated to the respective partners in the trading partnership on a pro-rata basis and are deemed to be a direct shareholding. The federal tax court stated that the lack of a specific reference to an asset-managing (as opposed to a trading) partnership indicates that the legislator did not see a need for such a reference since such a partnership generally would fall under the rules of section 39 (2) No. 2 AO.

The federal tax court also referred to section 9 No. 1 sent. 2 of Germany's Trade Tax Code, which allows an extended deduction for trade tax purposes if a company manages its own real estate. The federal tax court noted that, based on past jurisprudence, this extended

deduction applies when a company manages its own real estate that is held through an asset-managing, nontrading partnership.

The same principles have been applied by the federal tax court regarding capital gains taxation of shareholdings held by individuals under section 17 ITC. Such capital gains taxation only applies if an individual held a direct 1% minimum shareholding at any point during a five-year period prior to a transfer. The court also has applied section 39 (2) No. 2 AO for this purpose to determine whether a direct shareholding exists where shares in a corporation are held by an individual through an asset-managing, nontrading partnership.

The question of when a direct shareholding exists is relevant for purposes of the PSD, section 43b ITC, and several of Germany's tax treaties (including the Germany-US tax treaty). The German tax authorities traditionally have adopted a strict interpretation of the direct shareholding concept and, in many cases, have denied a reduced withholding tax or an exemption. Taxpayers should carefully analyze their structures and whether the decision of the federal tax court may provide withholding tax relief in their specific situation.